Planning Ideas for Business Owners

As most anyone reading this can attest, business owner clients are busy. This is why the shoemaker's children go barefoot! As a result, our business owner clients often suffer from a variety of gaps in their overall planning construct.

Here are a few planning ideas to raise with your business owner clients.

ASSET PROTECTION PLANNING

Financial, tax, and estate planning cannot be effective for a business owner if creditors end up taking away her valuable assets. This means all business owners should be focused on asset protection planning.

Business owners face a variety of creditor risks, including both "inside" and "outside" creditors.

An **inside creditor** is one who emanates from inside of the business. These risks might include a customer or vendor who sues the business for breach of contract. Another risk might include an employee who sues for any form of harassment suffered within the business.

Inside creditor protection is the most typical reason why businesses operate as business entities. Think corporations and LLCs. The corporate or LLC shield should be sufficient to insulate the business owner's personal assets from inside creditor risk. This leaves the business assets and operations to cover inside liabilities, potentially to the point of bankruptcy.

Key asset protection planning points for inside creditors include:

1. Ensuring that the company's books and records are complete and up to date – without formal business records an inside creditor could claim that business liability should extend personally to the owner under a legal theory called "piercing" or alter ego;

2. Considering whether the business should be reorganized to separate risky lines of business from non-risky lines of business – often tax-free reorganizations can be effectuated for this purpose;

3. Reviewing relevant business insurance policies to transfer as much risk as possible to third-party insurers – in addition to commercially available options, the client might consider captive or group captive insurance options as well; and

4. Analyzing the business' balance sheet to determine if excess cash (greater than necessary for working capital) remains on the books – if so, it might make sense to withdraw that cash and allow the owner to hold it in a protected structure.

An **outside creditor** is one who emanates from outside of the business. These risks include anything from your run-of-the-mill car accident to personal liability on debt guarantees, and fiduciary liability owed to business partners.

Most business owners are woefully underprotected from outside creditors. Outside creditor protection is a niche area of law with which many estate planning lawyers are uncomfortable or flat unwilling to advise.

Key asset protection planning points for outside creditors include:

1. Analyzing, as a baseline, the client's overall creditor risk by understanding which assets might already be protected – state law often (but not always) provides default asset protection to certain types of assets;
2. Considering whether the client will engage in asset protection planning by other means – for example, if a client is likely to make lifetime transfers of assets as part of her estate plan, those transferred assets will naturally be insulated from the client's creditors (but without careful planning may become subject to the creditors of the transferee);
3. Determining if the client should increase personal lines of insurance, including umbrella and other specialty policies, which may not be best written by mass retail insurers; and
4. Proposing the implementation of asset protection strategies including the insertion of "charging order" LLCs as holding companies for client assets and/or self-settled asset protection trusts in domestic (South Dakota, Delaware, etc.) or foreign (Cook Islands, Nevis) jurisdictions – this will most often depend on how asset protection motivated the client is since these strategies require investment of time and resources.

BUY/SELL PLANNING

Although succession planning is applicable to any business enterprise, the concept of buy/sell planning tends to implicate businesses with unrelated owners.

When it comes to buy/sell planning, many (maybe most?) business owners tend to fall into one of two categories:

- A wildly out-of-date buy/sell agreement that fails to set the buyout price at fair market value and may be very difficult to fund; or
- No buy/sell arrangement at all.

Key planning points for a client's buy/sell planning include:

1. Determining whether the client currently has a buy/sell agreement in place with his business partners. No matter the answer, consider modeling the economic, tax and financial planning effects of the existing structure. Walking through the result of the client's death or disability can be eye-opening (or heart racing).
2. Before pulling in the client's attorney or CPA, take the opportunity to speak with the client about what economic result the client would want in the event of his death or disability. Perhaps a forced buyout is unwarranted under the circumstances because the client's surviving spouse or children are capable of running the company. Or, perhaps the business or partners cannot afford an adequate buyout. These are discussions that can and should occur prior to bringing in an attorney who will charge hourly for the same discussions.

With these practical points determined, the client's attorney and CPA can be charged with the goal of crafting the most practical and tax-efficient buy/sell arrangement.

INCOME TAX PLANNING

It's not uncommon for business owners and their advisors to become complacent – especially when things seem to be going well. If your business owner client fits into this category, consider raising one or more income tax planning ideas. This is where a discussion with the client's CPA might be fruitful.

Potential income tax planning ideas include:

1. Revisit qualified retirement plan options. Does the business sponsor a qualified retirement plan? Consider reviewing plan design and opportunities to add compelling tax savings opportunities – like a cash balance plan – with our very own Retirement Advisory team!
2. Family members on the payroll. If a client is otherwise paying for a family member's expenses (typically an adult child), why not put the child on the payroll of the business? The child will experience the income at lower rates, use that cash to pay relevant expenses, and become eligible for an IRA contribution based on that same earned income.
3. Review the tax classification of the business. Is the client's business entity properly classified for income tax purposes? For example, consider analyzing the switch from partnership or sole-proprietorship to S corporation for potential self-employment tax savings. Alternatively, consider restructuring from S corporation to partnership to aid in key employee equity issuances and/or to make wealth transfer simpler. Or, consider modeling the switch from S corporation to C corporation to take advantage of the 21% federal income tax rate. Of course, any reclassification or restructuring has many potential income tax effects, which should be considered with the client's CPA or tax attorney.

Please reach to Choreo with any questions or to discuss how we can help make your business planning as smooth as possible. Together, we'll address your needs and the future you're building today. www.choreoadvisors.com.