Brown ADVISORY
Thoughtful Investing.

STRATEGIC PLANNING ROADMAP FOR ENTREPRENEURS

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We take a strategic approach to personal wealth planning. Our roadmap is meant to provide an easily digestible guide for tackling the important planning issues business owners should address. It is not – nor meant to be – comprehensive. We welcome the opportunity to have deeper discussions to identify, and address, your specific planning needs.

SETTING THE STAGE

1. It is important to create a mission statement that addresses all of the forms that your "capital" takes: human capital, intellectual capital, social capital and financial capital.
2. It is also important to determine whether or not you want to include your personal values in your investment philosophy and business planning. Between the "traditional" poles of investing and philanthropy lies a spectrum of options that may allow you to pursue your investment goals and express your values at the same time – this is known as "**Sustainable Investing**".
3. You should take time to make sure you have the right people as part of your advisory team. Your business requires a variety of advisors – accountants, attorneys, bankers, etc. – and so do you. While there are some areas in which your current advisors can serve dual roles as both business and personal advisors, you should be aware of when your personal planning needs will require additional specialization. If you aren't sure where to start or what you need, starting with a financial planner or wealth advisor may be a good place to begin. They can help you identify gaps in your advisory team, and make introductions to additional services when needed.

SETTING THE STAGE: BALANCE SHEET AND CASH FLOW FUNDAMENTALS

1. Prepare a comprehensive personal balance sheet as a first step in getting your financial life organized and action items prioritized. Even if you are not entirely sure of the value of certain assets, it is a useful exercise to list everything in one document.
2. Evaluate your potential sources of liquidity, such as lines of credit or the cash value of life insurance that can be tapped to cover excess cash flow needs while your business equity is the primary asset on your balance sheet. The goal is to eventually build up a bucket of liquid assets, but until that happens you should understand your options for having cash-on-hand if needed.
3. It is important to understand what your true cash inflows and outflows are currently, and what you anticipate for your long-term spending goals (e.g. retirement, education funding). Even if the business is covering some of these expenses on your behalf, it is important to know what your lifestyle costs are for future planning purposes. When considering expensive lifestyle purchases for the future, such as second homes or boats, be sure to consider how much the ongoing costs – not just the purchase cost – will be covered by available cash flow and/or liquidity reserves.
4. Create and maintain an emergency fund to cover any non-discretionary expenses in the event that unforeseen

financial issues arise (e.g., losing your job, recession). It is advisable to set aside enough to cover 6 to 12 months of necessary expenses. You may not need to set aside 100% of your current restaurant budget, but you should set aside 100% of your mortgage! Also, the emergency fund does not need to sit in a checking or savings account; however, we believe that any investment strategy for the fund should be very conservative.

5. It is important to periodically think through your debt obligations including your mortgage and any student loans. Refinancing may be useful to take advantage of lower interest rates and/or to alter your monthly cash non-discretionary expenses. Also consider eliminating any unnecessary debt, particularly credit card debt and high interest student loans.

SETTING THE STAGE: ESTATE PLANNING FUNDAMENTALS

1. You should have your basic estate planning documents in place, and plan to review them whenever there is a major change in your life, a major change in tax laws, or approximately every 5 years if there have been no major changes. Your estate planning documents should include:
   - A will that details the distribution of your estate and nominates a person to administer your estate, i.e., an executor. It may also name the guardians of minor children.
   - (Optional) A revocable trust that is established and funded during your lifetime. The revocable trust helps avoid court oversight of your estate after your death.
   - A durable financial power of attorney that appoints an agent to make financial decisions for you if you become incapacitated.
   - A healthcare power of attorney and advance medical directive that appoints an agent to make health care decisions in the event you become incapacitated and expresses your wishes regarding life-sustaining measures.
2. Confirm that your estate plan incorporates instructions regarding your wishes for the ownership transfer of your business interests, and takes into consideration any transfer agreements and/or restrictions that may be tied to your interest.
3. You should be aware of whether federal or state estate taxes will have any impact on your plan. The federal estate tax exemption is $11.4MM indexed for inflation starting in 2018. Estates are subject to a 40% federal estate tax on any amount in excess of the exemption. Under current tax law, the exemption and tax rate are scheduled to revert to pre-2018 levels, indexed for inflation, in 2026. Also, a number of states have their own estate tax, which may have lower exemption amounts and lower estate tax rates. Note that any assets passed to a spouse are not subject to federal estate tax, and a deceased spouse may pass any unused estate tax exemption to their surviving spouse.

