Strategically Planning Dealership Transition

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Successfully changing ownership and control of your business depends on your dealership being spec'd right, frontline ready and marketed effectively. A strategic plan is vital for the successful transition of your business. Operational performance improvement, leadership team preparation, change of power and tax/estate planning are critical for the successful transfer of ownership. The better prepared your dealership is for the exchange of leadership, the higher the valuation for your business and the more likely the ongoing success to the entity. This workshop will present the strategic view needed for an effective ownership transition.

Learning Objectives

- Define the due diligence process to identify operational, leadership and next generation transition gaps that would impact valuation and transition
- Build an effective transition plan of ownership, authority and power
- Identify how to protect assets through succession

Estate Plan

The process of determining a plan to transition financial wealth from one generation to the next.

Often involves parents determining how to get X assets to Y people.

A "technical" problem to solve.

Succession Plan

The process of "co-creating" psychological ownership of the vision, strategy, goals, roles, decisions, performance and results of the business enterprise between two or more generations.

Often all family members in business determining where you are headed, how best to get there, who will do what, and how that should be rewarded.

An "adaptive" problem to solve – no standard solution.

Estate Plan	**Succession Plan**
• What you have – Assets	• What you do – Skills, Activities, Decisions
• Easy to identify (balance sheet)	• Hard to clearly describe…lots of hats
• Solved by an expert	• Solved by you, assisted by advisors
• Responds to compliance/gov't regulations	• Involves business environment, strategy
• Solutions implemented quickly	• Solutions evolve over time
• Involves financial ownership	• Requires psychological ownership
• Determined by senior generation	• Collaborative between generations
• Activities occur at set times	• Takes place daily in the business
• Major transition often occurs at death	• Major transition occurs during lifetime
• Opportunity for conflict limited time	• Opportunity for conflict every day
• In-laws generally "passive" recipients	• In-laws often "active" voices
• Strategy tends to be clear	• Strategy can be very messy

Succession Plan

- Sale of business?
- Gift of business?
- Transfer of management to run business?
- Who will own and run the business in the future?

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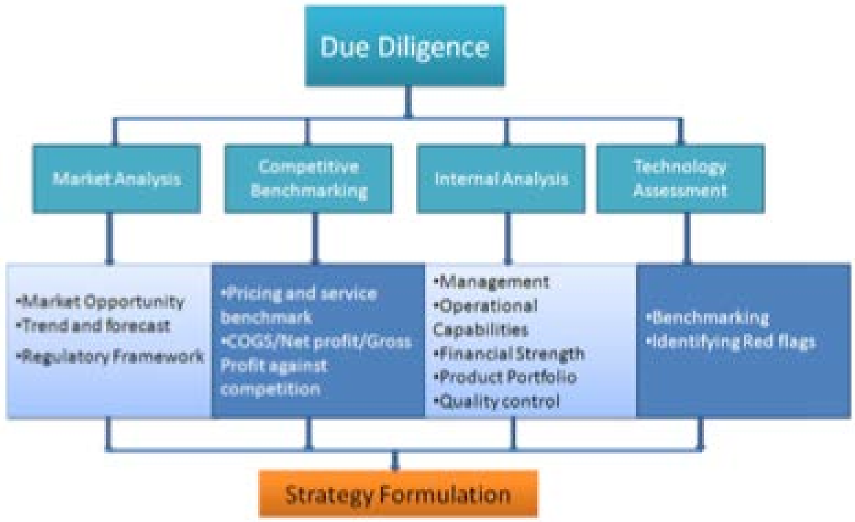
- Upwards of 80% of small business owners in the baby boom generation are anticipating selling their business according to INC. magazine. By 2025
- This is anticipated to be approximately a $10 Trillion impact on economy.
- Up to 75% have not exit plan
- Well planned transition with strong leadership team has significant impact on value and ongoing performance

Impact on Business Performance

- 3% of new leaders have few challenges
- 18% are replacing a legend
- 79% face serious change issues
- 46% of executives underperform during their transitions
  - The leadership team of a struggling new leader perform 15% worse
  - 20% of these teams are likely to disengage/leave
- Well accomplished transitions can boost performance by as much as 5 percent
- Teams led by high-performing transitioning leaders typically meet targets
- Attrition risk for these teams is 13 percent lower than average

Due Diligence



- Done in advance of marketing business (internal or external)
- Identify issues that would impact valuation
- Financial
    - Balance sheet
    - Income statement
- Market
    - Market share
    - Key customers
    - Growth
- Leadership
    - Strength
    - Retention
    - Gaps
- Other
    - Facilities
    - Vendors
    - OE
    - Other

