

# Business Owner Strategy Sessions



*CPAs / ADVISORS*



# Retirement Planning for Business Owners

1. How much do you need?
2. Invest in your business or someone else's?
3. What's the right vehicle to invest in other businesses?
4. Housekeeping

*These points are abbreviated and not intended to constitute legal, tax, or financial advice.*



BEACON HILL  
INVESTMENT ADVISORY

# Retirement Planning for Business Owners

What this presentation will *not* cover

- Details of deferral limits, rules and regs of each plan type
- Which plan is best for you
- Advanced strategies to maximize tax savings

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INVESTMENT ADVISORY

- **Disclosures**

- Not intended to be tax, legal, or financial advice. Please consult your financial advisor, accountant, or attorney for planning information specific to you.
- Any securities mentioned have risk, including the risk of total loss.

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# 1. How much do you need?

1.) Overused rule of thumb: 20 X annual spending needs (4% yield)

Expenses added to in retirement (i.e. Healthcare)

Expenses reduced in retirement (i.e. Mortgage)

Other sources of income (i.e. social security, rents)

2.) Is your business part of the equation?

Can it be monetized?

Do you want to monetize it?

What's your business's after tax value to an unmotivated buyer?

-Financial Buyer

-Owner Earnings vs. you as an Employee

-Multiple of Earnings

-Industry comparisons

-Strategic

-Liquidation value- Are there any assets?

Can you get an earnings stream out of it once retired?

# 1. How much do you need?

1.) Biggest Issues we see with business owners who don't save for retirement

- Believe their company will fund their retirement
- Believe their company is sellable, when it isn't
- Believe additional cash flows are just around the corner
- Believe they will work until they die

## 2. Invest in Your business or Someone Else's?

- Your business
  - Control
  - Ego
  - Stability
  - Simplicity
  - Returns?
- Someone Else's business
  - Diversification
  - Not reliant on you
  - Easier to invest through tax advantaged accounts
  - Can adjust your risk up or down
  - Returns?

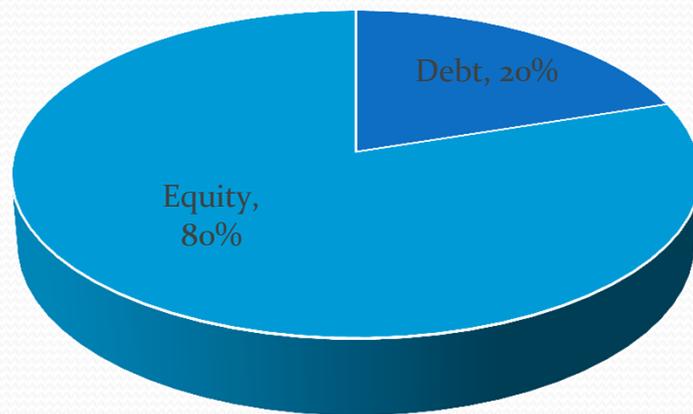
## 2. Invest in Your business or Someone Else's?

- A Framework to analyze Investing in your business:
  - What is the opportunity cost of continuing to invest in your business?
  - If you cannot invest in your company and earn your Cost of Capital, your capital would be better used elsewhere.
  - How do you analyze whether to conduct a future project, expansion, etc.?

## 2. Invest in Your business or Someone Else's?

- A Framework to analyze Returns: *Weighted Average Cost of Capital*

How your company is financed



■ Debt ■ Equity

Equity + Debt = Value of your company

### Cost of Debt:

Interest rate \* (1-Tax Rate)

i.e.  $8\% * (1-40\%) = 5\%$

### Cost of Equity:

Beta \* (Equity Returns- Risk free rate)

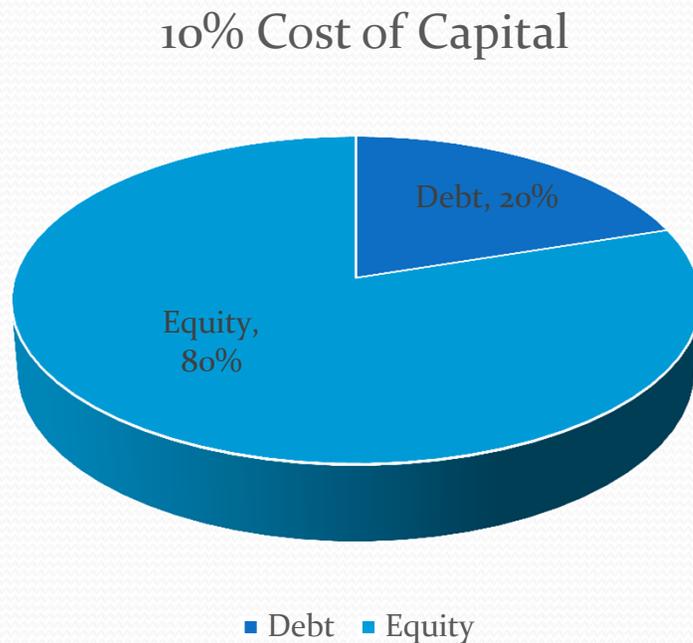
i.e.  $1.4 * (10\% - 2.5\%) = 10.5\%$

$20\% \text{ Debt Weighting} * 5\%$   
 $+ 80\% \text{ Equity Weighting} * 10.5\%$   
**9.4% Weighted Average Cost of Capital**

Beta is a rough approximation of riskiness. It measures how sensitive your cash flows and company value are to the economic cycle. During recessions, does your cash flow decrease the same (Beta =1), double (Beta=2), or half (Beta =.5) the average company? Look at publicly traded peers.

