Citi Personal Wealth Management

citi®

The Business of Life

You have built a thriving business.

But are you taking care of your own finances?

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If you own a business, you no doubt have your hands full.

You've got to deliver the best product or service you can, price it right, manage employees and stay ahead of the competition. But you also need to think about your own financial future: succession planning, retirement and how you'll cope if things go awry with your family's health—or with your business.

Your business, after all, isn't just a source of income for you and your family.

Its growth, and perhaps its sale, could be the key to your retirement. With that in mind, this is a good time to consider some crucial questions. The answers could make the personal finance side of your business journey a whole lot smoother.

- Do you have a succession plan in the event you aren't able to run your business or you decide to retire?
- What's the best and most cost-effective retirement plan that can help you attract and retain good employees, while also helping pay for your own retirement?
- How can you provide for the health care needs of yourself, your family and your employees, particularly given the new federal health care law?
- What financial pitfalls do you face—and how can you protect yourself from these threats?

Succession Planning

When you're working hard to build your business,

you probably don't have much time to think about who might take over when you retire or if you're no longer able to manage the business yourself. But the survival of your business and the people who depend on it—your family and employees—requires a well thought-out succession plan.

Unfortunately, many business owners don't do a very good job of planning for their own succession. Perhaps they are too busy or perhaps they can't visualize their children, grandchildren or any of their employees caring as much about the business as they do. And, of course, the subject of succession planning suggests another topic—mortality—which most of us would rather avoid.

When to Begin

You probably didn't consider succession planning when you were getting your venture off the ground—and it probably wasn't necessary. But as you approach retirement, the issue will likely become more pressing. If you plan to retire at age 65 or 66 and you're currently in your mid- to late 50s, this may be a good time to start the process. Even if you are only a few years away from retirement, you still have time to make meaningful decisions.

For example, you may have a number of employees in mind as a potential successor. The more time you have to test their business skills, leadership and commitment to the company, the easier it will be to choose the right candidate. You will also have time to get the views of other employees, customers and suppliers.

Once you have picked your successor, or if you have already chosen one, you will want that person to become completely immersed in your business. You will also want everyone you deal with—again, employees, customers and suppliers—to become comfortable with your choice. Of course, if a family member, such as a son or daughter, has been in line to take over, that should make the process somewhat easier—unless your chosen successor has siblings who think they are better qualified. In that case, you may need some of the negotiating skills you're already using in your business.

Your Financial Strategy

Once—or even before—you have picked a successor, you need to develop a financial strategy for handing over your business. If you plan to transfer the company to family members, you will need to consider gift and inheritance taxes. If you think you will be selling your business to employees who don't already own shares, you may need to set up an employee stock option program. Then again, maybe you just want to "cash out" and sell your firm to another company in your line of business.

An accurate valuation of your company is crucial, no matter which of these scenarios you are considering. For that, you'll likely need a professional business-valuation service to help determine the worth of tangible assets, including buildings, machinery, equipment and inventory, and intangibles, such as your company's reputation, the number and loyalty of customers and employees, and any patents. The valuation service will also analyze your sales and expenses through various business cycles. The purpose of the valuation is important. A valuation might be used for estate planning, buy-sell agreements or an outright sale of the business. Each of these may require a different set of assumptions and approaches, and may be affected by different laws.

Once you have an accurate valuation for your business, there are several ways to set up a financial transfer. The right one for you will depend on your specific situation.

Outright Sale

The simplest and cleanest way to transfer a business is probably to sell it outright, whether to family members or someone else. They get the business and you get the cash to pay for your retirement and possibly estate taxes. You can choose the best time to sell, which may be now, when you retire or at the time of your death. If the sale takes place before your death, there may be capital gains taxes.

Buy-Sell Agreement

Also known as a buyout agreement, this determines what happens if a co-owner chooses to leave the business, dies or is forced to leave. It's a binding agreement between co-owners and is often backed by an insurance policy on the participating owners' lives. Such an "insured" buy-sell agreement can ensure that there is money available for the remaining partners to pay for the departing owner's share of the business.

Among other things, the buy-sell agreement determines who can buy your share of the business. It may be a current partner, but it could also include a family member or other shareholders. The agreement spells out what events will trigger the buyout and—perhaps most important to you as the owner of the business—the price that will be paid for your share. You'll need an attorney with experience in drafting such agreements.

