A guide for business owners

Guardian®

Are you prepared for the exit?

Tips for successfully transitioning your business

As a business owner, you work hard to keep your business growing and staying ahead of the competition. You are innovative and have something unique to offer. You have the opportunity to take your business and your life in any direction you choose. Whether you are a family-run business, a sole proprietor, or a member of a professional team, if you are considering a change, now or in the future, considering selling your business and creating or are a new success story, this guide is designed to give you insight into the process.

Why preparation is important

There are a variety of reasons why business owners consider selling their company. For many, retirement is a driving factor. Other business owners may simply want a career change, aren't fulfilled anymore, are experiencing competitive pressures, or are looking for financial diversification.

Whatever your reason, planning to transition your business takes time, a plan, and forward thinking to help you avoid eye-opening surprises. Consider these points:

- When do you want to sell your business?
- Do you have a buyer?
- How much do you think your business is worth, and how did you arrive at that number?
- Will the proceeds from the sale of your business provide enough money for your retirement?
- How will you continue to build and optimize the value of your business?

Some of the key challenges you may encounter when you are ready to sell your business include:

- Maintaining a lifestyle and becoming financially stable without business income
- Identifying the best potential buyers with the necessary resources
- Understanding the terms of the transaction, including when and how you will get paid
- Minimizing the risks associated with the terms of your arrangement
- Minimizing estate and/or income taxes

Planning to transition your business takes time, a plan, and forward thinking to help you avoid eye-opening surprises.

The facts regarding your business and your life are different from other business owners. Planning to transition your business is not a "one size fits all" approach. Every business is different and unique and it's important for you to explore a range of possible outcomes. By taking a flexible approach, you are better able to identify the best type of buyer and the terms of the transaction that work best for your needs.

You don't have to go it alone. Selling or transferring your business can be a big financial event, so the earlier you get started, the better your chances will be for reaching your goals. Start now to devise strategies to extract cash from your business through refinancing or selling the business in part or in full. Work with experienced financial professionals who can guide you through the process. Experienced professionals can help you increase the value of your business, help you to preserve wealth, know how to get money out of your business, and will work with you to better understand your personal income requirements during retirement.

Consider these eye-opening, real-life scenarios

When do you want to sell your business?

Mark is a seasoned business owner who started his construction company (AJEX) in 1979. He has always lived on less than his income and although he is in a top marginal tax bracket, he has been fortunate enough to accumulate wealth outside of his business. He has three adult children from his first marriage and two of them work in the business. Mark has spent a great deal of time grooming these two children to take over the daily responsibilities of the business when he retires. Today, Mark is thinking the time is right — he is ready to retire. He doesn't need top dollar for AJEX because he is already financially stable. He wants to sell the company to his two children for the lowest amount that would not result in gift or estate taxes. The children are ready. They have hands-on experience, great relationships with the suppliers, and good credit. Everything appears to be ideal, except that the bank will not grant a loan to his children without his co-signature.

Eye opener #1

Your buyer(s) may not be financially prepared

If you have to personally guarantee a business loan, you may not feel like you ever left your business. Oftentimes, when you sell a business to "insiders," it involves relying on attaching post-sale payment streams from the business.

Whether you finance the note, personally guarantee your buyer's loan, design an unfunded deferred compensation arrangement, or use some other approach — you may bear a risk of loss for a period of time. What appears to be a simple question — "When do you want to sell your business?" — may still leave you tied to the ongoing success of the business.

Exit planning strategy #1

Plan for a possible post-sale financial concern

One way to address this scenario is to develop a plan to sell your business years before you want to leave. That way, you can stay in the business for a few more years and help to minimize your risks until you get paid. As a business owner, you can retain control of the company after the sale by selling most of the company stock as non-voting stock and keeping the voting stock until you are paid; this approach also works with S corporations. Other planning mechanisms may include stock bonuses, deferred compensation arrangements, and estate planning gifting techniques.

If you plan to sell your business to a third party and take installment payments, as the seller you may want key person coverage (life insurance and disability income insurance) on the buyer so that your payment is secured.

There are many transition planning mechanisms to help manage post-sale financial risk. The best way to help reduce this risk is to get started at least several years before you want to completely leave the business.

How much do you think your business is worth?

Lisa inherited her established restaurant three years ago when her husband suddenly passed away. She never intended to own/run her own business. She was a stay-at-home mom, really enjoyed managing the household, and enjoyed a comfortable lifestyle. Now, unexpectedly, she finds herself working day and night in the restaurant and dreams of the day she can sell it. Recently, one of her regular customers indicated that when she was ready, they would like to purchase the business. Like most business owners, Lisa reinvests heavily in the business and the business represents most of her wealth. She also has an outstanding loan on the business. She thought that since the business was doing well and she owns the real estate, she could sell it at a price that would allow her to continue her lifestyle in retirement.

Eye opener #2

The value of your business may be less than you think

Lisa has been living off of the business and hasn't accumulated any wealth outside of the business. Additionally, she has no retirement funds and real estate values have decreased over the past few years. Her customer who expressed interest in purchasing her restaurant has money and offered Lisa half of what she thinks the business is worth. Lisa can't accept less than what she thinks it's worth because the mortgage on the property is greater than its current market value.

