LA STATE OF BUSINESS READINESS

The Los Angeles Business Journal and San Fernando Valley Business Journal recently jointly hosted the 'LA State of Business Readiness' breakfast event, which featured a spirited panel discussion and the unveiling of our 67-page survey results report. This first-of-its-kind study focused on organizational benchmarks in market attractiveness and transition readiness and was discussed by some of the region's most trusted advisors, honing in on best practices and opportunities for owner improvement. Access the full report by scanning the QR code below.

Jeffrey K. Eisen
Mitchell Silberberg & Knupp LLP

R. Carter Freeman, CMC
JANAS Associates

Gaurav Malhotra
Lucas Horsfall

Chris Passmore
Withum

Stephen Rossi
Palm Tree LLC

Josh Schimmels
Los Angeles Business Journal & San Fernando Valley Business Journal

Joe Seetoo
Morton Wealth

Andrew Welzel
Mariner Wealth Advisors

DIAMOND SPONSORS

COMMUNITY PARTNERS

LA STATE OF BUSINESS READINESS

1 LA State of Business Readiness Panelists. 2 Diamond Sponsors and Panelists (from left): **R. Carter Freeman CMC** (Janas Associates), **Gaurav Malhotra** (Lucas Horsfall), **Stephen Rossi** (Palm Tree LLC), and **Andrew Welzel** (Mariner Wealth Advisors). 3 Attendee: **Sandy Nasseri** (MelroseMAC) asking panelists Q&A. 4 **Joe Seetoo** (Morton Wealth, Diamond Sponsor) 5 Withum Team (Diamond Sponsor) attending the breakfast.

Four Tax Implications to Consider When Transferring Ownership of a Business

By JEFFREY K. EISEN

Transferring a business is a complex undertaking that requires careful consideration of a variety of both tax and non-tax factors. Tax implications play a pivotal role in determining the structure of the transfer. Here are four critical tax considerations that every business owner should be aware of when planning the transfer of their businesses. The first two relate to businesses that will be sold; the second two mostly relate to businesses that will be passed to the next generation (either before a sale, or as part of passing it to the next generation to continue the business).

1. CAPITAL GAINS TAX

In the case of a sale of a business, it is beyond the scope of this article to discuss the considerations as to whether it is better to sell the assets of the business, or whether the stock/LLC/partnership interests will be sold. In all events, there is capital gains tax to be considered, both Federal and California. While there is a special reduced capital gains tax rate for Federal purposes, there is not a reduced rate in California, so the total tax on the gain could be as much as 37.1%. Real estate also has the potential for "recapture" taxes. Before a sale is contemplated and undertaken, the structure of the transaction, and the consequences to buyer and seller, must be considered.

2. VARIOUS TAXES BASED ON ENTITY STRUCTURE

The tax consequences of transferring a business are significantly influenced by its entity structure. Whether your business is a sole proprietorship, partnership, LLC, "C" corporation, "S" corporation or another entity, each comes with its own set of tax implications. Sole proprietors may face different tax considerations compared to those transferring shares in a corporation. Choosing the right entity structure from the outset can provide tax advantages and disadvantages in a transfer. However, since it is often difficult to change the form of an entity as part of its sale, the consequences to the sale of the form of entity, and the assets of the entity, must be considered.

3. ESTATE/GIFT PLANNING

Transferring a portion of the business to children/grandchildren/other family members, or to trusts for their benefit, can bring substantial gift and estate tax benefits to the business owner's family. If a sale of the business is contemplated, these transfers need to take place months, or more likely, a year or more before the business is put up for sale, much less a transaction closed. There are a wide variety of ways to transfer interests to family members at a value below the "liquidation" value of the business or its ultimate sale price. There are situations in which the business owner also can pay the next generation's income tax on the sale without the payment of such taxes constituting a gift for gift tax purposes. There also are ways to structure a gift so that the next generation has equity without a vote.

4. SUCCESSION PLANNING: STRATEGIC APPROACHES

Business transfers to the next generation often hinge on effective succession planning. This involves developing a strategic roadmap for the transfer, taking into account both business and tax considerations. During life, the business owner has the opportunity to write the "rules" governing how the business will be managed after the business owner retires or passes, instead of relying on the next generation to figure it out.

> 'Tax implications play a pivotal role in determining the structure of the transfer.'

There also are ways for the estate tax on the business to be paid over as long as 14 years after the owner's death, instead of being due in full nine months after the transfer. Having the estate tax come due all at once has been the downfall of many a business which fails to plan for this event.

There also are ways for the business owner to transfer interests in the business while retaining some or all of the income for a period of time. The complexity of such arrangements requires careful consideration and professional guidance.

CONCLUSION

An estate planning attorney, working together with the business owner's CPA/tax lawyer and other financial professionals, can help structure effective succession plans and estate planning for the business owner, whether contemplating a sale or not. By addressing these considerations, business owners can embark on a transfer journey that not only preserves the financial health of the business but also optimizes tax outcomes for all parties involved.

Jeffrey K. Eisen is a partner and the co-chair of Trusts and Estates practice group at Mitchell Silberberg & Knupp LLP (MSK). His practice is focused on estate planning, probate and trust administration, and the representation of beneficiaries (including charitable organizations) in contested or disputed trusts and estates. He can be reached via jke@msk.com. To learn more about MSK, visit msk.com.

