

# The value of a wealth plan for a business owner



Business owners need to integrate their personal goals with the needs of their business as they journey through the various stages of their personal and business life cycles. With so much time and effort invested in the business, there is often little time left to address personal and family issues. A well-thoughtout wealth plan will help to identify a business owner's personal and business needs and priorities.

A business owner is the driving force of their business. They are always thinking about their business, innovating and making changes, so that both they and their business can succeed.

Starting and operating a business is not for everyone. Being your own boss requires a huge commitment, and a significant and ongoing investment of both time and effort. Lasting success also requires business-specific knowledge, real passion and the ability to take smart, calculated risks in order to get ahead—and stay ahead—financially.

## Personal goals versus business goals

Owners of a private business constantly face the difficult challenge of balancing the needs of their business with the needs of their family. There are trade-offs in time and financial commitments that business owners must constantly make, as they strive to generate the reliable business earnings and growth that will help them achieve their own financial goals.

With so much focus dedicated to the business, there is a tendency to overlook these goals and to delay decision-making regarding important aspects of a wealth plan:

- Financial planning
- Tax planning
- Estate and Trust issues
- Philanthropy
- Business transition and succession

A wealth plan can address all of these areas to meet a business owner's personal and business needs. It allows a business owner to

make the most of their assets; it helps protect their assets; and it develops a plan for their wealth to end up in the right hands. An effective wealth plan employs tax-efficient strategies in every area of their financial dealings, plans for a comfortable retirement, and factors in the unexpected and takes care of loved ones — now and in the future.

## The wealth plan

A holistic wealth plan focuses on the big picture by implementing customized strategies to achieve three primary wealth goals: accumulation, preservation and distribution.

The implementation of a wealth plan and the achievement of primary wealth goals are enabled. By engaging in a financial planning process that includes several steps: clarifying goals, identifying hurdles and exploring options, evaluating the recommendations presented in the plan, deciding on solutions and strategies that best meet needs and goals, implementing the plan, and reviewing it on a regular basis.

Wealth planning for a business owner should include personal financial planning alongside planning for the business. Business and personal financial plans have very different areas of focus, but for the business owner it is very important that the two plans work together. At its most basic, a business plan documents the steps that the business will take to earn profits and grow, and to preserve the growth and sustainability of the business. These profits and the eventual value of the business may be withdrawn and used to achieve personal and family goals, implemented in a personal financial plan. These goals may include plans for cash management, tax planning, investment planning, insurance planning, retirement and succession planning, and estate planning.

## Key areas of focus in the personal financial plan of a business owner

### Cash management

Businesses in the start-up phase tend to have high capital investment needs relative to the amount of revenue that the business is able to generate. Access to investment capital and the reinvestment of earnings in the business may compete with the need for cash flow to support personal and family needs. The income of the business should finance day-to-day business operations, but it will also be needed to fund the lifestyle, daily living expenses and savings for other goals of the business owner and their family, as well as managing debt.

Even though it may be possible to withdraw regular profits to support personal needs, a business can represent a large illiquid asset for the business owner. Strong financial management is essential to ensure long-term business stability and, ultimately, the growth of personal wealth over a lifetime. Both the business and the business owner can benefit from a prudent and efficient cash management approach.

### Tax planning

Minimizing taxes is a major factor contributing to an efficient cash management approach. Business owners benefit most when personal and business taxes are considered in combination. Leaving funds in a C corporation business can help to minimize taxes if the corporate tax rate is less than the individual tax rate. However, this strategy may result in double taxation if dividend withdrawals are contemplated and also limits the growth of personal investment assets, but it may have advantages for the business.

It's important to consider the right business structure for the business to maximize tax efficiencies, but also to protect the business owner and the assets they have accumulated within and outside of the business.

There are many tax-saving strategies that may be implemented with guidance and advice from a tax professional: electing to deduct the cost of eligible capital additions, fringe benefit plans including plans for health, charitable donations, estate freezes, home office deduction, maximization of retirement savings with a MyRA, Simplified Employee Pension Plan (SEP-IRA), Savings Incentive Match Plan for Employees (SIMPLE IRA), 401(k), and defined-benefit plan.