## 2. Invest in Your business or Someone Else's?

- A Framework to analyze Returns: *Weighted Average Cost of Capital*



Equity + Debt = Value of your company

- Include your sweat equity in the expenses of a project
- Use WACC, or the incremental financing method?
- Don't overinvest; if you're not generating a return over your Cost of Capital, then you're not adding value beyond opportunity costs
- Be intellectually honest with yourself

### 3. Vehicle to Invest in other Businesses

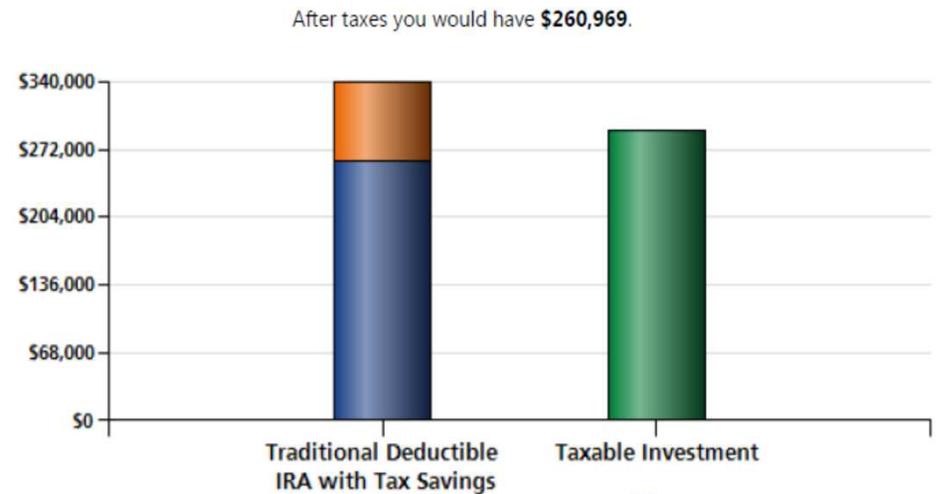
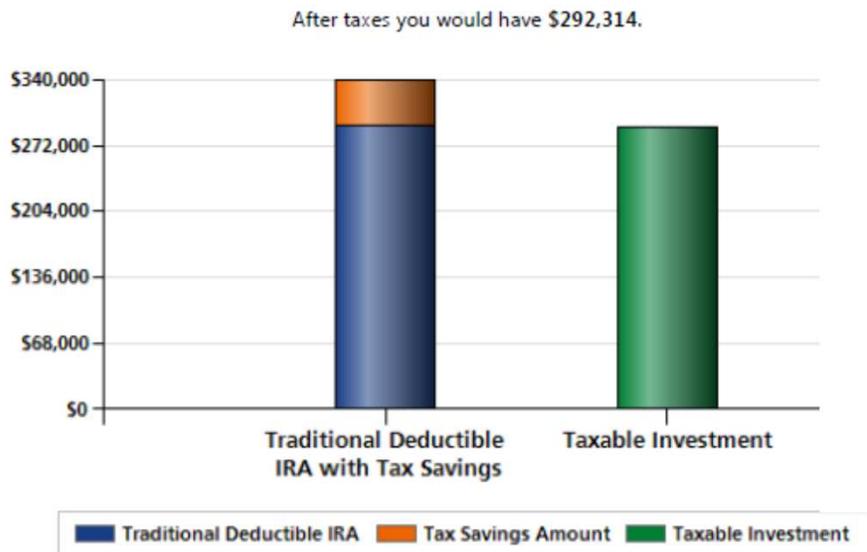
- Benefits of Qualified Plans
  - Tax Deferral or Tax Free
  - Asset Protection
- Drawbacks to Qualified Plans
  - Complexity & Administrative Burden
  - Restrictions on withdrawing
- Do you want to defer taxes?
  - *Estimate of tax rates now vs. in retirement*
  - *Social Security taxation in retirement*
  - *Duration of Deferral Period*
  - *3.8% Medicare Surtax effect on you (if over \$250k joint MAGI, 3.8% tax on investment income)*
    - *Qualified accounts don't get taxed on this during deferral period or when withdrawn*

