Business owners: An exit strategy should be part of your tax planning

Tax planning is a juggling act for business owners. You have to keep your eye on your company's income and expenses and applicable tax breaks (especially if you own a pass-through entity). But you also must look out for your own financial future.

For example, you need to develop an exit strategy so that taxes don't trip you up when you retire or leave the business for some other reason. An exit strategy is a plan for passing on responsibility for running the company, transferring ownership and extracting your money from the business.

Buy-sell agreement

When a business has more than one owner, a buy-sell agreement can be a powerful tool. The agreement controls what happens to the business when a specified event occurs, such as an owner's retirement, disability or death. Among other benefits, a well-drafted agreement:

- Provides a ready market for the departing owner's shares,
- Prescribes a method for setting a price for the shares, and
- Allows business continuity by preventing disagreements caused by new owners.

A key issue with any buy-sell agreement is providing the buyer(s) with a means of funding the purchase. Life or disability insurance often helps fulfill this need and can give rise to several tax issues and opportunities. One of the biggest advantages of life insurance as a funding method is that proceeds generally are excluded from the beneficiary's taxable income.

Succession within the family

You can pass your business on to family members by giving them interests, selling them interests or doing some of each. Be sure to consider your income needs, the tax consequences, and how family members will feel about your choice.

Under the annual gift tax exclusion, you can gift up to $15,000 of ownership interests without using up any of your lifetime gift and estate tax exemption. Valuation discounts may further reduce the taxable value of the gift.

With the gift and estate tax exemption approximately doubled through 2025 ($11.4 million for 2019), gift and estate taxes may be less of a concern for some business owners. But others may want to make substantial transfers now to take maximum advantage of the high exemption. What's right for you will depend on the value of your business and your timeline for transferring ownership.

Plan ahead

If you don't have co-owners or want to pass the business to family members, other options include a management buyout, an employee stock ownership plan (ESOP) or a sale to an outsider. Each involves a variety of tax and nontax considerations.

Please contact us to discuss your exit strategy. To be successful, your strategy will require planning well in advance of the transition.