



This issue brought to you by:

Daniel O'Brien
O'Brien, Riley & Ryan, P.C.
dobrien@orrpc.com
<http://www.orrpc.com>



Please contact Dan O'Brien for a free one hour consultation on your exit planning needs
Our new address is:
30 Braintree Hill Office Park
Suite 102
Braintree, MA 02184
Phone 781-410-2300
Fax 781-320-8608



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Elements of a Plan to Sell to Insiders

Today we discuss the essential elements of a plan owners use to transfer a business to insiders (with the help of skilled advisors) that keeps the owner in control until he or she is paid the sale price. If you suspect that the children, key employees or co-owners you would pick to succeed you do not have the funds to cash you out, consider the following 10 elements that make insider transfers successful.

Element 1: Time.

A transfer to insiders takes time: time to plan, time to implement and to pay the departing owner. Typically the more time owners take to transfer the company, the less risk they incur and more money they receive from the new owners.

For that reason, the first question an owner must answer is: Am I willing to take time (typically three to eight years) to execute and complete an insider transfer (while maintaining control)? If the answer is no, then it is probably best to consider other exit paths.

Element 2: Defined Owner Objectives.

If owners are willing to devote the time necessary for this exit strategy, they also must define and or quantify their objectives. These may include:

- Financial security and independence;
- Departure/retirement by a chosen date;
- Keeping family legacy or company culture intact;
- Rewarding key employees; and/or
- Taking the business to the next level—on someone else's dime.

In a well-designed transfer plan, these objectives are met *before control is transferred*.

Element 3: Cash Flow.

Healthy cash flow is critical to any sale. No buyer, (whether outside third party or insider) wants to buy a company with anemic cash flow. In a transfer to insiders, however, cash flow assumes gargantuan importance because initially it is the major, if not sole, source of your sale proceeds.

Element 4: Growth In Business Value.

Like healthy cash flow, buyers look (and pay top dollar) for companies that have the potential to grow in value. In transfers to insiders, only if cash flow continues to grow does the ownership transfer generally occur. For this reason, it is vitally important that owners contemplating an insider transfer install and cultivate Value Drivers before and during their exit transition. (For a quick refresher on Value Drivers, please contact me for one of our Value Driver White Papers.)

Element 5: Capable management desiring ownership.

Having a motivated management team in place and capable of replacing you is hugely valuable to any buyer. In a transfer to insiders, such management is essential. That management group must desire ownership and be willing to sign personally for any acquisition financing or ongoing company debt. Owners often assume that their management teams want to own their companies, and they do...but sometimes only until they realize that they have to pay for ownership.

Element 6: Minimize Taxes.

While no owner we know wants to pay more taxes than absolutely necessary, those contemplating insider transfers must focus on minimizing taxes. In an insider transfer it is imperative that you and your advisors structure the sale to minimize taxes on the company's cash flow (pre-tax income) because without planning the cash flow is taxed twice:

- once when the insider receives it (as the new owner) and then pays taxes before paying you to purchase the company; and
- again when you pay taxes on the proceeds you receive.

One goal of tax planning is to subject the company's cash flow to taxation only once. Accomplishing this feat takes considerable planning, but it's worth the time and trouble to save a third or more of the cash flow from this type of double taxation. One-time taxation means owners receive more money more quickly and thereby reduces risk of non-payment.

Element 7: Regulate an incremental transfer of ownership.

One of the most important advantages of the well-designed insider transfer plan is that it gives the owner the ability to regulate how ownership is transferred, when it is transferred and how much ownership is transferred. If company performance falters, employees stumble or if the owner chooses instead to sell to a third party, the well-designed insider exit plan keeps the owner in the driver's seat.

Element 8: Increase Control = Decrease Risk.

While business owners take risks every day, they don't relish risking their own and their families' future financial security. Therefore, we use strategies to retain voting and operational control in the hands of the owner and shift operational business risk from the owner's shoulders to that of the incoming owners so that owners stay in control of their companies until they receive the entire sale price. If you'd like to talk about the many ways to accomplish this, just call.

Element 9: Written Road Map with Deadlines.

To succeed, we believe that you must put your transfer plan in a written document and communicate it clearly (and regularly) to the eventual owners. If the plan is not in writing, it simply is not credible and neither you, nor

your employees, will take it seriously. More importantly, the written plan is the playbook for your exit that you'll use to coordinate your actions with those of your advisors (thus reducing delay and cost). The plan should include a timeline and provide accountability—who will do what, when—for all participants, including the owner! Without incremental, staged checkpoints, don't bother starting. You'll never finish a marathon if you don't have mile-by-mile goals to meet.

Element 10: Education (yours).

You need to understand the ins and outs of insider transfers because, unlike sales to third parties, you will control your business and the exit process until you've gotten all of your dough. That education begins as you read this newsletter.

If you'd like more education on our entire range of exit planning topics or wish to discuss transfer planning in general, please give me a call.

The examples provided are hypothetical and for illustrative purposes only and do not represent actual client experiences. Subsequent issues of The Exit Planning Review™ provide balanced and advertising-free information about all aspects of Exit Planning. We have newsletter articles and detailed White Papers related to this and other Exit Planning topics. If you have any questions or want additional Exit Planning information, please contact us.

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