



Pending Tax Increases and Succession Planning: A Coordinated Approach

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We've all heard the old saw, "The only two things you can count on are death and taxes." For business owners, the 2009 edition of this familiar quip should be, "The only two things you can count on are that

none of us are getting any younger and taxes are sure to increase in 2011."

What does this mean for business owners?

- Start making business succession plans now; and
- Make plans to address increasing income and capital gains tax rates **before** 2011.

We're Not Getting Younger

Baby Boomers are nearing retirement age and the statistics are staggering. Business owner retirements have mushroomed from 50,000 in 2001 to an expected 750,000 in 2009. However, studies indicate that most business owners have not implemented a business succession plan.

Business succession planning is a responsibility of every business owner. A business succession plan addresses critical issues about a company's future, like:

- How much is my company worth?
- When I am ready to retire, to whom will I transfer my ownership interest?
- If I sell all or a portion of my interest in my company, how much annual income will the sales proceeds generate?
- How can I minimize death taxes?
- How can I retain and reward my company's key employees?

Without a carefully designed and implemented plan, business owners may find themselves:

- Without adequate retirement income
- Without their key employees

- Having to sell their company at a distressed price or their company could even fail.

Taxes Increasing in 2011

Income and capital gains tax rates are almost certain to increase in 2011. With the massive government bailout of the banking and auto industries and funding shortfalls in social security and Medicare, many pundits agree that this may be just the first of many tax increases. Those businesses that plan now for these tax increases may be in a better position to compete in the future.

Tax and Succession Planning – A Coordinated Approach

For business owners facing the dual challenge of tax and succession planning, an Employee Stock Ownership Plan (ESOP) is a planning strategy they should consider. An ESOP offers the following benefits as a tax and succession planning strategy:

- Business owners can create an ESOP and have it purchase their stock for its full fair market value. They will be taxed at capital gains tax rates (not ordinary income tax rates) on the sales proceeds and in certain situations, may even be able to receive the sales proceeds income tax free.
- The company's employees (and especially its key employees) will receive the value of the stock purchased by the ESOP upon their death, disability or retirement.
- To the extent of the ESOP's ownership interest, the company could operate on a tax-free basis. For example, if the ESOP owns 100 percent of the company's stock, the company's income could be completely free of federal income tax.

Conclusion

Some of the most successful privately-held companies in the U.S. are taking advantage of the many benefits offered by ESOPs, including NAFCD member and industry leader, BPI.

Here is what BPI CFO Wally McAlexander says about how an ESOP has helped their company.

BPI has always practiced a "win-win" philosophy and the biggest win-win transaction in the history of our company was the decision by the BPI shareholders to sell 100 percent of their stock to the BPI ESOP. Going ESOP was a win for the individual shareholders because they were able to sell their closely-held business interest at a fair value and either retire or continue to participate in the business at their election.

The ESOP was a win for the outstanding senior and middle management team along with all of the other hard-working BPI associates that contributed to the success of the company because they became the beneficial owners of the company over time as the debt incurred to purchase the BPI common stock is retired.

The win for the company was that as a 100 percent ESOP-owned S corporation, BPI's corporate cash flow is free from federal taxation and free from state taxation by those states that recognize the federal subchapter S election or allow for a state Subchapter S election. The company's tax-advantaged cash flow will first be used to retire the stock acquisition indebtedness and then be used ultimately to retire all interest-bearing debt of the company.

The final win is that our ESOP has created a culture of managers and associates who think like equity owners. ■

Kelly Finnell is one of the nation's premier ESOP and Ownership Succession Planning consultants and one of the leading speakers and authors on this subject. He has spoken at more than 200 conferences and meetings throughout the U.S. and in London and Sydney, Australia. He has published several articles on the use of ESOPs in Ownership Succession Planning. Finnell has spent more than 25 years helping small to midsize business owners design and execute succession strategies and ESOPs. Finnell is an attorney and a member of BEI, a leading organization of exit planning professionals. He is acknowledged as the exit planner's expert on ESOPs. At the Association for Advanced Life Underwriting's 2008 Annual Conference (attended by more than 800 financial advisors), Finnell's presentation was voted one of the top three sessions of the conference.