A TIME OF TRANSITION: PLANNING FOR BUSINESS SUCCESS AND TRANSACTIONS

1. Ensure your advisory team is equipped with the details of your business ownership and/or equity compensation plan and has the experience to offer guidance around appropriate income tax planning, if your business is acquired or sold in the years to come.
2. Coordinate with CPA(s) to make a formal determination as to whether your business ownership interest qualifies for the Qualified Small Business Stock (QSBS) tax exemption. QSBS allows you to exclude $10 million of capital gains or even more upon sale, but you must make sure to follow all the requirements. (The goal of QSBS is to provide a tax incentive for establishing and investing in small businesses.)

3. Several years prior to any anticipated business exit or transition, you should assemble your team of advisors if you have not already and work with them to clarify your personal financial and non-financial goals. You should also be working with your business advisors to ensure that you have optimized the business structure, operational model and financial structure.
4. Approximately 12-18 months prior to any transaction, you should work with your team of advisors to clearly define the transaction objectives – in line with your personal financial and non-financial goals, and lay the groundwork for future liquidity. This includes considering income tax planning techniques, considering wealth transfer techniques (see below), identifying future liquidity needs and having preliminary conversations about investment strategies.
5. Approximately 90 days before the close of a transaction, you should confirm with your advisors how funds will flow into the wealth planning structures you have created over the prior few years and understand what the details of the transaction will mean for you personally. You should be working with your advisors to prepare for any post-sale wealth plan implementation action items.

A TIME OF TRANSITION: WEALTH TRANSFER AND PHILANTHROPIC PLANNING

1. Once your own cash flow needs have been met, you may want to consider whether starting to transfer some of your wealth to others – family, friends, charity – makes sense for you.
2. For making large gifts to family, children in particular, you should consider if establishing and funding one or more irrevocable trusts for the benefit of your desired gift recipient(s) is advisable. Gifts can be advantageous for estate tax planning as (1) you can receive the growth of the gifts outside of your estate and (2) you can structure gifts to help ensure that the value of the gift is discounted. You can also explore setting up an irrevocable trust for a spouse, so that you can retain some access to the funds if needed in the future.
   - Irrevocable trusts can provide strong asset protection, including from a person's creditors or from a divorce. Also, assets held in trust can be kept out of beneficiaries' estates for generations. However, these assets may still be available to the beneficiaries, if necessary.
   - Generally, assets contributed to an irrevocable trust – along with any future appreciation on those assets – are no longer part of your estate for estate tax purposes. This makes trusts a useful vehicle for transferring some of the future appreciation of your business to the next generation while saving on estate taxes.
   - Certain jurisdictions, such as Delaware, can provide further benefits, such as enhanced asset protection options or preferable state income tax treatment.
3. If you are considering making large gifts, you need to consider the impact of gift taxes on any strategy. The federal gift tax is unified with the estate tax, meaning that the gift tax exemption is also $11.4MM, indexed for inflation starting in 2018. Any use of the gift tax exemption also reduces the estate tax exemption by an equivalent amount. As with the estate tax, any gifts to a spouse are not subject to the gift tax. There are several exceptions available that allow for gifts to be made without triggering gift tax liability.
   - Gifts that do not exceed an annual exclusion amount of $10,000, indexed for inflation since 1998, per donor to each recipient are not subject to estate tax. For example, you and your spouse can each give a gift up to the annual exclusion amount to each of your children every year without being subject to gift taxes.
   - Additionally, payments made directly to educational institutions or medical providers are not taxable gifts. These may be made in addition to current annual exclusion gifts. Paying for grandchildren's tuition may be a great gifting strategy for wealthy grandparents.
   - With the exception of the state of Connecticut, there are no states that impose a separate gift tax.

4. When making charitable donations, transferring appreciated assets can be an attractive option. In addition to receiving an immediate income tax charitable deduction for the gift, any capital gains tax due on the sale of those assets could be delayed or eliminated depending on the charitable vehicle you use. The right charitable giving strategy to use depends on your broader goals for the donation.
   - For example, a **donor advised fund** – a charitable giving investment account established under the umbrella of an existing public charity that allows you to make grants to nonprofits in the future- is a good option for making a large charitable gift for tax deduction purposes when you are not entirely clear on what charitable organization(s) you would like to ultimately benefit.
   - Alternatively, a **charitable remainder trust** – a trust that is structured to pay an annuity to you for a certain number of years before paying out any remaining assets to charity – can be a good option for delaying (but not eliminating) the capital gains tax associated with a sale. There are many other charitable giving strategies available, and you should have a conversation with your team of advisors to determine the appropriate structure and timing of any strategy.

