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Exit Planning / Business Succession Planning

What is exit planning? Exit planning is a long-term process using legal, accounting and financial professionals to maximize an owner's exit from his or her business. The exit is the sale of the business to the next generation of family or key employees or to an outside buyer.

Let me begin with two introductory comments. *First*, exit planning is a complex process and can take years to complete. Business owners need to start the process sooner rather than later. If you wait until you want to "get out" to start, you might be forced into a fire-sale and/or leave money on the table for the IRS. *Second*, entire books are written on this subject. Because I only have one and a half pages here, I will over-simplify, especially as regards tax efficiency. I ask in advance for the forgiveness of any experts in the audience.

And without further ado... The goal of exit planning is to help business owners exit their business with maximum payoff, including (1) maximum legal security for payment of the purchase price, and (2) maximum tax efficiency.

Legal Security

In exit planning usually the buyer pays off the seller over time, not in one lump sum. This is even more true for sales to family or key employees, where the buyer usually has no money. Because the buyer has no money, the buyer depends on the cash flow from the business to pay off the seller over an extended period of time. The seller takes the risk of buyer default in the future.

The seller should structure the transaction to reduce the risk of buyer default during the time period before final payment. The seller can consider, among other things: (1) Taking a security interest in the business so that upon default, the seller can take the business back; (2) Getting the buyer's personal guaranty of payment; (3) Keeping a control interest in the business until final payment is made, or at least until the seller has confidence that the buyer won't run the business into the ground.

A more subtle form of seller security is helping the buyer maintain the business's cash flow after the sale. A buyer without cash flow can't pay the purchase price, and everyone loses.

Tax Efficiency for Succession Planning

In the sale of a business, you save tax money by reducing the layers of taxation in the deal. To do this, the seller and the buyer must cooperate in structuring the deal. Certainly cooperation is a lot easier if the seller is transferring the business to the next generation, be it family or key employees, than to an outside buyer.

The main thing to remember is that the seller should care about the buyer's tax. This is because by reducing the buyer's tax, the seller can receive a higher purchase price, and can strengthen the buyer's cash flow after the sale thereby ensuring that the buyer can pay off the seller.

A deal can develop multiple layers of taxation because, once again, the buyer uses cash flow of the business to pay off the seller. That is, the business earns money (tax layer #1) and pays it to the buyer (tax layer #2) so that buyer can pay the seller (tax layer #3). When you stack taxes one on top of the other, you increase the taxes paid on the deal. When the IRS gets more, you get less.

The basic mechanism for reducing the layers of tax is to have the business pay the seller directly, not via the buyer. The payments should be deductible expenses to the business, for example, consulting fees, rents, royalties, deferred compensation and more, all payable from the business directly to the seller. But recall my prior statements about lead time and cooperation – you will need lots of both to put any of these mechanisms in place.

This article only gives a brief introduction to exit planning. I strongly urge you to get competent legal, tax and financial help when you are ready to sell your business.

Ideas

I am not sure whether access to the internet has increased the number of cranks or whether it has merely increased the ease with which they can express themselves. Writing a letter requires a degree of determination and even forward planning that sending an e-mail does not. Since most human characteristics grow more marked when they are expressed than when, for whatever reason, they are denied expression (contrary to the hydraulic model of self-expression that was fashionable for a time), it is possible to surmise that the internet has increased the prevalence of cranks in society. –*Theodore Dalrymple*

Woody Allen Quotes

- I am at two with nature.
- Thought: Why does man kill? He kills for food. And not only food: frequently there must be a beverage.
- I took a speed reading course and read 'War and Peace' in twenty minutes. It involves Russia.
- I was thrown out of college for cheating on the metaphysics exam; I looked into the soul of the boy sitting next to me.
- I don't want to achieve immortality through my work... I want to achieve it through not dying.