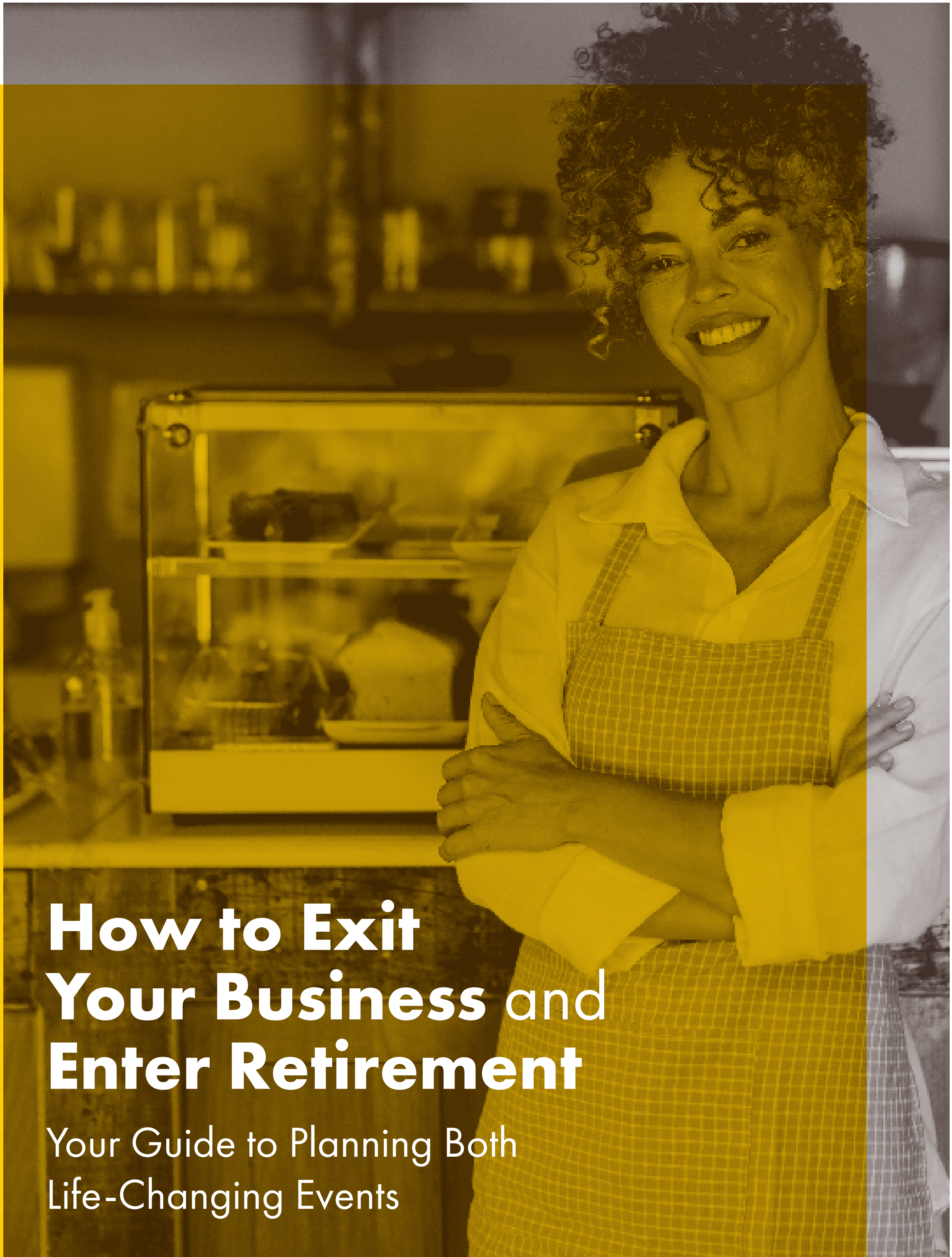

How to Exit Your Business and Enter Retirement

Your Guide to Planning Both Life-Changing Events

For many years, you've been the captain of your ship. Running your own business hasn't been easy, and success was never guaranteed. Retirement planning is the next uncharted waters for you, and there's no one-size-fits-all map.

Ultimately, as a business owner, you must create a unique retirement strategy that often differs greatly from an employee's. This means setting up a succession plan for your business and a retirement income plan for yourself that fits your unique needs. In this guide, we'll cover the following topics:

- **Succession Planning**
- **Retirement Income**
- **Tax Planning**
- **SECURE Act 2.0 Changes**

Succession Planning

Creating Your Succession Plan

You've dedicated years of work to grow your business to where it is today, but what will happen when you're not there to steer the ship? The first step in creating a unique retirement strategy for you is to figure out the who, what, and when of your business succession plan.

Who is Your Successor?

Now is the time to identify the best-fit successors for your business, whether a family member, partner, or employee. This includes officially naming managers and owners of the business and codifying their roles in writing, active or non-active, for all involved.

What Will They Do?