### 3. Vehicle to Invest in other Businesses

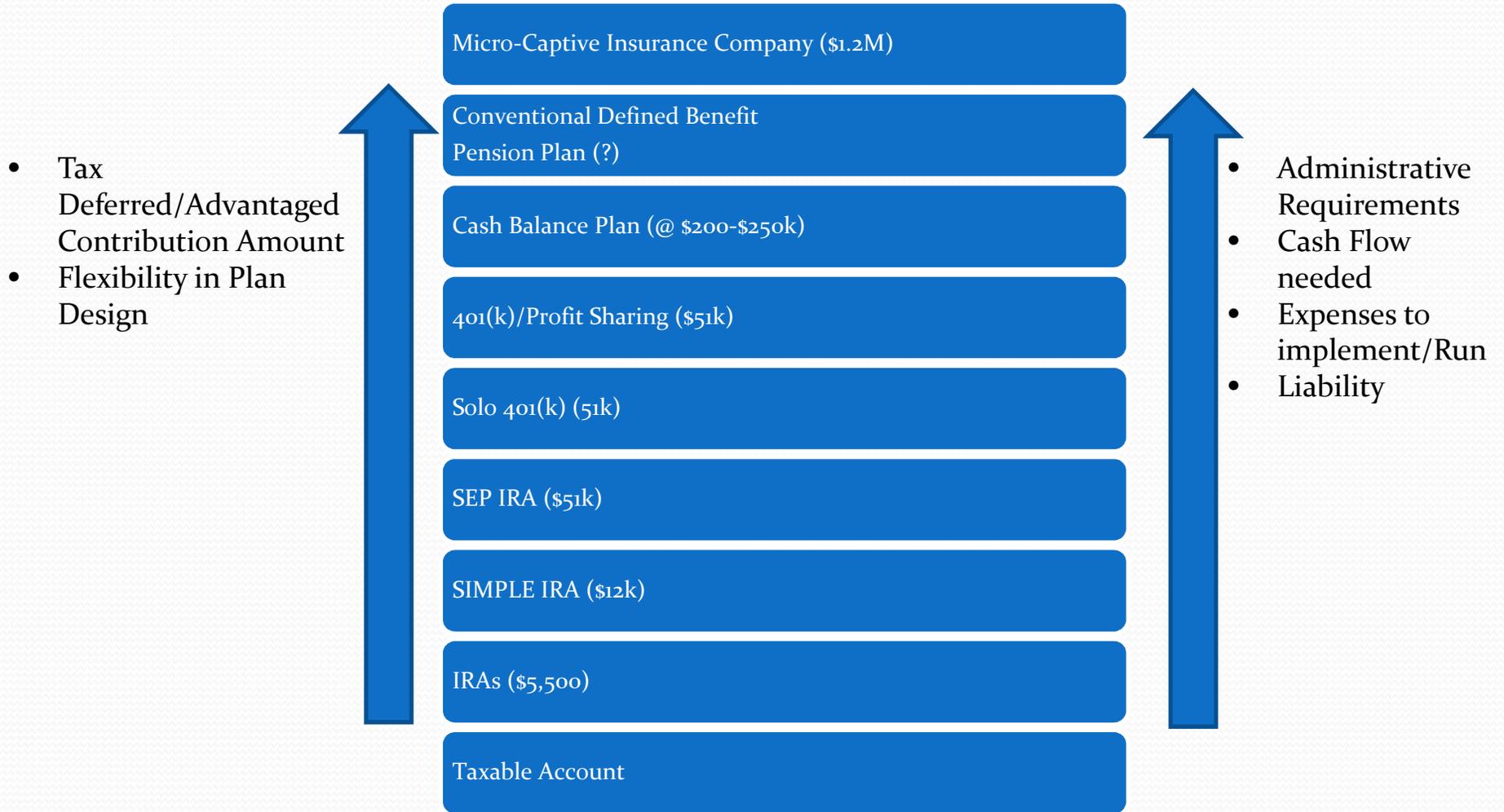
- Power of Tax Deferral- Not always obvious
  - Generally positive if tax rates similar or lower in retirement
  - May or may not be positive if tax rates are higher in retirement
  
- Assuming 2 scenarios.
  - Start at 45 y/o
  - Defer \$5,500
  - 33% tax rate during deferral period + 6% state
  - 8% Rate of return
  - Pull it all out on 70<sup>th</sup> birthday

Maintain Same Tax Rate (33%)

Increase Tax Rate (39.6%)



### 3. Vehicles to Invest- *The most overgeneralized chart ever:*



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### 3. Housecleaning: DOMA

- Significant confusion over what constituted a “spouse” for purposes of beneficiary designations, etc.
- Department of Labor Guidance 9/18/2013

*(Technical Release 2013-4)*

“...the term “spouse” shall be read to refer to any individuals who are lawfully married under any state law, including individuals married to a person of the same sex who were **legally married in a state that recognizes such marriages, but who are domiciled in a state that does not recognize such marriages.**”

“...do(es) not include individuals in a formal relationship recognized by a state that is not denominated a marriage under state law, such as a domestic partnership or civil union...”

*Does your Plan Document include a definition of Spouse?*

*How are you dealing with beneficiary designations of spouses and non-spouses?*

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