Income-splitting strategies can be effective in reducing a business owner's overall tax bill. For example, assets or income can be allocated to other family members in lower tax brackets.

Limited Liability Companies (LLC) electing to be taxed as an S corporation or other tax-efficient ownership structures should be set up in consultation with tax and legal advisors.

### Investment planning

A successful investment strategy begins with asset allocation. However, for a business owner, diversification from the business is a key consideration. As most of an owner's financial assets are tied up in the business, the achievement of other financial goals is dependent on saving and investing outside of the business in accounts such as 529 Plans, High Cash Value Life Insurance. Or in an annuity.

If surplus funds are left in the business or corporation, it is also possible to invest these amounts. Care should be taken regarding the liquidity and safety of any investments of this type, especially if short or medium-term cash needs are forecasted for the business.

### Insurance planning

Determining the best method to protect the business owner, their family and the business requires specialized knowledge of risk and of insurance-based strategies. In some circumstances it may be advantageous for insurance to be held by the business rather than personally.

Health-related risks that can be mitigated through the use of insurance include the risk of the business owner becoming disabled, suffering a critical illness or dying. Insurance can provide the funding necessary to protect the business owner's family in the event of an unforeseen illness, disability or accident. Policies that help meet the needs of the business are available, such as a policy that will continue to pay business overhead costs while the business owner is unable to work.

Life insurance should also be part of a business owner's estate plan, as it could be used to repay any outstanding corporate debt. Among many other possible uses, insurance could fund buy-sell arrangements with other shareholders, settle income tax liabilities arising upon death, or create an inheritance for children who are not taking over the business.

### Retirement and succession planning

Business owners often concentrate on their business and do not fund their retirement on a regular basis. There are a number of tax-advantaged savings options that can help a business owner save for retirement or for when they exit their business. These plans include MyRAs, Simplified Employee Pension Plans (SEP-IRAs), Savings Incentive Match Plans for Employees (SIMPLE IRAs), 401(k)s, and defined-benefit plans.

Will the business owner sell the business, or establish a deferred compensation plan to fund their retirement? A succession plan prepares the owner, the owner's family and the company's employees for the day when the business owner no longer participates in the business.

Professionals active in business transition and succession suggest that planning should begin as early as 10 years before the planned exit in order for the succession to be most beneficial. This will allow time for the owner's children or senior management to grow into their new roles and establish their authority. If the business succession involves selling the business to non-family members, life insurance can be used to protect the seller by insuring the life of the purchaser; if the purchaser dies prematurely, any outstanding loans could be repaid without depending on company resources.

### **Estate planning**

A business owner should make sure their estate and legacy goals are documented and include plans for business assets—with at minimum an updated Will and Living Revocable Trust. A valid Will and Living Revocable Trust for business assets to minimize future probate costs and secure a smooth business transition is beneficial. At the time that the business owner's Wills and Trusts are being updated, powers of attorney should also be refreshed, providing authority for trusted individuals to take care of the business should the owner be incapacitated.

A business owner's Will and Trust should include instructions for the handling of their interest in the business after their death. Whether it should be reorganized, wound up, sold or maintained as an ongoing concern, it is wise to have appropriate provisions in the Will and Trust. It's important to ensure that the instructions in the Will and Trust do not contradict existing contracts such as shareholders' agreements, loan agreements and other promissory notes.

## **Conclusion**

Having a wealth plan in place helps give business owners added confidence about their progress toward achieving their personal and business goals.

Wealth planning for a business owner poses unique problems, based on the combination of the owner's personal and business situations. It is important for business owners to separate their personal financial goals from those of the business, and work to accomplish these priorities as they progress through successive phases of their family and business life cycles with a personal financial plan.

We believe that professional advice and planning go hand in hand. By working with BMO financial professionals who understand the importance of addressing the personal needs of business owners, a business owner can get advice that is tailored to their individual and business needs, and can plan for a financially stronger future.



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