LUCAS HORSFALL
Accountants and Advisors

Where Outstanding Service Is a Given.

Any accounting firm can talk about their expertise. But are they fully committed to delivering the best service in the industry, day in and day out? **We are.**

Serving Owner-Operated Businesses Since 1957

For over 65 years, Lucas Horsfall has served the owners of closely held businesses and their families throughout Southern California and beyond.

From assurance and strategic tax planning to guiding you through the often turbulent and challenging world of M&A transactions, we're here to advise you through every stage of your business.

Because it's about more than just helping you run a more profitable business and growing your personal wealth. It's about supporting you in reaching your most important life goals.

ASSURANCE

CLIENT ACCOUNTING SERVICES

MERGERS & ACQUISITIONS

TRUST & ESTATE

TAX PLANNING & COMPLIANCE

LUCAS HORSFALL
FOR THE BUSINESS YOU LEAD, FOR THE LIFE YOU WANT.

LA STATE OF BUSINESS READINESS

1 Attendee: **Brendan McMahon** (Merrill Wealth Management) asking panelists Q&A.
2 **Josh Schimmels**, Publisher & CEO of the Los Angeles Business Journal, presenting survey results. 3 Panelist **Andrew Welzel** (Mariner Wealth Advisors, Diamond Sponsor), **Eva Juse** (Los Angeles Business Journal), and **Geoffrey Bremer** (Mariner Wealth Advisors, Diamond Sponsor) networking. 4 Diamond Sponsors and Panelists: **Jeffrey K. Eisen** (Mitchell Silberberg & Knupp LLP), **Chris Passmore** (Withum), and **Joe Seetoo** (Morton Wealth). 5 Panelist: **Gaurav Malhotra** (Lucas Horsfall, Diamond Sponsor) sharing insights with the audience.
6 Diamond Sponsors and Panelists: **R. Carter Freeman, CMC** (Janas Associates), **Gaurav Malhotra** (Lucas Horsfall), **Stephen Rossi** (Palm Tree LLC), and **Andrew Welzel** (Mariner Wealth Advisors); moderated by **Josh Schimmels** (Los Angeles Business Journal).

How to Create Value in Business Transition

By GAURAV MALHOTRA

Business owners often find themselves stuck between the desire to sell their business or passing it on to the next generation. While many advisors will point to the dismal statistics of the organizations failing into the next generation, it is still incumbent upon advisors to honor the wishes of the family and help create a path for success into the future.

I will argue that the planning required to pass the business on to the next generation also helps improve the enterprise value of the business and, therefore, makes it attractive to potential buyers. Simply put, the plan should entail replacing the business owner with a system.

Often, business founders wear many hats, and it becomes hard for them to let go of responsibilities. This is quite understandable, as they desire to be close to all aspects of the business. Over time, this leads to uneven growth in various “legs” of the organization. Broadly, a company stands on the “legs” of product development, production, financial reporting, and sales.

Over time, certain parts of the business get more attention than others. For example, the Company might receive a very large order, which might cause them to invest heavily in streamlining the production side of the house. The focus becomes squeezing the product out. The same company might have trouble producing reliable financial reports in a timely manner. This is because no one paid attention to the reporting side of the house, and the investment for it remained anemic.

Another reason for the uneven growth might be that an organization has built-in biases. Perhaps the founder enjoys new product development and pays more attention to it at the cost of other areas.

I would argue that most family businesses face uneven growth, as mentioned above. The task of value creation comes in the form of harmonizing these areas. So, how does one go about doing it?

This work takes years and requires investment of time, but it will pay dividends. Most importantly, there has to be a willingness to change.

Planning for the future requires making an assessment of the present. Making an honest assessment is hard work. While one can try to do this with internal resources, chances are that organizational biases might lead to incorrect conclusions. I would suggest looking towards third-party resources. For example, my firm gets engaged on a regular basis to assess the financial reporting function. Not only do we point to the weaknesses, but we also produce a plan for success. You might similarly engage with professionals to assess other areas of the business. While these assessments cost money, they should come up with recommendations that make the business more profitable.

Don't be surprised if you find out that you need to replace some personnel. Habits are hard to break. As a business grows, systems need to change, and I have found that it is hard for people to change habits. You might find that your most trusted key employees are the ones holding you back.

Naturally, you will lay out a near and long-term plan after you have made the assessments. Hopefully, it is ambitious. Visioning into the future is always the feel-good part. You will need to make sure that you are monitoring your progress.

> ‘While many advisors will point to the dismal statistics of the organizations failing into the next generation, it is still incumbent upon advisors to honor the wishes of the family and help create a path for success into the future.’

Monitoring needs to be systemized. This is where you hold managers accountable and help provide the support they need to succeed. What does monitoring look like? Some companies create Boards of outside advisors, while others hold monthly meetings. Not only should these meetings be designed to ensure that milestones are being achieved, but they should also be used to generate a sense of comradery and common purpose. This will create cooperation rather than silos.

Businesses that operate in this fashion are consistently valued higher than the businesses that don't.

Creating a system helps the business owner replace themselves with their heir or a third party. I know I have oversimplified matters here. My attempt is not to provide a roadmap but to evoke reflection.

The job of transitioning a business to the next generation is not easy. It requires a thoughtful plan, but most importantly, it requires a willingness to change.

Gaurav Malhotra is a partner at Lucas Horsfall.

Learn more at lhmp.com.