You must clearly outline how family members, business partners, or anyone else will be affected and what their roles will be once you officially exit your business. This may include creating a method for resolving disputes, along with listing out new roles and their responsibilities clearly.

When Will it Happen?

Consider establishing a timeline for the implementation of the overall succession plan. Whether you plan to sell your business, step down, or close up shop, there are key timelines and due dates that must be respected in an official process for there to be a smooth transition for your business and for your retirement life.

Retirement Income

Where Will Your Retirement Income Come From?

Where your retirement income may come from is a much different matter for you than it is for an employee of a company, big or small. You may not have had access to the employee retirement benefits many others may have had during their working years, but it doesn't mean you don't have retirement income options; It just means that yours are different and require a unique approach.

1. Income Sources If You're Stepping Down or Closing Up Shop

   Most small business owners must consider passing their business on to a successor or simply discontinuing operations. If either is the case, you'll need to consider legally gifting your business and its assets to your successor. This may provide you with tax benefits associated with the gift tax exemption rule, but proper planning with a detailed understanding of the relevant laws and benefits is required to successfully execute this plan.

   If you're closing your business, another option you'll want to consider is what to do with your assets. Clearing out your business real estate and preparing it for sale, as well as selling other business assets at auction or to competitors, may be a viable option. However, you'll need to enlist a real estate agent and find a relevant broker or auction for your materials, among other tasks that a financial professional with business succession knowledge can help you navigate.

   Note that selling your business property and any associated materials of value is a separate process from selling your business as a revenue-generating organization.

2. Income Sources If You're Planning to Sell Your Company

   If you plan to sell your business, you will need to professionally assess the valuation of your company to reach a reasonable sale price. To do this, you may need to bring consultants to the table who can help you in the business sale process. A proper inventory and valuation of your business and its assets will help you come to a reasonable number that you can pitch to potential buyers. But note that this will take a strong business growth plan as well as a lot of hard work and may not be realistic for many small business owners.

Once You've Left Your Business, What's Next?

Once you've left your business, you've either grown savings from setting aside money each month and/or earned a lump sum from selling your property or business. No matter how you have earned your savings, retirement can last for decades, and the risk of running out of money is a real concern, especially if high inflation and market uncertainty come into play. To help protect against these effects, your retirement plan should include strategies for these components of your income plan. Here are some potential income sources in retirement:

Investment

- If you have a Solo 401(k), SIMPLE 401(k), IRA, or other retirement account as a business owner, you'll need to have a plan to draw down your account in retirement in a way that provides you enough income but doesn't deplete your savings too soon.
- Distributions from these tax-deferred retirement accounts are taxed as ordinary income and may be subject to a 10% penalty if taken before age 59 ½.[2] Also, many of these accounts have differing contribution limits, which may impact the rest of your retirement savings plan, especially when factoring in proceeds from a sale of assets or inventory you'd like to contribute to your accounts.

Social Security

- Social Security is more complex than you might think, and there are many misconceptions about it that may influence important decisions, negatively impacting your retirement strategy. For business owners, this could be especially relevant given how you may have the option to structure your own income.
- However, because you have more freedom with your income, it may help to check with the Social Security Administration to see if they've recorded your income the same way you have. By doing this, you can find out where any discrepancies may lie and why they've documented your income in the way they did.

Annuity Income

- An annuity can help protect against outliving your money by providing guaranteed payments to you for life or a predetermined amount of time.[3] There are also potential tax benefits: Some annuities can be funded with untaxed dollars, and some annuities can offer tax-deferred growth during the accumulation phase.[4]

Together, these options and others can form a robust income strategy, but only if it's tailored to your financial situation and unique goals. See a few of the many hypothetical situations illustrated below.

- Some business owners may benefit more from a plan that favors annuity income over their other options. If they weren't able to save as much but successfully sold their business or assets at favorable prices, they're likely to have a lump sum to put towards their retirement. That lump can be invested into an income annuity with specifications that meet their financial needs.
- Another business owner could have only received a modest sum when selling their assets but utilized their tax-advantaged savings options well. In this case, they may decide not to opt for a customized annuity but see an opportunity to max out their retirement contributions with the proceeds from the assets they sold, for example.
- Other business owners may have been able to sell their real estate and could have a different option in the form of rolling over the proceeds from that sale to a new investment property, which may come with tax-deferred status if executed properly.

We've only scratched the surface of what your income strategy may include. A financial professional can work with you to understand the components of your unique financial situation and help develop an income plan that can cover your needs throughout your retirement timeline.

Tax Planning

Tax Implications for Your Business

Many business owners make the decision to sell their business assets and property as they retire, sometimes even their whole company. But have you considered how selling your business might impact your tax situation or how the tax code may change in the next few years in ways that could affect your overall retirement strategy? Laws could change that make some business succession options more costly than others, so it's always important to stay vigilant and listen to knowledgeable professionals for guidance.

How is the Sale of a Business Taxed?[5]

Although the process of selling a business as a revenue-generating entity is much different than selling the parts and assets associated with your business, the IRS taxes the sale of a business as the sale of all its parts and assets.