Life Insurance

Although life insurance is an important component of the buy-sell agreement, it can also be the key to keeping the business going if the owner dies before selling or transferring it. The insurance proceeds can provide cash for emergencies, help meet expenses and salaries during a transition to new owners, pay off estate taxes, and even buy out a family member who owns a share of the company but has no interest in being part of the business. If you have partners who are key to the success of the business, a business-oriented life-insurance policy can also allow for an automatic buyout should one of them die. If structured correctly, life insurance has another plus: The settlement can be free of estate and income taxes.

Gifting

You can use gifting to pass a business—or, at least, part of its value—from one generation to the next. Each year, you can give up to $13,000 to as many people as you like without paying any gift tax. Your spouse can also give $13,000, for a total of $26,000.

You can use gifting to pass a business

Let's assume you have been thinking about incorporating, or have already done so. Now, as a corporate entity, you can transfer shares to employees, partners and family members. Let's also assume you and your spouse have a son and daughter who will take over the business. The two of you can give the kids a total of $52,000 in shares each year free of gift tax. That gives them an increasing share of the business and shrinks your estate for tax purposes. Be careful, however, in valuing the shares. If the IRS doesn't agree with your valuation, you might have to pay some hefty taxes. You will need the help of your tax attorney and a valuation company for this.

Family Limited Partnerships

Another way to keep a business in the family is through a family limited partnership. These generally consist of parents and their children. The parents contribute business assets, establish themselves as general partners and continue to run the company. The children are classified as limited partners and do not participate in the control or management of the firm. Eventually, the children will take over the business but, in the meantime, you have removed a big portion of the value of the business from your estate.

There are, however, possible pitfalls. Depending on your state, the partnership may end when one of the general partners dies. So, if a parent were to die suddenly, the whole business might have to go through probate. Probate will also come into play if you simply leave the business to your child in a will.

Trusts

A relatively simple succession-planning solution, and one that can avoid probate, may be a revocable living trust. It is considered revocable because, as long as you are alive, you control the assets and you can modify or revoke the trust at any time. Your son or daughter might be the successor trustee, but you would continue to manage the business, which is owned by the trust that you control. At your death, there would be no probate because the trust, not you, owns the business and your child could take over. Although you would be your own trustee, you can name another individual or an institution to serve in this capacity, which may be required if you become incapacitated.

Assets placed in a living trust are still potentially subject to estate taxes. But they avoid legal review by the probate court and, instead, go directly to the named beneficiaries. Keep in mind that you don't avoid probate simply by creating a trust. Instead, the business must be transferred into the trust before you die. This is called "funding" the trust. The company and any other assets you want in the trust should be transferred as soon as the trust is created. As the business grows, you can add more assets to the trust.

With another type of trust, a grantor retained annuity trust, or GRAT, you can remove assets from your estate and continue to receive annuity payments from the trust. A couple of caveats: If you take more income from the trust than you can spend in your lifetime, you will have to put the unspent money back into your taxable estate. Also, GRATs are irrevocable, so you need to be sure you won't need any assets back later.

You will, of course, need an experienced estate-planning attorney to take you through your options and help you create the best trust for you. But, if you plan well, you will be able to continue to manage your business, while keeping it in the family and reducing your taxable estate.

Retirement Planning

At some point in your life, you may have worked for an employer who provided a handsome list of benefits.

Among them was a retirement plan. Participating was easy: You filled out some paperwork and decided how much of your salary to put aside each payday.

Now that you're on your own, you need to set up a retirement plan for yourself. If you have employees, you may also want to offer some kind of plan to them. To be sure, you don't have to. They can always contribute to their own Individual Retirement Account or Roth IRA. But if your goal is to hire and retain good employees, a competitive company retirement plan can be enormously effective.

The retirement plans for small business owners vary by how much money can be contributed, whether both owners and employees can participate, how much—if anything—you have to contribute to your employees' account, and the cost and complexity of the plan.

SIMPLE IRAs

This option can be used by businesses with fewer than 100 employees. SIMPLE is an acronym for Savings Incentive Match Plan for Employees. The plans are indeed pretty simple. The employer and employees can contribute up to $11,500 each year (indexed for inflation). If participants are over age 50, they can make additional catch-up contributions of $2,500.

Employers are required to contribute an additional 2% of each employee's annual compensation to the plan or, alternatively, they can match 100% of each employee's contribution, up to 3% of salary.

Setting up SIMPLE IRAs is fairly easy and many financial companies offer them. If you opt for the SIMPLE IRA, you can't set up any other retirement plan.