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Leadership Transition

- Identify and communicate why
- Plan the process
- Communicate what is working and not working - constantly
- Measure performance
- Support and guide

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Transfer of Financial Ownership

- Fair versus Equal
    - Which family members have contributed to the overall growth of the estate
    - Which family members should own the business?
    - Which family members have extraordinary needs?
        - Medical
        - Education
        - Charitable (e.g., support of missionaries in the family)
    - Personal philosophies

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- Asset Transfer
    - Real estate can provide a more stable retirement income than operating assets
    - Those providing the management and labor should be rewarded appropriately
    - Senior family member should not place themselves in the position of relying on other family members to fund your extraordinary medical or living needs
- Buy Sell Agreement
    - Business with more than one owner
    - Bring in new “partner with fractional ownership”
    - Terms and process for an orderly transfer of ownership
    - Events
    - Owner wishes to sell
    - Disability
    - Divorce
    - Retirement
    - Death
- Redemption agreements
    - Company buys ownership
- Cross purchase
    - Each owner buys the other
- Hybrid agreements
- Life insurance
    - Best for payment at death
- Self-funding future cash flow / earnings or equity
    - Installment sales
    - Cash sales

Effect of a Sale

- Asset sales versus stock sales
  - Entity selection
    - Corporation
    - Pass through entity
      - S corporation
      - Limited Liability Company (LLC)
- Capital gain tax versus ordinary income tax
  - Federal
    - Capital gain tax 15% or 20-% rate
    - Federal Net Investment Income Tax (NIIT) 3.8%
    - Ordinary income tax 39.6% + phaseouts
  - State(s)
- Installment sale benefits
- Increase in tax basis for depreciation purposes for buyer of selected assets

Effect of Gift of Assets

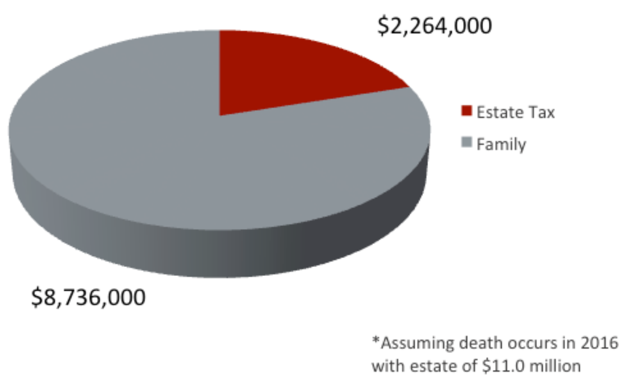
- No income tax on receipt of gift
  - If certain gifts of property are received and cashed, there may be an income tax on the gain components
- If gifts are given within the annual gift tax exclusion, no gift tax and no use of the lifetime gift tax / estate tax exemption

Transferring Future Growth to Younger Generation

- Real estate partnerships (dealer real estate)
  - If children own the operating entity, keep rents low (to keep estate from growing as fast)
  - Mechanism for giving of partnership interests to non-active family members, when other non-family assets are not available
- Operating partnerships (business)
  - Allocation of current earnings to younger generation
    - Guaranteed payments to children
    - Lower (but reasonable) rent for older generation's land
    - Self-employed tax planning implications

- Withdrawals by older generation create effective redemption of partnership interest
  - Each year, the older generation's percentage ownership declines
  - Requires annual valuations
- Gifts of partnership interest to children while maintaining control
- Upon death, discounts available
- Lend funds to children for business acquisitions
  - Rather than being partners with them
  - Lending of funds fixes the rate or return for the creditor
    - If business is successful, all growth accrues to the owner
    - Benefit of low-interest rate environment

