WEALTH MANAGEMENT **ADVISOR**

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2 tax-wise strategies for high-net-worth investors

Take advantage of a versatile Health Savings Account

It's 2024: Do you know where your retirement savings are?

Closely held business owners

MAKE AN EXIT PLAN BEFORE YOU NEED IT

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If you own a closely held business, it probably accounts for a significant portion of your net worth. So a sound exit strategy may be critical to the health of your retirement and estate plans. Here are some tips for getting started before you decide to retire, move on to a new venture or otherwise make your exit.

What's it worth?

The first step in exit planning is to obtain a professional valuation of your business. This will help you understand how prospective buyers or investors view it and gauge its value. It may be tempting to rely on a rule of thumb, such as earnings multiples commonly used in your industry. But rules of thumb typically are based on industry averages and aren't a good substitute for professional appraisals that, among other things, consider your company's underlying fundamentals, unique attributes, risk profile and future earning potential.

A valuation professional will examine the factors that drive your business's value and highlight weaknesses that may reduce it. Analyzing these factors can help you identify changes that will likely boost your company's value and can increase its selling price. For example, if your management team lacks depth and relies too heavily on your talents, prospective buyers may be concerned about the company's ability to perform without you. Bringing in executives with the skills needed to take over after you've left can enhance your business's value.

What are your options?

There are many options for exiting a business, and the right ones depend on your goals. For example, if your goal is to diversify your assets for financial and estate planning purposes, selling the business outright to a third party might be appropriate. But if you're not ready to give up working in the business, a better option may be to sell a minority stake in the company to a private equity firm or other investor group.

It's also important to consider your family circumstances. Do your children or other family members work in the business or plan to?

If so, you may wish to transfer ownership interests to them as part of your estate plan. But if your liquid assets outside the business are insufficient to fund your retirement, it may make sense to sell the business to family members, perhaps in installments over time.

What if your family isn't interested in taking over the business, but you're reluctant to sell to a third party or dilute your ownership by bringing in outside investors? There are other options that allow you to tap your equity without giving up control (at least not right away). Examples include management buyouts and employee stock ownership plans (ESOPs). See "Is an ESOP right for you?" at right.

IS AN ESOP RIGHT FOR YOU?

If your business is a corporation, one exit strategy to consider is an (ESOP). An ESOP is a qualified retirement plan, similar to a 401(k), that invests primarily in your company's stock. Not only is an ESOP an attractive financial benefit for employees, but it can also be a powerful tool for exiting the business on your own terms.

For example, an ESOP typically allows you to:

- Create a market for some or all of your shares (by selling them to the ESOP).
- Tap your equity in the company without immediately giving up control. You can continue to manage the company, plus, if you serve as trustee of the ESOP trust, you'll be able to vote the trust's shares on most corporate decisions.
- Defer or eliminate capital gains taxes on the sale of C corporation stock by reinvesting the proceeds in qualified replacement securities, assuming you meet certain requirements.
- Generate substantial tax benefits for the company, including tax deductions for ESOP contributions and, if your company is an S corporation, eliminating tax on income passed through to shares held by the ESOP.

What are the tax implications?

Taxes can have a major impact when you exit a business, especially if you're selling it. For example, if your company is a corporation, selling stock rather than assets is usually preferable because your profits will generally qualify for more favorable capital gains treatment. Plus, if your business is organized as a C corporation, you'll avoid the double taxation associated with asset sales.

In such cases, proceeds are taxed once at the corporate level and again when they're distributed to shareholders. Buyers, on the other hand, usually prefer to acquire assets because they obtain a higher basis in fixed assets for depreciation purposes.

If you sell assets, it's important to consider how the purchase price will be allocated. There may be opportunities to reduce your tax bill by allocating a portion of the purchase price to assets that generate capital gains, such as goodwill and certain other intangibles. And if your company is a C corporation and you're able to allocate some of the purchase price to your personal goodwill, that amount will be paid directly to you, avoiding double taxation.