SEP IRAs

Unlike the SIMPLE IRA, the SEP (for Simplified Employee Pension) IRA is funded entirely by the employer, who can contribute as much as 25% of annual compensation, up to $49,000 (also indexed for inflation). Because of this higher limit, SEP IRAs are often used by sole proprietors. Like the SIMPLE IRA, administrative costs for the SEP IRA are generally quite low.

Loans are not permitted from either SIMPLE IRAs or SEP IRAs.

Profit-Sharing Plans

Like the SEP IRA, profit-sharing plans are funded by the employer. They have the same 25%/$49,000 contribution limit. Even though you, as the employer, are responsible for funding the plan, its vesting provisions make it a good way to retain employees. You can require employees to work a certain number of years before they become fully vested—which means that, if workers leave prior to that, they forfeit any contributions you've made on their behalf. You can also offer "partial vesting." Employees might be eligible to take, say, 20% of their plan assets if they leave after two years, 40% after three years and so on, so they are fully vested after perhaps six years.

Unlike SIMPLE and SEP IRAs, profit-sharing plans can include a loan feature. Employees repay both the principal and interest to themselves, which can seem appealing—but employees should keep in mind that, during the period the loan is outstanding, they will miss out on any investment gains the money involved might have earned. There are pretty strict rules regarding vesting and loans, so you will need to see a qualified plan consultant or plan administrator before putting a loan provision in place.

Setting up and funding defined benefit plans

If you establish a defined contribution plan for your employees, you can also contribute to an account for yourself, of course. But it could also open the door for you to establish a defined benefit plan that allows you and other key employees to save significant sums each year—and receive large, immediate tax deductions for these contributions. As long as you make moderate contributions into a defined contribution plan on behalf of your employees, you may be eligible to fund one of these defined benefit plans. Setting up and funding defined benefit plans often works best for small business owners and professionals who are age 40 and older.

401(k) Plans

This is the retirement plan most commonly offered by big corporations, but it's also useful for small businesses. These plans are usually funded by employees, while you—as the employer—may make a matching contribution. You can also make discretionary profit-sharing contributions. Like the profit-sharing plan, the 401(k) can offer loans and you can set up a vesting schedule for your share of the contributions.

Qualified plans, like profit-sharing plans and 401(k) plans, are somewhat more complex to set up and administer, with the 401(k) the most complex. Also, with qualified plans, you need to make sure that all employees—including you and any other business owners—are treated equally when it comes to contributions and benefits. Your plan consultant or administrator can help you navigate the rules and regulations.

often works best for small business owners...

Health Care

According to a 2008 survey by the Kaiser Family Foundation and the Health Research & Educational Trust, 99% of large corporations offer health coverage, but that number falls to 49% for businesses with three to nine employees.

The big driver of this disparity is cost. According to the National Federation of Independent Business, small businesses pay an average 20% more for health insurance than big companies, and their premiums can eat up an even larger share of their revenues.

That doesn't mean you shouldn't have a health care plan. As with a retirement plan, a competitive health plan can be crucial in attracting and retaining employees. Of course, you need one for yourself and your family, too. The new federal health care law is changing the rules of the health care business (see box). Some of these changes will make providing health care more affordable for small businesses; others will make it harder for some businesses to have plans that discriminate between key executives and regular employees.

One place to start looking for coverage for you and your company may be your own state's insurance division. Most states now have some version of "group reform" to help small businesses get health insurance. Some states also subsidize small business plans, while others let small businesses band together to buy insurance as a group at potentially lower rates.

Also, if you haven't already, consider joining your local chamber of commerce. In addition to being a great source of business contacts, these organizations may be able to help you get insurance at a modest discount, perhaps through an insurance broker who's also a member of the chamber.

> DOCTOR'S ORDERS

The 2010 health care law includes a number of provisions that could make it easier for small businesses to buy and afford health insurance. Several provisions won't kick in until 2014, but some have already gone into effect.

For example, there is now a tax credit to cover up to 35% of the premiums small businesses pay toward their employees' health insurance. In 2014, that credit will increase to 50%, according to the Small Business Administration.

Also, as of September 23, 2010, employers with 50 or more employees are subject to nondiscrimination rules. For example, these companies could not offer better or less expensive benefits to the owner of a company or to key employees.

Starting in 2014, businesses with 100 or fewer employees will be able to pool their buying power and reduce administrative costs by purchasing insurance through an exchange, which will be set up by each state.

Also starting in 2014, insurers will have to follow "community pricing" rules, which will prohibit them from charging more or raising premiums when one employee gets sick and files a claim. In addition, insurers will have to eliminate exclusions for employees of small businesses who have preexisting conditions.

