

Financial Adviser

Exiting a Business in a Troubled Economy



Our lingering economic downturn has pushed many northwest Pennsylvania businesses to the brink. Highly stressed owners are weighing whether to wait out the economy's eventual rebound, or just throw in the towel before losses grow worse. At stake are the owner's reputation and legacy, future plans for working or retirement, and the company's ability to build real wealth someday.

If opting for an exit strategy, owners have to make difficult decisions about their options for transferring control to a family member, selling to an outsider, or just closing the shop for good. This article summarizes some of the key steps for business owners who decide on an exit strategy involving transfer of control to relatives.

Succession Planning

Succession planning is a must. It can range from a reevaluation of strategies already in place to the first step toward long-range succession management. Family-owned enterprises often find the process emotional, if not distasteful, as it involves family talks about money, retirement, disability and death.

Today's ownership generation likely has lost substantial retirement account value, leading to worries about having a sufficient income stream during retirement. The up-and-coming generation may be anxious over uncertain financial times and reluctant to commit to funding long-term payouts. In addition, both sides may be at odds over the valuation of the business in the current economy. Families typically struggle with how to recognize each other's concerns,

and how to identify a consensus of goals and objectives to ensure a successful continuation.

Ownership Gifting

Lower revenues and weakened profitability have caused the value of many companies to plummet. For many, this likely is temporary, and values should increase as the economy recovers. If owners are considering making a gift of ownership, now can be a good time for this kind of transfer. Because the fair market value of their assets is currently low, owners can gift a more substantial portion without reaching their federally imposed limits. Currently, individuals may make yearly gifts of up to \$13,000 per person without paying gift tax, or without tapping into their \$1 million lifetime gifting cap. These figures are doubled for married couples.

Ownership gifting also will benefit the new owners if the assets someday appreciate, as they will reap the financial benefits.

Owners can accelerate the gifting schedule through such techniques as valuation discounts allowed by the Internal Revenue Service, which can potentially drive down value even further.

'Freezing' a Company's Value

Another alternative for sellers is to "freeze" the value of the business at today's value. This can be done using a grantor retained annuity trust (GRAT) or an intentionally defective grantor trust (IDGT).

If a family business is incorporated, another option is an outright stock

sale. Long-term capital gains tax rates still are relatively low, and currently are capped at 15 percent. Owner financing of the sale also could provide payment flexibility. Low capital gains tax rates and payment flexibility, in conjunction with valuation discounts, could make a stock sale an attractive option.

Managing Emotions

One of the keys to success in exit planning is knowing how to separate strong sentiments from rational, logical judgment and decision-making. In the highly charged emotional atmosphere of ownership transition, it often is the judgment, diligence and personality of an owner and his or her professional advisers who make the difference between arriving at a smooth successful plan, or having it collapse without a favorable result.

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