How the IRS Sees Your Business

A business usually has many assets and inventory items, all of which are taxed differently, according to the IRS. Individual assets are treated as if they are being sold separately, even if sold to the same person or entity at the same time. Assets held, often for longer than a year, are taxed at capital gains, and inventory items used and not held for a full year are taxed at ordinary income rates at the time of sale.

The distinction between asset and inventory is an especially important one, as many business owners would prefer to categorize all their property as assets so that they are taxed at the favorable capital gains tax rate, as opposed to the higher income tax rates. But an unrealistic characterization of your assets and inventory might signal to the IRS that your business items are miscategorized. This could slow down the process of your deal, potentially even driving buyers away.

On the other hand, the buyer often wants as much of the price as possible allocated to costs that can be deducted, such as depreciable assets. This, in turn, can reduce the new owner's tax bill. The potential for competing interests between the buyer and seller makes the asset versus inventory distinction an important part of business sale negotiations. As such, a seller may compromise on the price of an asset or a bundle of assets and the terms of the deal to get a more favorable asset distinction for tax reasons.

Payment Structure Matters for Your Retirement

In addition, there may be different ways to structure the payments involved in a sale to help ease the potential tax burden. For instance, you could contractually agree with the buyer to receive payments in installments over time. You can even stipulate that the installments accrue interest or add other contingencies.

However, this may impact the retirement income options that make the most sense for your financial situation. For example, if you're receiving installments, then a lump sum annuity may not make as much sense as an annuity that takes premium payments over time or another option entirely.

Note that if part of the structure of the deal is a merger rather than an outright sale of your business, there may be tax benefits involved.

Passing On a Family Business

Since a business is considered property, how you gift it is subject to the gift tax exemption rules.[6] Property that is transferred to someone for free or for less than its fair market value is taxed under gift and estate tax rules. If the original owner is still living, the gift tax exemption applies, while the estate tax applies after the original owner's death.[7] That means you may have the option to incrementally gift pieces of your business each year to stay under the annual gift tax exemption limit. Business sales that happen when the original owner is alive may be subject to capital gains taxes imposed on the difference between the adjusted basis of the business and its sale price.[8] Businesses generally receive a step-up in basis upon the death of the original owner, which means that taxes are based on the value of the business at the time of the owner's death and not when it was originally bought or started.[9]

SECURE Act 2.0 Changes for Small Businesses[10]

The SECURE Act 2.0 outlines measures to increase the ease at which businesses can offer retirement savings and investment benefits to employees.

If you're still operating your business, utilizing these new rules can help you support and attain the high quality of talent needed to succeed. And maybe you'll find the successor for your business by being able to retain talent with these improved retirement benefits.

Tax Credits for Setting Up Retirement Plans

It can be expensive to implement, maintain, and inform employees about their retirement options. Starting in 2023, companies with as many as fifty workers may qualify for a three-year start-up tax credit that covers 100% of administrative costs, up from the previous 50%, with a ceiling of $5,000 annually. In addition, small businesses may be eligible for an extra credit of up to $1,000 for every employee, which is generally a portion of the amount their employer contributes on their behalf. The full additional credit is accessible only for employers with fifty or fewer employees and diminishes as the number of workers reaches 51-100.

Simple & SEP IRAs Get Roth Options

A new law has introduced two kinds of workplace IRAs that can be set up with a Roth basis: SIMPLE IRAs and SEP IRAs. Those who contribute to these Roth accounts will have to pay taxes on their annual income for these contributions.

Introducing Starter 401(k)s

Starting in 2024, businesses not providing retirement plans will be able to provide a simpler and more cost-effective starter 401(k) plan. This starter 401(k) necessitates that each employee is signed up by default at a 3-15% proportion of their salary. The yearly contribution limit for this plan is equal to that of the IRA contribution limit, and employers are not allowed to make matching or non-elective contributions. Alternatively, businesses can offer a starter safe harbor 403(b) plan that has similar guidelines.

This may lower your costs of administering benefits for your employees, helping cut your expenses and save more for retirement, as well as retain the employees who may become your successors.

Launching Auto-Enrollment

There's a key change to retirement savings benefits that the SECURE Act 2.0 introduced that could potentially increase your operating costs and encourage you to sell or exit your business.

Starting in 2025, employers have to auto-enroll employees in newly created 401(k) and 403(b) plans, with a minimum pretax contribution equivalent to 3% of their wages. That percentage will increase by 1% annually until the employee is contributing at least 10%, but not more than 15%, of their salary. Workers are allowed to opt out of contributions and the predetermined increments.

Exceptions to this auto-enrollment provision are businesses that are under three years old and those with 10 or fewer employees.

Disclosure

This is designed to provide general information on the subjects covered. Pursuant to IRS Circular 230, it is not intended to provide specific legal or tax advice and cannot be used to avoid penalties or to promote, market, or recommend any tax plan or arrangement. You are encouraged to consult your personal tax advisor or attorney.

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