Not all the changes may be welcome by small businesses. For instance, starting in 2014, businesses with more than 50 employees will be required to offer health care coverage or pay a penalty of $750 per full-time worker. Coverage will also have to meet minimum benefits, including covering a specific set of services and 60% of health care costs, to avoid additional penalties.

Other Important Planning Issues

As the owner of a small business, you're often at more financial risk than someone who has a steady job at a big company. It can be important to keep your personal debts low, have a decent-size emergency fund, take steps to wall off your personal finances from your business finances and have liability coverage. With that in mind, here's a brief rundown of a few personal finance issues you should keep in mind.

Emergency Fund

A common rule of thumb says you should have at least six months of living expenses in liquid assets, like a savings or money market account, for emergencies. But that advice is meant for people who have full-time jobs. In your case, you may want to keep a larger emergency stash or make sure your family has easy access to borrowed money through, say, a home equity line of credit or a margin account. If your emergency fund is on the slim side, consider finding ways to shovel a little extra into a money market fund or bank account each month.

Credit Lines

When big corporations want to finance the company's growth, they might sell bonds or shares. That option isn't available to most small business owners. If you don't want to borrow from family or friends, or put too many expenses on a credit card, a better choice can be a line of credit, which can give you access to funds whenever you need them. The money can be used to purchase inventory, pay suppliers and even pay employees while you're waiting to receive payment for a project you completed weeks ago. While the funds are available any time, you don't pay interest until you use them.

Business lines of credit come in two varieties: unsecured and secured. As its name suggests, an unsecured credit line doesn't require any collateral, like your car, your equipment or your office. It may be the best answer for new businesses that don't have any equipment or inventory to put up as collateral. But, compared to a secured credit line, your credit limit is likely to be lower, while the interest charges and penalties are higher.

A secured credit line is often used by larger, well-established businesses that have something of value to put up as collateral, such as inventory or accounts receivable. The latter may be preferred by lenders since it is easier to seize.

Whatever credit line you choose, do everything you can to meet the loan payments. Indeed, before assuming more debt, carefully consider whether you'll be able to meet the required principal and interest payments. A poor credit history can be just as damaging to a business as it is to an individual.

> LLC OR S-CORP

When you were getting your business off the ground, you may have started it as a sole proprietorship. That certainly kept things simple: less paperwork, easier to start and stop the business without legal fees and expenses, and not having to pay taxes as a corporation. You just fill out Schedule C with your federal tax return and you're done.

But, as a sole proprietor, you are personally responsible for the liabilities of the business. If you are sued, your home and investments may be at risk. As a result, for many small businesses, one of two basic legal structures should be considered: the LLC (limited liability company) and the S-Corp.

Named after a section of the Internal Revenue Code, the Subchapter S corporation is designed for smaller companies that need liability protection but don't have multiple shareholders to deal with. In fact, the S-Corp is limited to no more than 75 shareholders. The IRS refers to the S-Corp as a "pass-through" entity in which all profits and losses pass through to the owners, who report this information on their personal tax returns. The S-Corp can be a good choice for new businesses, since they often lose money in the early years and you can offset those losses against personal income. Later, as the business becomes consistently profitable, it may make more sense to switch to C corporation status.

The LLC is also a pass-through entity, in which profits and losses flow to the individual investors, who are called members. Like the S-Corp, members of the LLC aren't personally liable for its debts or obligations. But unlike the S-Corp, there is no limit to the number of members. The LLC is also somewhat more flexible than the S-Corp in that profits of the business can be allocated differently among various members.

The LLC is a relatively new structure, while the S-Corp can be somewhat complex, so you should consult with an attorney with plenty of experience in this area before deciding which route to take.

Separate Bank Accounts

If you don't already, you should have separate checking accounts for your personal finances and your business. You probably should have separate credit and debit cards, too. Since you'll be filing a separate income-tax form for your business, you will want to keep all your expenses and income separate from your family's finances. Before opening a business checking account, you will need to give your business a name and register it as a DBA (short for "doing business as"), and file that name with the secretary of state or similar agency in your state, and perhaps with your city or town, too.

Liability Coverage

While an LLC or S-Corp can protect your family's finances from liability issues related to your business, it is probably a good idea to increase your personal-liability coverage. The easiest way to do that is by adding an "umbrella" or "excess liability" policy. Even though standard homeowner's policies come with some liability coverage, perhaps as much as $300,000 to $500,000, it may not be enough to protect against a court judgment that could be $1 million or more. A $1 million umbrella policy can be purchased for about $150 to $300 a year. The next million will cost about $75, and about $50 for every million after that. The cost may be higher in large metropolitan areas. You typically purchase the umbrella policy from your current homeowner's or car insurance company.

