



Exit Planning

NAVIGATOR

Exit Planning Strategies for the Entrepreneur

Issue 54

Tax Planning Begins Now

Prepare for a shock.

Current tax rates are likely the lowest we will see in our lifetimes. At some point, burgeoning budget deficits, ballooning costs of social programs and the War on Terror must be paid.

Expect tax increases.

For nearly all business owners contemplating a business exit, this prediction means that the tax bill due on the exchange of your ownership interest for cash is going to rise.

Here is a list of actions that you can take today to minimize the size of that future tax bill:

1. **Prepare to sell sooner rather than later.** This doesn't mean rushing to the market today. It does mean that it is time to begin the planning necessary to maximize the money you receive. Your planning goals are to increase the value of the business and to reduce the tax bite on that value as the business is transferred. If you accept the argument that taxes likely to rise, it just makes sense to be prepared to sell before the increases arrive.
2. **Recognize the importance of careful tax planning.** Your tax planning goal is not just to minimize *your* taxes. Recognize that the tax consequences affecting your eventual buyer are even more important. The greater the tax on the stream of income available to pay you your purchase price, the less money is available. If there is less cash available, the buyer will offer a lower purchase price or extend the time it will take to pay you off. (Neither option is particularly attractive to you or to the Buyer.) Proactive tax planning can cushion your business from future tax increases. Obviously, you need to consult with an experienced tax advisor.
3. **Don't ignore Estate Taxes.** Estate taxes may increase along with the Income Tax and Social Security taxes. At a minimum, don't expect to see a decrease or elimination of Estate Taxes. Delaying a decision to engage in estate and gift tax planning, pending resolution of estate tax uncertainties, may benefit the IRS rather than your family.
4. **Check your entity.** If your company is currently organized as a regular or "C" corporation, talk to your tax advisor about the possible benefits of converting to an "S" corporation in advance of a sale of the business. Resolve to begin a dialogue now with your advisors regarding the advisability of creating multiple entities (for tax as well as asset protection reasons).

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5. **Evaluate capitalization.** Beware of overcapitalizing your business. Delaying the decision to distribute cash from the company may cost you more in taxes in the future. Consult with your advisors about the practicality of taking cash out now.
6. **Examine various tax-advantaged tools.** You and your company may (with some planning) be able to take advantage of tax-advantaged transfer tools, such as Employee Stock Ownership Plans (ESOPs), Charitable Remainder Trusts (CRTs), or tax-free exchanges. Investigate today the benefits *and the detriments* of each tool. Remember that when the IRS “giveth” (a tax benefit) it usually “taketh away” something else.
7. **Consider a partial transfer of ownership.** If you are thinking about passing part of your business to children or employees who have little money and who must look to the business as a source of cash flow (and pay tax on that cash flow as they receive it), consider beginning that transfer today. Today’s tax rates are lower than they are likely to be in the future so taxes will have less impact on cash flow today than they will tomorrow.

The bottom line is that when (if) tax rates increase, you will end up with less money. Keep in mind that, if your goal is to leave your company with a bushel of cash, the IRS may take an ever-larger amount of that bushel— based not only on the size of the bushel but also on the size of the U.S. Government’s need.

Subsequent issues of The Exit Planning Navigator® discuss all aspects of Exit Planning.

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