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What Planning Should You Do Prior To Selling Your Company?

Congratulations! Youâ€™ve beaten the odds, built an enduring, valuable company, and are looking to sell it. If youâ€™re like most business owners, youâ€™re primarily focused on working with your investment banker and M&A attorney to get the best price and structuring the deal with favorable terms. But donâ€™t overlook personal wealth management strategies that can increase the value of the transaction and give you peace of mind. Itâ€™s essential to include your personal advisors â€” your estate planning attorney, tax accountant, financial advisor, and maybe therapist â€” early in the process.

Here are the top wealth management topics to consider before selling your company.

Estate Planning

Transferring a portion of your company to irrevocable trusts outside your estate before the sale is a powerful planning strategy because the transferred shares will be valued at a discount to the eventual sales price. This is because shares in a closely-held company qualify for discounts for lack of control (where non-voting stock or less than a majority are transferred) and lack of marketability.

Hereâ€™s an example: Carl Grey, the 100% owner of Diversified Industries, is negotiating to sell the company for $100 million to a strategic buyer. Carl and his wife, Carla, each have $10 million of estate and gift tax exemption available and would like to use their exemptions to fund a trust for their children and grandchildren. They hire a business appraiser who determines that the shares are currently worth one-third less than they will be at the time of the sale due to the aforementioned discounts. Thus, a 30% interest in Diversified is worth $20 million. Carl (and Carla via gift splitting) gift 30% of Diversified into an irrevocable trust for the benefit of their children and other descendants. When the sale of Diversified closes a few months after the gift, the new trust will receive $30 million even though only $20 million of estate and gift tax exemption was used. Plus, Carl will owe taxes on the gains attributable to the stock held by the trust, which means that the trust gets to keep the entire $30 million. Hereâ€™s my prior article about Irrevocable Gift Trusts with more information on how these trusts are typically structured: How to Use Irrevocable Gift Trusts to Take Advantage of Your Estate and Gift Tax Exemptions

A complementary strategy is to sell shares of Diversified to an irrevocable gift trust before the sale of the company. This would allow the discount to be enjoyed on Diversified shares amounts beyond Carl and Carlaâ€™s exemption amounts. For example, Carl could gift 30% of the shares and sell another 29% in return for a note at the one-third discount. (If Diversified had voting and non-voting shares, Carl could sell an even bigger proportion to the trust and still enjoy the lack of control discount.)

It is essential to involve your estate planning attorney early in discussions of planning involving gifting or selling shares to a trust because the timing of when the gift/sale is fact-dependent (this strategy wonâ€™t work once the sale is legally binding).

Charitable Planning

If you are charitably inclined, making a significant gift to charity in the year of your companyâ€™s sale to offset your large tax bill may make sense. The easiest way to do this is to give cash received from the sale (or appreciated publicly traded stocks if you have a stock portfolio).

In the Carl Grey example above, if he and Carla plan on giving $500k a year to charity and would like to fund 20 years of giving, they can transfer $10 million of cash to a Private Foundation or Donor Advised Fund and receive a $10 million charitable deduction. That charitable deduction will reduce their tax bill from the sale of the company and provide them with a philanthropic pool to fund future gifts.

Another option would be to transfer shares of Diversified Industries to charity before the sale. This strategy has two benefits: (a) Carl will still get a charitable deduction for the value of Diversified stock transferred to charity, and (b) heâ€™ll avoid paying taxes on the gains on the transferred stock because such gains will be allocated to charity (which doesnâ€™t pay income tax).

There are two important caveats to this strategy: (a) the donee charity should not be a Private Foundation (because then the charitable deduction will be limited to the cost basis of the contributed shares), and (b) the value of the Diversified stock will reflect discounts for lack of control and marketability, just like in the estate planning example in the prior section. Given the added complexity of gifting closely-held shares, itâ€™s essential to work with your financial advisor or tax accountant to run the numbers to quantify whether thereâ€™s a benefit to using closely-held stock instead of cash or publicly traded stocks. For more information on the pros and cons of Private Foundations and Donor Advised funds, check out my article on that topic here.

