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BUSINESS CONCEPTS
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Retirement Income and Succession Planning

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Many business owners today are thinking about their retirement options and which plan is best for them and their business.

There are important aspects in picking the best succession plan for your company especially if the buyers are going to be children, in-laws, or key managers. All business owners want to maintain the net worth that they have accumulated over the years but they also want the succession plan to work.

Over the past 35 years we have learned that about 30% to 40% of the current owners will sell to one or more family members. About 15% to 20% will sell to key managers, another 10% to 15% will sell to another store owner in their industry, and the remaining stores will just go dark.

<u>Selling to Family and/or Key Managers</u>
If you are selling the business to a family member or key manager you have a lot of options pertaining to future retirement income, reducing income taxes on the sale, protecting your net worth, and protecting the company and all of your employees.

A good starting point is to think about which one or two individuals are going to take over control of the company. If it is one person then they will obviously have more than 51% at some point in the future. If it is two individuals then we need to decide which of those two individuals will have 51% and which one will have 49%, or perhaps the division will be 60/40 or 70/30.

Another important decision to make at the front end of this process pertains to owning the property. If you own the real estate that the company is located in then you have more options to work with.

Having a long term lease and receiving rent for the next 10 to 15 years is always one good source of retirement income. If you own the real estate then perhaps that property will remain in your name and continue to contribute to your family's net worth.

Many owners are not quite sure which key manager or which child should take over. Because of that uncertainty we sometimes recommend that the current owner let the potential buyers take over more control over the next 12 to 24 months. Let them make some of the big decisions and let them work with the employees, the vendors, and attend the national coop conventions. Let's see how the children do over the next one or two years and then we can make a final decision about who will have 51% or more of the stock.

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Retirement Income and Succession Planning *(continued)*

Lock in Retirement Income

For many business owners it is a very tough decision to give up voting control of a company and at the same time reduce their salary substantially.

This is where tax planning and structuring the sale becomes very important. The owner wants to minimize as much tax as possible, but the business transaction with the next generation must be designed to work. Sometimes if the current owner gets all of the tax breaks and the children get none, then they will not be able to make all of the payments. At the same time it is not fair for the children to get all of the tax breaks and the current owner is forced to pay higher taxes. Somewhere in the middle is where we must land and the flexibility to come up with the overall best plan is normally easier with children or key employees. They normally do not have a large down payment but they are willing to be very flexible.

Sometimes a current owner will still get some salary for working part time. They can be paid to be chairman of the board of the company. As I said before, perhaps they will continue to receive rental income because of a new 10 year lease agreement signed by all parties. Sometimes the business owner will received deferred compensation or salary continuation for several years. That income is basically a payment to the owner because they left a lot of cash in the company over the last 20 or 30 years to help grow the business.

Sometimes it is appropriate to use consulting agreements, non competition agreements and an agreement to sell goodwill.

The goal is to combine the best two or three retirement income options in order to minimize income taxes and maximize the amount of cash flow that the business has to work with.

The "usable cash flow" is like the gas in your car. As you travel down the road you want to make sure that the car does not run out of gas. This same analogy is true for the company. We must make sure that we do not run out of usable cash flow in this transaction. It is very important that we understand how much usable cash flow is available and make sure that there is enough to pay an income to the new buyers, make all the required payments to the seller, and pay the required income taxes.

There are many different options for an owner to look at in order to sell their business and protect their retirement income. Picking the best combination of the options available to you is very important for the success of this transition that you are thinking about. For more ideas call or e-mail our senior partners.

Gary Pittsford, CFP®, is President and CEO of Castle Wealth Advisors, LLC. Castle specializes in helping families and closely-held business owners with valuations, succession planning, estate and income tax analysis and retirement income projections. Castle's senior partners work with clients throughout the country in making logical decisions that help them fulfill their personal and business financial goals. For more information visit www.castle3.com, call 1-888-849-9559 or e-mail Gary directly at gary@castle3.com.

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