WILBANKS SMITH & THOMAS
Asset Management, LLC

A Comprehensive Guide to Selling Your Business

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TABLE OF CONTENTS

You've put a lot of hard work, time, and sweat equity into building your business, likely the largest asset you will own.

Making the decision to sell a business is a hefty one requiring evaluating priorities and requirements for the transaction to be deemed a success. As you contemplate selling your company, you will want to be sure you get the most you can get out of it, whatever your goals may be.

Success in selling a business can take many forms. For some, success can be a way to create liquidity to enjoy the financial rewards of their hard work. In other cases, transferring ownership to family members or trusted colleagues could ensure business continuity. Some owners even use the sale of their business as a springboard to start again with another endeavor.

Selling a business is undoubtedly one of the most significant financial decisions in one's life. If you're navigating this process for the first time, it's natural to have many questions. You might be wondering about the real value of your business, how to attain the maximum possible sale price, or the most appropriate deal structure. This whitepaper aims to guide you through these crucial matters. It offers insight into the journey you're about to embark on, helping you explore various options, and strategize how to enhance the legacy you'll leave for your loved ones.

Getting Your Business Ready to Sell

Preparation is vital to a successful sale. Before you put your company on the market, you will want to make you have a detailed understanding of issues.

Start by defining your primary goal. For some, this is simply creating liquidity; for others, the focus is on passing the family business on to the next generation. Your goals and priorities will shape much of this process, so clarify them before you begin.

Next, consider who will be handling the workload. Selling a business is a task-intensive process, so assemble a roster of the individuals within your organization who will participate, and clearly define their roles. Also, determine who your key advisors will be, such as lawyers, accountants, tax experts, and business brokers, as these individuals will be integral to the process.

You will also need a realistic idea of how much your business is worth. You can get a rough idea of your selling price by researching earnings multiples on other companies in your industry. However, for an accurate reading, you may need to consult an expert such as a chartered business valuator, a corporate finance specialist, or an accountant with experience in business appraisals.

If you are planning an external sale potential buyers may include strategic buyers, usually larger companies in a complementary business, or financial buyers, including private equity funds. If your intention is to pass the business to family members or business partners, you will need to identify suitable candidates for crucial roles within your organization, such as the CEO.

Lastly, before initiating the process, examine crucial legal and business documents, including your company's operating agreement, voting agreements, shareholders' rights agreements, buy-sell agreements, and any other documents that may influence the sale. Verify that all documents are up-to-date, legitimate, and duly signed.

Managing Tax Implications

Once your initial planning is complete, your focus will shift to taxes — this is particularly important if you plan to transfer your business or the proceeds from a sale to family members.

> **The estate tax applies to all asset transfers that exceed the filing threshold of $12.9 million (in 2023). Assets over this threshold are taxed at federal rates of 18 to 40 percent, and many states also levy additional estate taxes.**

The sooner you begin planning your asset transfer, the more flexibility you will have to reduce estate taxes. By giving or selling business interests to your heirs before you sell your company, you transfer all future appreciation in these assets to them tax-free.

Also, it's important to know that privately held assets can often be valued significantly lower than their public market value. According to a legal expert, there are two types of discounts applicable: 'lack of marketability' which can range from 25 to 35 percent, and 'lack of control' discounts which can vary between five and 15 percent.

To avoid any complications with the IRS, make sure to finalize any private sales or gifts before signing a letter of intent with a potential buyer. It's worth noting that the IRS typically considers the execution of a letter of intent as setting a price.

In a scenario where you have accepted an offer but have not yet transferred ownership to your heirs, there might still be some options available. For instance, there are certain discounts that you may be eligible for before finalizing the deal, based on uncertainties related to the transaction. These could be discounts for the time value of money held in escrow, the likelihood of achieving earnout targets, or the risk arbitrage related to whether the deal will proceed.

Seven Strategies for Minimizing Taxes

Without careful planning, estate taxes can significantly diminish the value of a business owner's legacy and might even necessitate the sale of a family-owned business or property. While every business owner's circumstances are unique, there are several common estate planning strategies that can reduce the tax implications of asset transfers, potentially saving millions of dollars. These plans can be put in motion years or even decades before a significant financial event.

