Business Succession: The Basis of Successful Retirement and Estate Planning

BMO PRIVATE BANK www.bmoprivatebank.com

By Rick Kollauf, BMO Private Bank

In a perfect world, business owners begin planning for the succession and continuation of their business when the business itself is in development. Such pre-launch advance planning would be quite beneficial since the decisions made at the start of a business will inherently impact the business owner's ultimate succession and business continuation options. Business succession forethought inevitably makes later decisions easier to follow. In addition, consideration of succession planning at the outset helps focus the business plan from inception.

However, the reality for most business owners starting a new business is that they tend to be completely consumed with decisions surrounding the development and implementation of the business plan itself. Choice of entity and jurisdiction, organizational documentation, hiring personnel, distribution and marketing channels are extremely time consuming and understandably dominate one's focus. Business succession planning and continuation of the business are rarely given their due until a business owner begins contemplating a personal exit strategy. What many business owners fail to consider until they are closing in on the finish line is the highly integrated and overlapping nature of the two—continuation of the business operation, and ownership transition as their foundation of retirement and estate planning.

Retirement Planning

For business owners in particular, retirement planning can be complicated. Issues and concerns are often compounded by the transition from being consumed by running the business to a succession of ownership and changing goals and lifestyle. Let's look at three key considerations:

Financial Security

Obviously, financing your retirement is paramount. Until now, the business was likely the largest asset on your balance sheet and the driver of the majority of cash flow. In order to assess whether the calculated business valuation and succession plan strategy will be sufficient — (i.e., family, ESOP, or outside buyer) — you should establish what your lifestyle expectations will be post-retirement. Usually, retirement brings some expenses not fully transparent in the years before retirement. These might include supporting college-age and young adult children, as well as caring for elderly parents. With individuals living longer, this can be more time consuming and financially straining than one may realize. Moreover, inflation needs to be factored into the planning equation as it can eat into the purchasing power of the nest egg.

> "In order to assess whether the calculated business valuation and succession plan strategy will be sufficient — (i.e., family, ESOP, or outside buyer) — you should establish what your lifestyle expectations will be post-retirement."

BMO Private Bank

Having a budget and financial plan in retirement is probably even more important than during your working years. Regular spending habits (cash flow) should then be more fully mapped out and any desired large acquisitions considered (such as purchasing a new home or a boat to enjoy in retirement). If the valuation of your business doesn't support your desired retirement financial goals, you may need to continue to build the business to a higher valuation level or scale back retirement goals.

If, on the other hand, there will be an excess of capital above what you will need for retirement, investment structure and planning should be defined before actual exit. This will facilitate a smooth transition from wealth accumulation to asset protection. Developing a wealth management plan with your financial advisor, much like any business plan, will be the logical next step.

Personal Goals

While it is certainly true that not everything is about money, you would be hard pressed to get an accurate read on your financial security goals if you didn't coordinate personal goals with the anticipated costs of seeing them through. Where you want to live when you retire is one of the first things to think about. Many opt to retire to a sunshine state, while others decide to be snowbirds — perhaps maintaining a home near family and also acquiring a home in a warm weather destination — which obviously can have an impact on finances. Things to evaluate before moving are the cost-of-living in the new location, including property and income taxes. Some states are no-tax states which can help stretch one's retirement dollar.

How you want to retire is another personal decision that can greatly impact finances and thus retirement planning in general. You may become less of a spender in retirement, or you may decide to become a world traveler and annual expenses could ratchet up. You may also choose to become more philanthropic than before, causing charitable expenses to impact cash flows. Likewise, how you decide to spend retirement could impact your cash flow calculations. Will you continue to be involved in business opportunities? Will you support other businesses by angel investing? Will you become the grandparent who covers family expenses such as grandchildren's college tuition and/or first home purchases?

> "Where you want to live when you retire is one of the first things to think about."