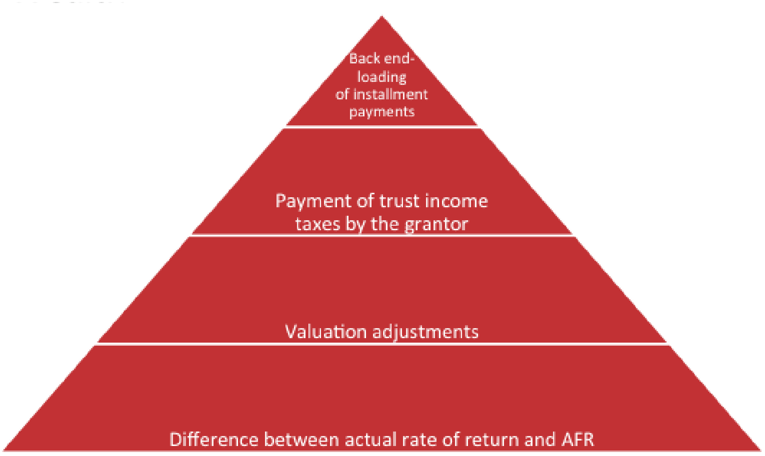
The Federal Estate Tax



- Lifetime exemption
  - Single person
  - Married couple
    - Portability
- State estate tax issues
- Lifetime gifts
  - Annual exclusion gifts
  - Lifetime gift / estate exemption gifts
  - Taxable gifts
- Interfamily sales
  - Installment sale
  - Self-Cancelling Installment Notes (SCINs)
- Sales to Defective Trusts (IDGT)
- Grantor Retained Annuity Trusts (GRAT)
- Life Insurance Trusts (ILITs)

Lifetime Gift Tax Exemption

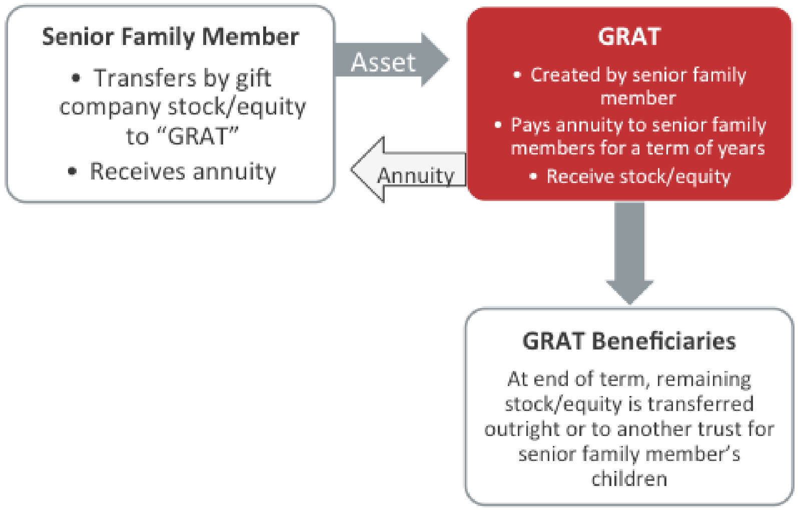
- $5,450,000 per taxpayer 2016
- Indexed for inflation each year
  - $10.9 million for married couple
- Future values sheltered from gift tax
  - Aggregate value included on taxpayer's gross estate at death
    - Original value not date of death value
      - Freezes value at date of gift
  - Post gift appreciation is not included
  - Post gift income / cash flow not available to taxpayer for cash flow needs



"Intentionally Defective Grantor Trust"

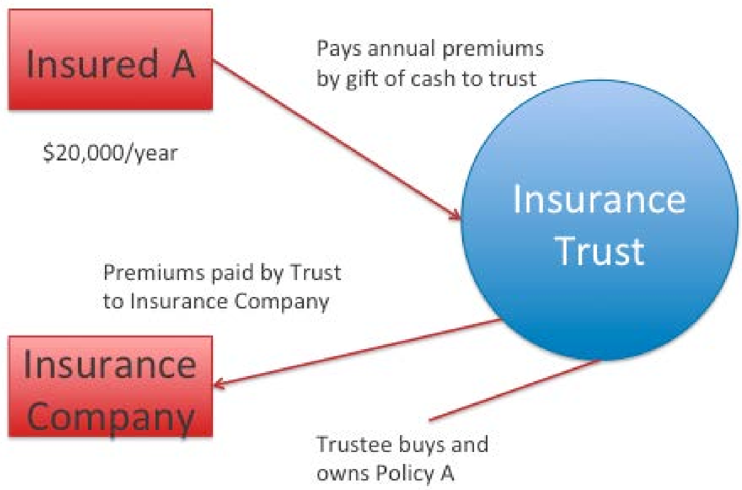
- It's an irrevocable trust, and
- It's a Grantor Trust (income taxed to Grantor), and
- It's a Defective Trust (income tax purposes only), and
- Trust and transfers to trust are respected for gift / estate tax system

Grantor Retained Annuity Trust



- A GRAT is a carefully drafted trust that accomplishes two very important estate objectives:
  - The GRAT technique "freezes" the value of the senior family member's highly appreciated assets at today's value
  - A GRAT provides the senior family member with an annuity payment for a term of years
  - Deliver benefits without potential transfer tax disadvantages
    - To grantor
    - To family
    - To trusts created
- Lower interest rates make GRATs more attractive
  - February 2016 IRC Sec. 7520 rate = 2.2%

Irrevocable Life Insurance Trust



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Irrevocable Trust at Death