Start early

Identifying the right exit strategy and laying the groundwork for leaving your business can take time. So the earlier you start planning and discussing goals with your advisors, the better. ■

2 tax-wise strategies for high-net-worth investors

There are so many considerations that go into buying a particular security or applying an investment strategy that it's easy to forget or forgo tax efficiency. But for high-net-worth investors, some investments can generally help reduce tax exposure. Here are two.

1. Qualified small business stock

For investors who meet the requirements, qualified small business stock (QSBS) offers an extraordinary tax break. When QSBS acquired today is sold, 100% of the capital gain up to the greater of 10 times the initial investment or $10 million is excluded from income, provided requirements are met.

QSBS was created more than 30 years ago by Internal Revenue Code Section 1202 as a tax incentive for investments in "small" businesses. Initially, 50% of the gain was tax-free, but Congress raised the exclusion to 75% for stock issued after February 18, 2009, and to 100% for stock issued after September 27, 2010. Sales of QSBS are also exempt from the 3.8% net investment income tax and, for stock issued after September 27, 2010, from alternative minimum tax.

The tax incentive typically is available for qualifying QSBS issued after August 10, 1993. But shares must have been issued by:

- A domestic C corporation whose aggregate gross assets were $50 million or less at any time after August 10, 1993, and immediately after the stock was issued,
- An active business, meaning it uses at least 80% of its assets (with certain exceptions) to conduct one or more active businesses, and
- An eligible business. *In*eligible businesses include those involved in health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, banking, insurance, financing, leasing, investing, farming, oil and gas, mining, and hospitality.

The tax break is available to individuals and trusts, as well as certain pass-through entities. To qualify for the exclusion, investors must acquire the stock directly from the corporation or an underwriter in exchange for money or property. They (or their heirs) must hold the stock for at least five years.

Exchange funds allow investors to swap their concentrated stock holdings for shares in a diversified fund, without triggering capital gains tax.

Note that there are some disadvantages to owning QSBS. Investments in small companies can be risky, so it's important to weigh those risks against potential rewards. Also, the five-year holding period can cause investors to hold the stock longer than they would otherwise, potentially losing early gains should the stock's value then decline. There's also a risk that the benefits will be lost if, for example, the company ceases to meet the active business requirement.

2. Exchange funds

It's not unusual for investors to end up with heavy concentrations of certain stocks in their

portfolios. This can happen if, for example, you inherit a large block of stock or receive stock shares when you sell a business. In such situations, you may wish to rebalance your portfolio, but could be concerned that rebalancing would generate sizable capital gains taxes.

One potential solution is to take advantage of an exchange fund (or "swap" fund). These funds allow investors to swap their concentrated stock holdings for shares in a diversified fund, without triggering capital gains tax. Exchange funds invest in a diversified mix of stocks — they're often designed to track the S&P 500 or another market index — potentially reducing investors' overall risk.

Keep in mind a few caveats. Exchange funds are usually restricted to "accredited" investors with substantial investable assets. Also, assets will be tied up for a seven-year holding period.

Beyond taxes

You should never make investment decisions based on taxes alone, but tax efficiency can be a critical factor. Your advisor can help you evaluate these and other strategies for making your portfolio more tax-efficient. ■

Take advantage of a versatile Health Savings Account

If your employer offers a Health Savings Account (HSA) and you don't participate in it, you may be passing up an excellent opportunity to reduce taxes, boost retirement savings and even leave more to your heirs. Similar to 401(k) plans, HSAs are tax-advantaged savings accounts funded with pretax dollars.

Among the many benefits of HSAs is that funds can be withdrawn tax-free to pay for a range of qualified medical expenses. (Withdrawals for nonqualified expenses are taxable and, if you're under 65, subject to penalties.) Let's look at the details and some best practices.

Follow the rules

Your HSA needs to be coupled with an employer's high-deductible health plan (HDHP). For 2024, qualified HDHPs must have annual deductibles that aren't less than $1,600 for self-only coverage or $3,200 for family coverage. Annual out-of-pocket expenses (deductibles, co-payments and other amounts, but not

premiums) can't exceed $8,050 for self-only coverage or $16,100 for family coverage.