> "After so many years of focus on the business, it is common for business owners to have difficulty transitioning to retirement."

New Lifestyle

As a business owner, you have likely devoted many hours each day, each week, and each year to the running of your business. After so many years of focus on the business, it is common for business owners to have difficulty transitioning to retirement. That big black hole of time to be filled itself needs to be considered beforehand. In some instances, by the time a business owner retires, many friends and family may have passed or the relationships may not be strong. For this reason alone, it is important for business owners to have fulfilling personal as well as professional lives — hobbies, activities, close personal relationships — so that when retirement comes, there will truly be a "harvesting what you have sowed."

Even things as simple as personal health care should be considered. You may have had a Cadillac health coverage as a business owner to which you no longer have access in retirement. You may or may not be at the age where Medicare is available and, if it is, you should consider the need for supplemental coverage and prescription drug coverages over and above Medicare.

Estate Planning

No business succession plan should be considered without integrating a well-defined retirement plan and a comprehensive estate plan. Imagine a business owner working tirelessly for many years to build a successful business and accumulate wealth in the process, only to have the government take a large chunk of it because the owner did not do everything legally available to minimize transfer taxes between generations.

Judge Learned Hand wrote long ago that anyone may arrange their affairs to keep their taxes as low as possible, and "no one owes a duty to pay more tax than the law demands." Charitable inclinations aside, proper succession planning needs to integrate both retirement and estate planning.

Estate planning is generally meant to accomplish two things:

Estate Maximization – ensures that your estate is as large as possible to support you in your retirement years and to pass on a financial legacy to your desired heirs.

Estate Conservation – ensures the value of your estate is not eroded by taxes, probate fees, administrative costs, market loss and inflation.

The following chart illustrates some fundamental elements of an effective estate plan that you and your advisors need to consider:

Assets and Investments	Beneficiaries	Estate Administration	Needs of Surviving Family
Develop a proper investment policy statement and asset allocation strategy to maximize your estate. Establish a family values statement or family constitution to embody the family philosophies and values you hold important and to define the roles other family members might play in managing post-retirement wealth. Consider how assets are titled to assist in minimizing probate and estate taxes/costs.	Consider the people you want to receive your assets and how the dispositions should be handled. For instance, outright versus in trust.	Determine who should administer your estate and any trusts after death. Surviving spouse, family, and friends are alternatives usually initially considered, but thought should be given to professional administration—an entity with the proper experience and financial support to provide a smooth transition. Fiduciary liability can be a daunting responsibility and should not be thrust on inexperienced individuals.	If there are special needs, for example, certain types of bequests in trust with special language should be considered to protect and preserve rights to governmental assistance. Consider asset protection at the next generation regarding potential creditors and "unworthy" spouses of your children.

Conclusion

When it comes to business succession and continuation planning, and the interrelated nature of retirement and estate planning, one piece of wealth management advice may be most important. Have ongoing meaningful dialogue with your family as part of the succession planning process. Regardless of their level of involvement with running the business, today or post-succession, taking into account all relevant short- and long-term family needs and concerns will lay the groundwork for a much more satisfying next chapter.

And remember, it is to your advantage as a business owner to begin the succession, retirement and estate planning journey well in advance of any such transition.

Feel Confident About Your Future

BMO Private Bank — its professionals, its disciplined approach, its comprehensive and innovative advisory platform — can provide financial peace of mind.

For greater confidence in your future, call your BMO Private Bank Advisor today.

www.bmoprivatebank.com

Rick Kollauf is the U.S. Estate Planning Manager for BMO Private Bank. He specializes in providing customized estate planning solutions to high net worth individuals and families as part of an overall personal wealth management strategy. Rick has over 28 years of experience in the financial services industry.

Rick received his BS in Accounting and JD from Marquette University. He is a Certified Public Accountant.

A more in-depth look at the broader context of Business Succession and Continuation Planning is available on our website at **bmoprivatebank.com.**

August 2014