What seems like an ideal buyer just fell into her lap, but Lisa finds herself in a situation where she must continue to work until she can accumulate enough money outside of the business or grow the value of the business.

Exit planning strategy #2

Plan to accumulate wealth outside of your business and have a current business valuation

Experienced professionals indicate that your wealth should be diversified and not all tied to your business. This is one reason why qualified plans can be so important for business owners — because they provide an opportunity to build wealth outside of the business.

Additionally, a bank might not allow ownership of a business to be transferred when there are outstanding business loans. Key person life insurance coverage can help to pay off debt, which may allow the sale to take place.

You should also have a business valuation conducted by an independent third party that has experience with business valuations, so there are fewer surprises when it is time to sell the business.

Your business may be worth more or less than you think. While the question, "How much do you think your business is worth?" seems straightforward, it is important to understand what drives value, and to have realistic expectations and consider a flexible range of values, rather than a single, fixed value. A financial professional can help you to manage your business for maximum value so you will have a better chance of obtaining the highest possible value in a sale.

Does Mark's or Lisa's story sound familiar? Now may be the ideal time for you to review your succession plans (or create them, if you currently do not have any) to help ensure they are up to date and will enable you to carry out your plans. The following 5 steps are designed to help you set the foundation for an effective transition.

Preparing your transition in 5 steps

Assumptions about the details of your sale can lead to misunderstandings and costly estate and income taxes.

1 **Determine your personal and professional long-term goals and objectives**

What are your goals and objectives? This includes what, when, and how you want to accomplish them. Determining these goals will help to determine your overall planning requirements — including financial planning, retirement planning, business planning, business succession-transition planning, tax planning, and estate planning strategies.

2 **Determine your financial requirements and approaches for achieving them**

Consider your financial requirements during retirement and how much money you will need to maintain your lifestyle. Think about where that money will come from.

If you are like most other business owners, you may have most of your money intertwined with your business. Your financial professional can help you identify sources of income during retirement.

3 **Identify and develop your management team**

You will want to decide who will be the future management of your company. Identify the team that is able to help you maximize the value of your business. Whether it is key employees, family members, or a combination of the two, you should begin delegating day-to-day responsibilities. This approach will help you develop your new management team and give them time to grow into their new responsibilities. If you do plan to transition your business to family members, address ways to help ensure key employees stay with the company for the long term. Effective plans may include employment agreements, non-qualified deferred compensation arrangements, stock option plans, and change of control agreements.

4 **Determine who will own your business and how to transfer your interest in the business to the 'new' owner**

The question of who will take over the reins will be a major factor in preparing the disposition of your business. Other areas to consider include evaluating various sales strategies you may use to transfer ownership, such as installment sales, private annuities, exchange of stock, and/or self-canceling installment notes. There may also be estate-freezing techniques, such as grantor-retained annuity trusts, and installment sales to intentionally defective grantor trusts, which may prove beneficial.

5 **Minimize transfer taxes and prepare your estate plan**

While this step in the process is listed as number 5, it is by no means the least important. This step involves designing strategies to transfer ownership of your business to help you minimize gift and estate taxes. You will want to anticipate what your federal estate taxes will be at the disposition of your business. Your financial professional can review with you the current situation on federal estate taxes and, based upon your personal circumstances, can help you work with your tax professional to design the best approach.

Transitioning approaches… your choice for new ownership

Your business represents your biggest investment. Whether you are considering selling your business, passing it on, or simply closing it, your choice will ultimately be based on many personal factors.

Understanding your transitioning strategy options and properly structuring the transaction can often produce significant value upon the disposition of your business. The sooner these options are understood, the better positioned you may be to create your next success story.

When you plan to transition your business, you have several options, including:

1. Transferring to a family member by sale or gift
2. Selling to a current employee
3. Selling to a third party
4. Selling to a co-owner
5. Liquidating
6. Fragmenting your business into smaller businesses

Although there are many ways to transfer ownership, there are other options you should be aware of, such as:

- minority sales and recapitalizations
- variations that can allow for retention of partial ownership or management control
- Initial Public Offerings (IPOs)
- ESOPs (employee stock ownership plans)

The approach that may work best for you will be based upon your individual circumstances, preferences, and goals. Similar to your developing a management team, you should also consider coordinating a team of financial professionals, tax, and legal advisors that can help with the planning process. No one person is likely to have all the skills necessary to help you transition your business. Yet, the process does not need to be overwhelming. There are several individuals who should become essential members of your transition planning team. Engaging an intermediary team will enable you to continue to focus your attention on growing your business.

The outline below provides a number of areas you should consider. Your financial professional can coordinate the team that can best assist you.