Income Tax Planning

Taxation of corporate mergers and acquisitions is complex; thus, your corporate transaction team must include a competent tax attorney and tax accountant. These advisers will work to provide you with the best tax structure.

From a personal planning perspective, beyond the charitable giving planning discussed above, deciding in which tax year the gains from the sale will be realized is the primary planning opportunity.

Taxes are due on April 15th of the year after tax liability is incurred. Additionally, taxpayers must make estimated tax payments to avoid penalties for underpaying taxes. There are two ways to avoid underpayment penalties: (a) pay in 90% of your current yearâ€™s tax liability, or (b) pay in 110% of the prior yearâ€™s liability.

Letâ€™s see how this can work. Assume that Carl can choose between Diversified selling in 2022 or early 2023 and that his tax liability related to the sale will be $25 million. Also, assume that his tax liability in a typical non-sale year is $1 million. If the deal closes in 2022, heâ€™ll owe $26 million in April 2023 ($25 million from the sale and $1 million related to his other income). Now suppose the sale doesnâ€™t occur until 2023. In that case, he needs to make sure he has paid in $1.1 million for his 2023 liability (his $1 million usual tax liability times 110%) and can wait until April 2024 to pay the $25 million attributable to the sale without penalty. In this instance, the benefit of waiting is enormous because he can earn a year of extra interest on the tax money. A one-year treasury bill currently yields about 4.75%, meaning that waiting a year to pay the $25 million will provide Carl with nearly $1.2 million in interest.

Of course, transactions in the works later in a year are likely the only viable candidates to be delayed into a new tax year. Plus, there may be non-tax and non-economic reasons not to want to delay closing.

Investing

First and foremost, make sure you have the right financial advisor â€” one whom you trust and who is accustomed to managing the size of the portfolio youâ€™ll have after your company sells. Managing a large investment pool spread across trusts and various family members is akin to running a small business.

Next, thereâ€™s no rush to invest proceeds from the sale of a business right away. Focusing on the sale and transitioning the company usually is and should be the priority. However, you should figure out where to park the cash once the proceeds hit to enjoy the highest possible yields. The difference between earning a 2% and 4% return on your cash makes a material difference ($5,500 a day on $100 million).

Another issue youâ€™ll face is whether to invest the proceeds all at once (a lump sum) or over time (dollar cost averaging). My previous article digs into this question: Youâ€™ve Received an Influx of Cash. Is It Best to Invest It as a Lump Sum or by Dollar-Cost Averaging?

Control the Message

Itâ€™s essential to control the messaging to your family members, friends, and the broader community about the sale of your company. People talk. They speculate. Consider how much and what youâ€™ll share about the transaction and with whom. Plus, the transaction details might be made public if a publicly traded company purchases your company. Be prepared for the word to spread about your liquid wealth and to be inundated with people trying to sell you investment advice, business deals, private jet charter services and the like. Charities may also come calling. Plan how to handle these (friendly) predators. A best practice is to direct all such inquiries to a trusted advisor who will act as a gatekeeper for you.

Talking to your kids about the sale of the business is also critical, even if they are young. It is crucial to plan for what to say (and not say) to them now and as they get older. An experienced wealth advisor or a wealth psychologist can help craft the right message for your children, family, and friends.

Preparing for Life After the Company

Preparing yourself (and other family members) for life after the company is essential. Families gain identity from owning a successful business. The company ties family members together. It provides jobs, purpose, and focus. When it goes away, there is a void. We advise taking time and deliberately considering your purpose post-owning your business. A best practice is to work with a therapist on various emotional and relationship issues that arise over the weeks, months, and years after the sale of a business. Here's a book on this topic that I love: What Happens When You Get What You Want: Success and the Challenge of Choice

Conclusion

Selling a business is exciting, stressful, and life-changing. While focusing on the myriad things necessary to sell and transition the business is the top priority, donâ€™t neglect the personal side of the transaction. Having the right team of personal advisors is critical and planning with them should start well before the business transaction is finalized.

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