

# TALKING ABOUT my generation

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## What to Consider Financially in Taking Over the Business

WHAT STEPS DO YOU NEED to take to assure the transition of the garden center business from the first generation to your ownership is as smooth as possible? There are a number of important things to consider, financially.

First, you should get a professional valuation from a certified expert to help you understand how much the business is worth. This doesn't necessarily mean it is the price you'll pay for the garden center, but it does provide an external and impartial value of the business. And this isn't the only reason a professional valuation is important.

The IRS will want their piece. Let's say the garden center is worth \$5 million, but mom and dad only charge you \$2 million. The IRS views the \$3 million difference as a gift with possible taxes due. Then, let's say your parents have died, and the IRS does a review and discovers the discrepancy. Guess who pays the taxes - you. Guess who won't have the liquidity at the moment - you. Guess who is forced into a fire sale of the garden center - you guessed it.

The good news is, there is a recognized range of valuations. For example, the value of a business to a strategic buyer would bring the highest value. A strategic buyer is a business that needs another business to complete its portfolio, enter a new market

or block a competitor from getting into the market. Think of Microsoft buying Skype for \$8.5 billion, even though Skype lost \$7 million the previous year and had about the same amount in debt. Microsoft didn't want Google or Facebook to get their hands on Skype.

Through a more simplified financial analysis, without strategic buyers waiting in the wings, how much is the garden center business worth? Get a valuation from a certified professional, and inform them that you need the valuation for the purpose of transferring the business to the next generation, you. That way, if the IRS has a question, the onus is on the valuation professional to justify the price.

If the plan is to be co-owners with your siblings or anyone else, it is wise to establish a buy-sell agreement with a valuation process defined. This way, if it turns out that someone wants to leave the garden center, the separation process will already be understood.

Another critical step in understanding the financial ramifications of buying the garden center from the first generation is developing solid financial skills yourself. The best way to gain these skills is by spending a stint as the chief accountant, with the responsibility of generat-

ing the monthly financial statements. If this isn't possible, sit down once a month to review financial statements in detail with your CFO, and attend multiple financial statement analysis courses. You could rely on professionals for this, but considering the importance of the topic, having your own understanding is best.

### Dealing with Family Matters

The next step in preparing to take over the business is to be involved in the estate planning of your parents. In many regards, this is the last step in the development process. There are two critical elements for this to go smoothly: having the relationship, trust and healthy communication to be involved and having the knowledge to assist. When it comes to the relationship, it is vital to understand that you may not see eye to eye with your parents on their needs and desires after they retire or when they die. It can be a delicate situation.

Assuming you have the relationship to be involved in the estate planning process, get yourself up to speed with the various aspects of estate planning, including insurance, investing, tax ramifications and legalities.

There may be other family members involved in this process as well, including siblings in and outside the business. The estate plan will need

to treat each sibling in a fair and equitable manner. Business ownership is a key area to consider. If a family member is not working in the business, it doesn't mean he should get shares of the business because he is family. This is only considered, usually, if there is no other liquidity available, or the liquidity available is too important for the growth of the business - which is what happened at my family's business.

My uncles were working in the business, but my mother and aunt weren't. However, the company was growing at such a rapid rate, there was no interest in peeling dollars out to establish

a financial fund for my mother and aunt. Thus, ownership was provided with the thought that somewhere down the line, they would need to be bought out. That time came, and everything went smoothly. However, it doesn't always work out this way. Another standard way to reconcile this is to have some life insurance available to buyout those who are not in the business.

### Moving the Sale Forward

Now, after all this, you'll likely still need to buy the garden center from

your parents. If they are financially secure, it's in their best interest to get the purchase price as low as legally possible. Then, they can gift you up to the maximum tax-free amount, and pay gift tax after that level. The current law, through 2012, allows a tax-free gift up to \$5 million, which means parents combined can gift \$10 million. Beyond that, the tax is 35 percent, which is

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the lowest it's been since 1931. In 2013, the exemption rate is scheduled to drop to \$1 million, so, if a transfer is imminent, I would advise you to get moving.

However, if your parents aren't financially independent, you'll need to purchase some or all of the business. This is typically done one of two ways: by borrowing money from the bank to pay your parents, then paying off the bank over time or simply paying your parents over time. For certain businesses, an Employee Stock Ownership Plan

(ESOP) could be considered. An ESOP could be thought of as a more tax-efficient method to borrow money to pay your parents. However, they are expensive to execute and require a large enough business, consistent profit and enough time to gain the benefits.

Another exotic funding mechanism is a "captive," which involves setting up your own insurance company to

fund the insurance needs of your company. You can own or partially own the insurance company. Over a period of time, the insurance company can shut down, leaving the owners with the pro-

ceeds with extraordinary tax savings. Again, this is highly sophisticated and shouldn't be entered into lightly.

Finally, if you don't have a board of advisors, put one in place. Get three to five people who are fully independent of the garden center and its stakeholders but have knowledge that can be helpful to the business. At least one member with strong financial experience would be wise. This will provide you with a good sounding board as you go through the transition process, from a business, family and financial perspective. ■