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# Crafting an Elegant Exit Strategy for Your Small Business

When planning your estate, consider the art before the sale.

By Jonathan DeYoe

Money generally winds up in one or more places after the sale of a business: the pocket of the seller, the family of the seller, the seller's favorite charity, and government coffers. The primary aim of most sellers is to allocate a significant amount of the proceeds to personal accounts that will help fund day-to-day expenses and realize lifelong dreams. But if the seller also wants family or charity to reap rewards from the sale of a successful company, there is ample opportunity to minimize the tax-man's share. However, certain steps need to be taken long before the keys are surrendered to the new owner and money changes hands.

Maximizing the useful capital and minimizing the tax hit from the sale of a business requires strategic thinking and careful consideration. The seller should have a clear picture of how the proceeds will be used and who she'd like to see benefit, so that the transaction is structured with these goals in mind. Integrating deal terms with one's estate and philanthropic goals offers significant advantages, but many elements contribute to a successful transfer, so business owners should give themselves at least three to five years lead time. I call this advanced planning "the art before the sale."

When a small business owner sits down to negotiate the sale of a company, the primary focus often is maximizing the sales price. Many sellers believe that a higher dollar figure will translate into greater satisfaction and a bigger personal bank account. While this makes emotional sense, there are some common sense reasons why this may not be the case.

For example, many sellers agree to accept some payment in the form of stock or future revenue in exchange for a higher purchase price. But by agreeing to accept less cash today in the anticipation of more cash tomorrow, the seller is taking on additional risk. Unfortunately, capitalism is replete with examples of mergers that didn't work as their architects intended, so sellers and not just buyers should beware. Revenues from a once-thriving business could plummet due to a flagging economy or missteps by the new owners, or the acquiring company could flounder or fail, leaving the stock worthless. This is why I recommend that business owners consider how to best maximize the total *value* they will realize from the sale, and not just the total price.

There are many investment tools designed to maximize the value of assets transferred to family. One I find particularly useful is the "**Grantor Retained Annuity Trust**," which allows a business owner to avoid being taxed twice if they sell their business and then leave the proceeds to their family. First, the business owner must grant a minority share of a privately held business to a trust created for the ultimate benefit of the family. Thereafter, a proportionate share of company profits will go to the trust and not the owner, while the owner receives in exchange from the trust a fixed payment for a fixed term — usually not more than five years. The upside is that at the end of the term, the value left in the trust is passed to the grantor's heirs without gift tax, although the grantor remains responsible for any income or capital gains inside the trust. The grantor's estate also will be entitled to a tax break on the value of the business transferred to the trust.

If the company grows steadily and the owner eventually negotiates an attractive sale price, the grantor retained annuity trust will serve as a good tool for maximizing the value of the business to the heirs. But if the company experiences very rapid growth and commands an even higher sales price than expected, establishing a grantor retained annuity trust could prove to be a *fantastic* tool for such a transfer. One caveat: These trusts may not be suitable for businesses unlikely to experience annual growth exceeding the fixed payment an owner can receive during the term of the trust, which is currently set by the US Treasury at little more than 3 percent. Business owners should consult with their attorney and tax professional to see if this makes sense for them.

When the business entity is a **C-Corporation** and philanthropy is one of the owner's primary goals, a "**Charitable Trust**" is another planning tool that can magnify the value realized from a business transition. Transferring a share of the business into a charitable trust prior to a sale can support philanthropic goals while also providing significant tax advantages. This solution works best if the owner's current assets combined with some fraction of the proceeds from the eventual sale are enough to meet the family's long-term spending needs. During the owner's lifetime, an income-stream may be drawn from the trust, with the remainder reverting to the designated charity following the owner's death.

The tax benefits alone can make this strategy very worthwhile. If the owner of a C-Corporation transfers shares of a privately held company into a charitable trust, he receives a current income tax deduction. When the owner subsequently sells the business, the shares held inside the charitable trust can be liquidated without incurring capital gains. In other words, transferring shares of the business to a charitable trust may help the business owner neutralize capital gains from the sale, reduce current and future income-tax obligations, and create a lifetime income stream. However, there are many intricacies involved in establishing a charitable trust, so consulting with an attorney and CPA is essential to determining whether this is a viable option.

Engaging in the art before the sale will help a small business owner maximize the value realized from the sale of a successful company. It takes plenty of time to create a masterpiece, though, so I recommend allowing at least three to five years to craft an elegant exit strategy.