1 Giving away your business

A straightforward strategy to pass part of the business value to your heirs is to give them an interest in the company during your lifetime, either directly or by funding a trust for their benefit. There are substantial tax benefits to transferring non-controlling interests in privately held companies. These shares can generally be valued at a discount to the public market price of your business due to two factors: lack of marketability and influence.

Consider that an interest in a private business is illiquid — meaning it is generally more difficult to buy or sell than comparable public market securities — reducing the market value of your gifts to your children since they cannot easily sell their interest for the total value. In addition, many business owners give their children non-voting shares or limit their ownership to a minority share in the company. As a result, they have little or no influence over the company’s operations. This lack of control makes their shares inherently less valuable than a controlling stake.

For both these reasons, the IRS permits owners to value their gifts of private company ownership at discounts to their total market value. Consider the following example. An entrepreneur owns a private company worth $10 million. They want to transfer 30 percent of their company to their only son.

Those shares have a public market value of $3 million. However, a 23 percent discount for lack of control reduces this value to $2.3 million. An additional 23 percent discount for lack of marketability decreases the declared value to $1.6 million. With this, they can give their son $3 million in ownership while only using up $1.6 million of his lifetime maximum estate and gift tax. In addition, all future appreciation, including any increase when the business sells, and shares are marked to public market value, has been moved from the business owner’s estate to their son.

Note: *This transfer will only be tax free to the extent that the business owner’s total lifetime gifts to his son do not exceed the estate tax threshold of $12.9 million.*

Exhibit 1: Discount Application Example

$10,000,000	100% Equity Value *(1,000 shares)*
$3,000,000	30% Pro-rata Value *(before discounts)*
($690,000)	Less: DLOC (23%)
$2,310,000	**Minority, Marketable Value**
($693,000)	Less: DLOM (23%)
$1,617,000	**Minority, Non-Marketable Value**

Exhibit 1: *Example is for illustrative purposes only.*

2 Gifts to irrevocable trusts

The tax implications of gifting to an irrevocable trust that benefits your child are similar to those of making a direct gift. As the name implies, an irrevocable trust cannot be changed once established.

Establishing a trust is more complicated than making an outright gift but can offer additional benefits.

For instance, the grantor can set up the trust so he continues to receive income from the trust until he dies, with the assets in the trust passing to his heirs upon his passing. Trusts can also protect assets from creditors or, if the beneficiary gets divorced, from ex-spouses. An irrevocable trust is particularly useful for business owners with heirs who may struggle with financial responsibility.

3 SALE TO LOVED ONES

If you have already exhausted your estate and gift allowance, or need cash from the business for personal expenses, selling the business to heirs can be an attractive option. A common strategy involves lending money to heirs to purchase your company, thus creating a steady income stream. Family sales can present an attractive opportunity to shift future growth to the next generation while paying little or no federal gift tax on the transaction.

4 SALES TO INTENTIONALLY DEFECTIVE GRANTOR TRUSTS

Another option is to sell your company to an Intentionally Defective Grantor Trust (IDGT). In this structure, you sell shares in your business to the IDGT in exchange for a promise that the trust will make regular interest payments to you throughout your lifetime and then pay out the value of those shares to your heirs when you pass away.

The shares you sell are immediately transferred out of your estate, freezing the size of your gift for estate tax purposes at their value on the day you complete the transaction. However, you continue to be considered the owner for income tax purposes. You, not your heirs, pay all taxes on investment income.

Why would you want to pay taxes on assets you no longer own? Consider that the taxes you pay are a tax-free gift to your heirs. When you die, your heirs will not have to tap trust assets to cover capital gains taxes. Moreover, you pay no capital gains taxes on the shares you sell into the trust; for tax purposes, you sell these shares to yourself.