Considerations	**Team member who can assist**
Business brokers	Attorney/CPA/financial professional
Business continuation agreements	Attorney/financial professional
Business planning	CPA/financial professional
Business valuation	CPA/business valuation firm
Capital and liquidity requirements	CPA/financial professional
Coordination of team members	Financial professional
Estate planning	Attorney/CPA/financial professional
Funding the sale of the business	CPA/banker/financial professional
Insurance for funding	Financial professional
Negotiating contracts	Attorney
Personal financial planning	Financial advisor
Retirement planning	Financial professional
Setting up trusts	Attorney/financial professional
Tax planning	Attorney/CPA

Positioning the business — a pre-sale checkup list

You may sell a business only once in your lifetime. Planning your transition provides an opportunity for you to take a fresh look at where your company is headed, establish new goals, identify any missing pieces or talent, and take action steps necessary to help drive more value until you are ready to sell. Early planning will also help you manage the tax, funding, and legal implications associated with your transaction. Proper planning may help you:

- Maximize the value/sale
- Minimize your taxes
- Successfully transfer or sell your business
- Exit the business on the date you choose

A pre-sale checkup list is an essential diagnostic overview of your personal situation and helps to pinpoint areas that may need to be shored up in order for you to maximize the value of your business before the sale.

Personal

How much longer do you plan to work in your business before retiring or transitioning it?

________________ years

When you transition your business, what approach do you plan on using?

- ☐ Sell it to a family member
- ☐ Gift it to a family member
- ☐ Sell it to a key employee
- ☐ Sell it to an outsider
- ☐ Sell it to a co-owner
- ☐ Close the business
- ☐ Liquidate it
- ☐ Fragment it into smaller businesses

When you no longer work in your business, where will you get your retirement income?

- ☐ Sale of the business
- ☐ Qualified plan account(s)
- ☐ Social Security
- ☐ Other employment
- ☐ IRA
- ☐ Non-Qualified Deferred Compensation Plan
- ☐ Investments/personal savings
- ☐ Life insurance
- ☐ Annuities
- ☐ Stock options
- ☐ Real estate
- ☐ Not sure

What percentage of your total wealth is made up by your business?

- ☐ 25%
- ☐ 50%
- ☐ 75%
- ☐ 100%
- ☐ Other ______________

If you stopped working tomorrow due to a premature death or an unexpected accident/illness, what would happen to your business?

- ☐ It would need to be sold
- ☐ It would have to be closed
- ☐ It would continue

If you stopped working tomorrow due to a premature death or an unexpected accident/illness, what would happen to your household's income?

- ☐ It would stop
- ☐ It would continue

For how long? ____________________________________

Where would the money to continue your business operations or fund your household expenses come from? ____________________________________

Do you know how much money you will need for a comfortable retirement?

☐ Yes ☐ No

Financial

How much do you think your business is currently worth? $________________

Where did you get this number?

- ☐ Independent business valuation appraiser
- ☐ CPA
- ☐ My best guess

Are all your business taxes paid and up to date? ☐ Yes ☐ No

Legal

Have you identified various transitioning options and related trade-offs? ☐ Yes ☐ No

Do you have any contracts with co-owners, customers, suppliers, employees, banks, and/or landlords? ☐ Yes ☐ No

Are there any pending lawsuits or potential litigation against the business? ☐ Yes ☐ No

Miscellaneous

Do you have a list of likely buyers and understand how they may impact the value of your business? ☐ Yes ☐ No

Are there any improvements you can make today that would increase the value of your business? ☐ Yes ☐ No

Are your files well organized and easy to locate? ☐ Yes ☐ No

No matter how you acquired your business, whether you inherited it, purchased it, or built it from scratch, ambitions change over time.

Whether you are a sole proprietor or a larger corporation, selling your business does not have to be difficult. There are some necessary steps for selling or transferring any business. Planning for the day when you will sell or transfer your business is exciting and is a long-term, multi-dimensional process that you may need to revisit as your business and life unfold. It is important to work with financial professionals who can help you along the way.

The net proceeds you receive from the sale of your business can be significantly affected not only by the actual sale price, but also by the taxes payable on the sale or the estate taxes on a transfer. With proper planning and guidance from financial, tax, and legal professionals, you can maximize your net proceeds, minimize your taxes, successfully transfer or sell to the successor of your choice, and exit your business on the date you choose.

After completing the pre-sale checklist, schedule an appointment with your Guardian financial professional to consider your personalized approach.

If you're not already working with a financial professional, visit **guardianlife.com** to find one in your area.

As the owner of your business, you've built your company into what it is today. By planning now, you can help to ensure that your business will continue to thrive for many years to come.

All scenarios and names mentioned herein are purely fictional and have been created solely for educational purposes. Any resemblance to existing situations, persons or fictional characters is coincidental. The information presented should not be used as the basis for any specific investment advice.

This material is intended for general use. By providing this content, Park Avenue Securities LLC and your financial representative are not undertaking to provide investment advice or make a recommendation for a specific individual or situation, or to otherwise act in a fiduciary capacity.

Guardian, its subsidiaries, agents, and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation.

Guardian®

The Guardian Life Insurance Company of America

guardianlife.com

Pub4691 (01/24) 2024-168167 (Exp. 01/26) | New York, NY