Disability Insurance

With all your other expenses, this may seem like an extra cost you don't need. But disability insurance could be vital if you have an accident or lengthy illness and can't manage your business. If you are looking to hold down the insurance premiums, consider getting the longest "elimination period" you can comfortably afford. That's the amount of time before benefits begin. Also, as the owner of a small business, you might consider "key person" disability insurance. It can provide the cash flow needed to keep the business going or pay to hire a temporary manager to run the company in your absence. If your disability is permanent and you can't return to the firm, a key person policy can help pay the costs of hiring and training a replacement.

Long-Term Care Insurance

Because a severe injury or illness might require you or a key partner to at least temporarily move into a nursing home or receive home health care, you should also consider long-term care insurance. The median annual cost for a private nursing home room in the U.S. is over $75,000, and it can be significantly higher in major cities. Even if you can afford to "self-insure," that is, pay these costs yourself, doing so could be a significant drain on your finances.

The annual premium will depend, in part, on your age when you first buy the policy, perhaps ranging from around $1,800 for folks in their 40s to nearly $2,300 for those in their early 60s. As with disability insurance, premiums can be trimmed with a longer elimination period before benefits kick in. You can often opt for 30, 60 or 90 days, depending on how long you think you can afford to pay these costs yourself. You might also consider other options, even though they may add to the policy's cost. A "waiver of premium" clause, as either a basic feature or a rider, means you won't have to pay premiums at the same time you are receiving benefits. Meanwhile, an inflation-protection rider can ensure that benefits increase with inflation. This is particularly important if you are under age 60 when you first purchase the policy.

...disability insurance could be vital if you have an accident or lengthy illness and can't manage your business.

How Citi Can Help

Whether you are planning to start your own company, or your business is already up and running, Citi has tools that can be tailored to your specific needs.

We would be happy to explain these options in greater detail and help you find the right strategies for your business and your family.

- **Bank financing.** Citibank has an array of financing options to help you seize growth opportunities or to provide needed working capital. To learn more about these options, talk to one of our business bankers.
- **Retirement planning.** Nearly two thirds of employees working for companies with fewer than 500 workers do not have access to retirement plans. Many business owners believe it is too costly and complicated to offer them. A Citi Personal Wealth Management Financial Advisor can work with you to implement a plan that is both cost-effective and helps attract and retain employees.
- **Financial planning.** You may be busy running your business, but you shouldn't neglect your own financial planning. Our Financial Advisors can help you address a variety of your family's financial needs, including managing investments, purchasing insurance, and funding college and retirement accounts.
- **Succession planning.** Only 30% of family-run businesses pass into the hands of the second generation, and just 15% survive into the third generation. Citi can provide guidance that can help owners who want to keep a business in the family for succeeding generations.

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CDs maturing on or before December 31, 2013, are insured by the FDIC up to $250,000. Through December 31, 2013, FDIC insurance has been increased to $250,000 for all ownership categories, principal and interest combined, per depositor, per institution, for all deposits held in each insurable capacity. Unless otherwise extended, insurance coverage will revert to the $100,000 limit on January 1, 2014, except for IRAs and certain self-directed retirement accounts which will remain at $250,000. Any CD with a maturity date after December 31, 2014, will be FDIC insured only for $100,000 principal and interest combined. Please consult a Financial Advisor to discuss how to manage the amount of funds invested in CDs while maintaining complete FDIC insurance coverage. Refer to the CD Disclosure Statement for more information on our CD program.

Since life insurance and long-term care insurance are medically underwritten, you should not cancel your current policy until your new policy is in force. Your actual premiums may vary from any initial quotation you receive. A change to your current policy may incur charges, fees and costs. A new policy will require a medical exam. Surrender charges may be imposed and the period of time for which the surrender charges apply may increase with a new policy. You should consult with your own tax advisors regarding your potential tax liability on surrenders. Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in an issuer's credit rating, or creditworthiness, causes a bond's price to decline. High yield bonds are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues. Finally, bonds can be subject to prepayment risk. When interest rates fall, an issuer may choose to borrow money at a lower interest rate, while paying off its previously issued bonds. As a consequence, underlying bonds will lose the interest payments from the investment and will be forced to reinvest in a market where prevailing interest rates are lower than when the initial investment was made.

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