Exhibit 2: **Sale to Intentionally Defective Grantor Trust (IDGT)**

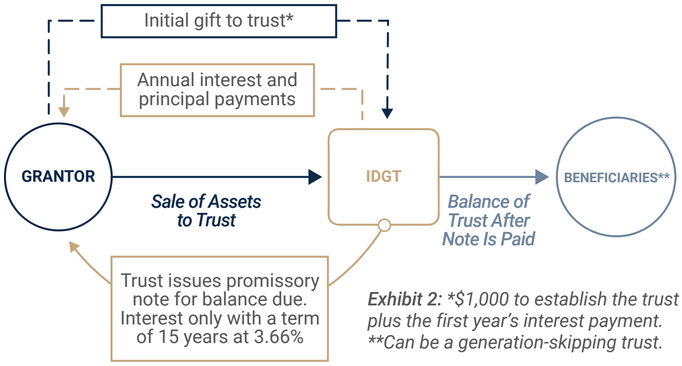

Exhibit 2: **$1,000 to establish the trust plus the first year's interest payment. **Can be a generation-skipping trust.*

Exhibit 3: **Example of Inflows and Outflows of an IDGT**

Year(s)	Beginning Amount	Growth	Required Payments	Remainder
1-14	$1,000,000	$2,294,398	$504,000	$2,790,399
15	$2,790,399	$279,044	$1,036,000	$2,033,439
Summary	**$1,000,000**	**$2,573,439**	**$1,504,000**	**$2,033,439**

Exhibit 3: *For informational purposes only. Example is illustrated using a 15-year IDGT term with beginning (year one) amount of $1,000,000.*

5 SALE TO GRANTOR RETAINED ANNUITY TRUSTS

A Grantor Retained Annuity Trust (GRAT) can be another good solution. As with the IDGT, you sell your business shares into a trust, but unlike an IDGT, a GRAT gives an annuity in return.

Through this annuity, the GRAT will pay an annual amount for a specified term of years. An IRS schedule determines the amount of the annuity. Suppose the trust earns more in investment income than the payout, its value increases. If it earns less, the payment reduces the value of the assets in the trust. However, the mandated payment is relatively low, and most business owners find their companies grow more than enough to cover the outflow. As a result, the assets within the trust can continue to increase without affecting the ultimate estate tax liability.

Exhibit 4: Sale to Grantor Retained Annuity Trust (GRAT)

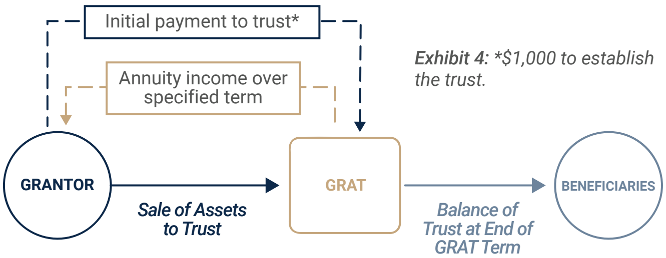

***Exhibit 4:** *$1,000 to establish the trust.*

After the trust's term ends, payments end, and you no longer own the trust's remaining assets. These assets are distributed to your children or other heirs. For gift and estate tax purposes, the gift value is the amount you contributed minus the value of all the annuity payments you received over the life of the trust.

A GRAT can be useful, but it has one major limitation, especially if you are planning to make gifts to generations after your children. The gift to the GRAT occurs when your annuity interest in the GRAT terminates. At that time, exemption from the generation-skipping transfer tax could be allocated to the trust, but the amount of exemption used would be based on the fair market value of the trust at the end of its term rather than when it was funded. That means any appreciation becomes part of your total gift for gift and estate tax purposes, pushing your estate closer to, or even over, the threshold for estate tax liabilities.

Exhibit 5: Example of Inflows and Outflows of a GRAT

Year(s)	Beginning Principal	10% Growth	0% Annual Income	Required Payments	Remainder
1	$1,000,000	$100,000	$0.00	$222,109	$877,891
2	$877,891	$37,789	$0.00	$222,109	$743,571
3	$743,571	$74,357	$0.00	$222,109	$595,819
4	$595,819	$59,581	$0.00	$222,109	$433,291
5	$433,291	$43,329	$0.00	$222,109	$254,511
Summary	**$1,000,000**	**$367,057**	**$0.00**	**$1,110,545**	**$254,511**

***Exhibit 5:** For informational purposes only. Example is illustrated using a 5-year GRAT term, 3.60% IRS hurdle rate, $1,000,000 valuation of contributed assets and 10% annual principal growth.*

6 A 1031 EXCHANGE

If your business owns real estate, such as a warehouse, factory, or office, you may be able to reduce your tax exposure with a 1031 exchange. In this strategy, you sell property your business owns and immediately buy similar property elsewhere without paying taxes on your gains.