BEYOND THE (FINANCIAL PLANNING) BASICS: INSURANCE

1. You should give careful consideration to where there are areas of financial risk in your personal life that may be appropriate for insurance coverage. Not everyone needs every type of insurance at all times, so you should plan to revisit your risk management strategies periodically.
2. Your **homeowner's or renter's insurance** provides protection to your home and the physical assets within your home, as well as some protection for any liabilities that arise within the home. You should ensure that you have the appropriate level coverage – particularly for your physical assets – to ensure that you are able to quickly recover from any event that triggers payment from the policy. You should review your coverages annually.
3. **Personal liability/excess liability/umbrella insurance** helps provide protection against lawsuits or creditor claims, as well as for claims that may be inadequately covered by your homeowner's policy. These policies are typically purchased as a rider to other insurance (i.e. homeowners' or personal property policies), and we often recommend having at least $5–$10 million of coverage. These policies are particularly important for business owners and executives, or anyone else who has a high profile that makes them an easy target for lawsuits.
4. **Life insurance – whether term (i.e. temporary) or permanent** – can be used to provide a variety of financial needs in the event of your untimely death. For example, you may want to ensure that a mortgage is paid off, your income is replaced for a number of years and/or that there is funding available to cover a buy-sell agreement for your business. Some policies can also be used as a retirement savings vehicle. You should coordinate with your financial planner to determine both the appropriate level of coverage and the best type of policy to meet your needs. Your life insurance policies should be reviewed annually to ensure that they still meet your needs.
5. You should also be aware of how your **healthcare policies** work and can be coordinated with other types of related coverage. In addition to your health insurance, you should consider if you need to purchase disability insurance and/or long-term care insurance. Disability insurance provides income to you in the event you are unable to work because of illness or injury. Long-term care insurance provides coverage for nursing home stays and other types of care not covered by health insurance (nursing care, intermediate care and custodial care).

BEYOND THE (FINANCIAL PLANNING) BASICS: RETIREMENT SAVING STRATEGIES

Retirement accounts can also provide a great opportunity to invest with favorable tax consequences. These opportunities may include lowering your current year's taxable income, maximizing employer benefits and having investments grow without being taxed. There are many retirement savings vehicles that can be used, including employer sponsored plans (e.g. 401(k), deferred compensation) and plans that are established and funded by you individually (e.g. IRAs, Solo 401(k)). The appropriate savings vehicle for you will depend on many things including the structure of your business, your status as it relates to the business (e.g. self-employed, employee, executive), and your planning goals. You should have a discussion with your tax accountant to determine the most appropriate option to use and the right level of contributions to help you meet your ultimate retirement goals.

BEYOND THE (FINANCIAL PLANNING) BASICS: EDUCATION FUNDING

1. If you have dependents for whom you would like to cover college costs in the future, it is important to plan for these costs as early as possible. College costs are increasing at a rate higher than inflation, and the sooner you start to save, the less you may need to actually put aside for those costs.
2. While a regular savings or investment account can be used to save for college, a **529 college savings plan** may be a better option. All growth and distributions in a 529 savings plan are income tax-free if the distributions are used for qualified education expenses. Qualified education expenses may include tuition, books, fees, room and board, etc. for college and graduate school. Additionally, you can use $10,000 from a 529 savings plan per year, per child toward elementary and secondary education expenses. If the funds contributed ultimately not be needed by the initial beneficiary, a new beneficiary can be named or the funds can be withdrawn funds from the 529 plan – subject to income taxes and penalties on the distribution. Also, contributions to a 529 savings plan may provide a state income tax deduction depending on your state's law.

KEEPING THINGS GOING

Planning is an iterative process that does not end after a business transition. A good team of advisors will remain in contact with you over the long-term to ensure that your plan reflects your most up-to-date needs.

STRATEGIC PLANNING

CHECKLIST

SETTING THE STAGE

	Gather your team of personal advisors early, and plan to communicate with them often – even if you don't think anything important is happening in your financial life.
	Give some thought to your own financial philosophy, high level goals and values so that they can be incorporated into your plans.
	Create a comprehensive personal balance sheet, even if asset values are not completely known.
	Figure out how much your lifestyle actually costs and how those costs can be covered now and in the future. This includes big ticket future items such as additional home purchases or sending kids to college.
	Set aside 6 to 12 months of living expenses. This can be in a bank account, or can be in a liquid, conservatively invested account.
	Have basic estate planning documents drafted and executed, and plan to review periodically.

A TIME OF TRANSITION

	If a business exit or transition is anticipated sometime in the next several years, start planning today.
	Work with your team of advisors to develop and implement strategies for cash flow and liquidity, investment management, income tax mitigation, wealth transfer planning and philanthropic planning as needed.

BEYOND THE (FINANCIAL PLANNING) BASICS

	Explore retirement savings strategies regardless of when or whether you plan to retire. While saving early for future cash outflows makes good basic financial planning sense, there are current income tax planning benefits that may be of interest.
	Make sure you have protected your assets and your dependents with appropriate types and levels of insurance.

KEEPING THINGS GOING

	Periodically re-evaluate who you have and need on your team of personal advisors, and continue to communicate with them often – even if you don't think anything important is happening in your financial life.