SMART WAYS TO TRANSFER THE FAMILY BUSINESS

Three ways to create a meaningful legacy, while generating a healthy retirement income for yourself

FOR MOST BUSINESS OWNERS, retirement is either a subject they welcome or the last thing they want to think about. If you're looking forward to that day, you've probably already started preparing to move on from your business. “For many business owners, their retirement plan *is* their business,” says Judith Anderson, senior vice president, Retirement Personal & Wealth Solutions, Bank of America.
If you're not thinking ahead, bear in mind that there are very real advantages to beginning to prepare for it now. “Small business owners typically re-invest their profits back into running their business and generally do very little planning ahead for a retirement that may be five, 10, 15 or more years down the road,” says Anderson.
Selling your business at retirement will supplement your income, but it shouldn’t be the only asset you have to rely upon, says Anderson. “Instead, in anticipation of that day, choose an actual retirement plan that fits your needs.”

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Taking the time to plot your company's future can ensure that you leave on your own terms. It also puts you in a better position to retain control, at least during any transition period, so that proceeds from your business—which in many cases are your biggest asset—have the greatest potential to provide you with strong, steady retirement income. Ask yourself these questions as you begin to create a plan to help meet your needs.

What's Your Company's Real Value?

Many privately held companies reflect the people who've built them. In some cases, the owner is the business, begging the question, “Can your business still survive after you sell it?” As you assess your company, Anderson suggests thinking about what your business is actually worth. Consider if that value could be enough to base your retirement on, notwithstanding other savings and investments that you may have.
If you conclude that the company is viable without you there to run it, your next step is to get an accurate valuation of its worth, says Joe Astrachan, emeritus professor of management at Kennesaw State University in Georgia. That's essential not just for a sale, but also in consideration of taxes and to help you gauge how much retirement income you might expect. A professional valuation and tax expert can help you look past your emotional attachment to the company, gauge its true value as well as the market for such a business, and arrive at a realistic number.

What Are Your Retirement Income Needs?

If you're planning on selling your business, Anderson advises that you determine how much income you'll need to support your lifestyle and retirement goals, and what portion of that will come from the sale of the business—as compared with your investments and other assets. Keep in mind, too, that merely matching your current salary in retirement may not be enough if the business has also been paying for things like health insurance, car leases, club memberships and tax preparation—expenses that you'll have to start covering yourself. “Some owners may be used to living a $400,000 lifestyle on a much smaller income from the business,” Anderson says. “It can be a shock to discover what it costs to replace those things.”

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Even after receiving a lump sum from a sale, many former business owners can stay involved and earn income by serving on the board of directors or consulting. You might even continue helping out in day-to-day operations in a reduced but vital role such as serving clients who've been with the company for years and are used to working with you.

If you own an office building or other physical assets, another option for generating retirement income is to retain those assets and lease or rent them back to the business. Astrachan recommends that such arrangements be agreed upon beforehand and spelled out clearly in the formal transfer or sale agreement with the new majority owners. That should also be the case if you're turning the business over or selling it to other family members.

How Can You Structure the Transfer?

If you plan to transfer the business to family members or longtime employees, rather than sell to an outside buyer, weigh these options. Each has its own advantages. Consider transferring the business as a gift, and drawing an income from the new owners. The lifetime federal gift tax exemption for 2021 is $11.7 million for individuals and $23.4 million for married couples. That gives business owners considerable latitude to transfer a part or all of the company as a gift. You may owe federal gift taxes on amounts exceeding the exemption, but once the business is out of your hands, it's no longer part of your estate, and future growth of the company won't subject your estate to additional transfer taxes.

You might sell the business by providing financing assistance. You may choose to sell the business to heirs—or an outside buyer—by lending them the money through sale in exchange for a promissory note, which allows the buyer to pay you back directly. The advantage to you is a steady stream of income from the principal and interest from the loan for an agreed-upon period.

You could execute a partial sale while retaining a portion of business assets and income. You may pay capital gains tax on any profit from the sale, but you'll also get a steady income from rent or lease of office space or other assets.

Whatever choice you make, a smooth transition can be the crowning legacy of the years of care and effort you've poured into your business. It can also leave you with income to support your life's next act, or in some situations keep you involved in a business you love. And you can have the satisfaction of knowing that your vision has the potential to live on for generations to come.