Your basis in the new property is the basis of the old property; you will only have to pay taxes once you sell the new property. The new property must be "like-kind" or a business investment property.

The 1031 exchange is a powerful tool to help you defer your tax liability on the sale of investment real estate, including property you own as part of your business. However, it is a complicated undertaking, and you should consult an experienced real estate lawyer before getting started.

> **There are strict identification and timeline rules for a 1031 exchange, which must be adhered to.**

First, you must identify the exchange properties in writing within 45 calendar days of the relinquished property's closure per one of the following rules:

- Three-Property Rule: Identification of up to three properties regardless of the total value of property identified
- 200% Rule: Identification of any number of properties wherein the combined FMV (fair market value) does not exceed 200% of the relinquished properties' FMV
- 95% Rule: Identification of any number of properties regardless of the aggregate FMV, as long as at least 95% of the property is ultimately acquired.

You must also close on the replacement property or properties within 180 calendar days of the closure of the relinquished property.

7 OPPORTUNITY ZONE FUNDS

Opportunity Zone Funds were created as a part of the 2017 Tax Cuts and Jobs Act to generate and facilitate investments into "opportunity zones," or regions within the country that have been identified as being economically distressed. In short, an opportunity zone fund allows an investor to divert gains from any capital assets into one of the designated communities, allowing them to defer income taxes on those gains until December 31, 2026.

While the tax advantages of these vehicles may sound appealing on the surface, as an investment vehicle, there are certainly better options, and they may not be the best suited for all.

Charitable Strategies

For many entrepreneurs, the sale of their business unlocks opportunities to significantly impact their communities, address issues they deeply care about, or make a broader global contribution. Designating a part of the sale proceeds to charitable causes not only helps reduce potential estate tax liabilities but also imbues their lives with greater purpose and fulfillment.

The simplest method to incorporate charity in your estate plan is through outright donations. Affluent families may consider setting up a family foundation or endowment to oversee their charitable contributions. Alternatively, some may choose to use donor-advised funds to achieve their philanthropic objectives. Numerous business owners discover that charitable contributions foster family unity, as family members convene to discuss the causes they wish to support and the organizations they want to sponsor.

> **Charitable trusts can provide additional benefits, enabling donors to support the organizations they value while meeting their financial needs. These trusts are often called split-interest trusts because they benefit the charity, the donor, and loved ones.**

Charitable remainder trusts (CRTs) are financial tools that allow donors to transfer assets to a charity while still receiving income from those assets. They have a dual advantage: donors can claim a tax deduction for the charitable contribution in the year the trust is established and also remove any future growth of those assets from their taxable estate. At the same time, they will continue to receive regular income from the trust for many years or even for their entire lifetime.

On the other hand, charitable lead trusts (CLTs) function in the reverse way. They provide regular income to the designated charity for a predetermined number of years. However, the donor and their heirs maintain ownership of the assets placed in the trust. So, while the charity benefits from the income generated by these assets for a specific period, the assets themselves will eventually revert to the donor's family or heirs.

Turning Your Business Sale Into a Lasting Legacy

Selling a business is a significant and emotional milestone, encompassing not only substantial financial implications but also marking the end of an important chapter in your life. The process can seem overwhelming, with myriad responsibilities to juggle, and little room to contemplate the financial security of your family in the future.

Despite the complexities facing business owners during the time leading up to the sale, the decisions made during that interval can establish a lasting legacy for your descendants. Through meticulous planning and diligent preparation, you can safeguard the financial fruits of the sale for you and your successors, while also minimizing the potential tax implications. The earlier you embark on this preparation, the more options and flexibility you will retain in the journey.

WILBANKS SMITH & THOMAS
Asset Management, LLC

For over 30 years, Wilbanks Smith & Thomas has been privileged to serve as a trusted partner in the effort to preserve and grow wealth. We are dedicated to and defined by our clients' trust and the achievement of their goals.

You are why we're here.

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