You can't participate in an HSA if you're enrolled in Medicare or covered by any non-HDHP insurance (for example, a spouse's plan). Once you enroll in Medicare, you're no longer allowed to contribute to an HSA, but you can maintain an existing HSA and withdraw funds to pay for qualified expenses.

There are also limits on HSA contributions. For 2024, the annual contribution limitation for an individual with self-only coverage is $4,150. For an individual with family coverage, the amount is $8,300. There's an additional $1,000 "catch-up" contribution amount for those age 55 and older. Typically, contributions are made by individuals, but some employers contribute to their employees' HSA accounts.

Reduce medical expenses

HSAs generally lower health care costs in two ways. First, they reduce your insurance expense (HDHP premiums are substantially lower than those of other plans) and allow you to pay qualified expenses with pretax dollars.

Second, any funds remaining in an HSA may be carried over from year to year, continuing to grow on a tax-deferred basis indefinitely. This is a huge advantage over health care Flexible Spending Accounts, where funds usually must be spent or forfeited. When you turn 65, you can withdraw funds penalty-free for *any* purpose (although funds that aren't used for qualified medical expenses are taxable).

Leave assets for heirs

Unlike with traditional IRA and 401(k) plan accounts, there aren't required minimum distributions with HSAs. Except for funds used to pay qualified medical expenses, your account balance continues to grow tax-free, adding tax benefits and providing additional assets for your heirs.

The tax implications of inheriting an HSA are different depending on who receives it. If you name your spouse as beneficiary, the inherited HSA will be treated as your spouse's own. He or she can allow the account to continue growing and withdraw funds tax-free for qualified medical expenses. If you name your child or someone else as beneficiary, the HSA terminates and the account is taxed on its fair market value. In some cases, it's possible to designate your estate as beneficiary. Ask your estate planning advisor about the best course of action.

Retirement benefits

HSAs can be flexible tools. For example, if you save some of your account funds until retirement, you generally can use them for medical expenses or for housing, day-to-day living, travel, debt and other expenses. You might even use them to help pay for a grandchild's education. ■

It's 2024: Do you know where your retirement savings are?

It's easy to lose track of your retirement savings if you switch jobs several times. Each time, you may leave one or more retirement accounts at your previous employer and open new ones with your new company. You also may have one or more traditional or Roth IRAs.

This phenomenon sometimes is described as "retirement sprawl." As your accounts accumulate, it becomes increasingly difficult to manage them and track whether your asset allocation reflects your financial goals, time horizon and risk tolerance.

Taking control

To take control of your overall retirement plan, consider consolidating your retirement savings into fewer accounts. For example, you might roll over balances from a previous employers' 401(k) plan into an IRA or your new employer's plan. This is particularly advantageous if your account balances in previous employers' plans are relatively small.

In fact, if your account balance is $7,000 or less, your former employer is permitted to roll it over into a "safe-harbor IRA." However, these accounts may charge administrative fees and their returns often are relatively low.

So be sure to review and compare each plan's investment options, fees and terms. If, for instance, you have a cost-efficient traditional IRA that offers investment flexibility, it may make sense to roll over your accounts with former employers into the IRA rather than into your current employer's less-flexible plan. However, moving retirement savings to your current employer's plan may be advantageous if you plan to continue working for that employer beyond the age that required minimum distributions (RMDs) kick in. That's because many plans allow you to defer RMDs until you retire.

Leaving it alone

In some cases, it's preferable to leave savings in a former employer's plan. This may be the case if the old plan offers attractive investment options at a low cost. It may also be beneficial if the plan allows former employees to withdraw funds penalty-free starting at age 55 rather than the usual age 59½. If you're between those ages and you move the funds to your current employer's plan, you'll lose that option.

There's another potential reason to leave your savings in a former employer's plan. If it invests in the former employer's stock, you may enjoy significant tax savings by leaving the stock in the old plan.

Simplifying management

If your savings suffers from retirement sprawl, talk to your advisors about consolidating accounts. Under the right circumstances, this strategy can simplify investment management and make it easier to achieve your retirement goals. ■

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