

topical tips

Issue 24 Spring 2003 Preparing for retirement – a guide for entrepreneurs and owner managers

Preparing for retirement

Recent research carried out for us by Kingston University found that only one third of small and medium sized enterprise (SME) owners have a solid exit plan in place for their business. Even worse was the news that 60% of SME owners over the age of 60 have no firm plans for when and how they will leave their business.

Succession planning should be high on every business owner's list of priorities, and not just for the sake of the continuity of the company and its employees. The way you eventually leave the business or pass it on to your children can have enormous financial consequences for everyone involved.

This Topical Tips guide examines the issues entrepreneurs and owner managers face when

preparing for retirement. In doing so it looks at both personal and business planning for retirement and how to finance them.

Why plan?

The extent to which we all make plans varies from individual to individual. Retirement planning is no different, except that without some structure and forethought, any other plans you may have will be much more difficult to achieve if you don't have the resources available to you. Today's difficult environment increases the need for planning.

A careful review of where you are now, followed by some consideration of where you want to be and what you want to achieve before and during retirement is crucial to

determine the level at which you need to save for the future. Once you can determine your objectives, we can help you choose how best to achieve them. While pension planning is important, there are numerous other ways to build and preserve wealth. We all have different views on what we consider to be acceptable risk and reward. We can help you to find a way through the maze and develop your retirement strategy.

Another crucial issue to consider is your will – how do you want your estate to be devolved? Who should benefit from your estate? Which dependants, family members or other organisations such as charities should benefit and to what extent? These are all issues that we can help you with.

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Your personal retirement plans

What lifestyle do you want in retirement?

- **How much income will I need to fund this lifestyle?**

Lifestyles tend to change in a number of key ways in retirement. You have more time on your hands for a start! This in turn means you have less (or no) time earning money, and more time to consider how to spend it!

Hopefully some major expenses will be coming to an end, such as mortgages, and children, if there are any, should be becoming more financially independent.

Without these major “expenses” it should be possible in most circumstances to maintain a similar standard of living on 50% - 60% of pre retirement income.

- **How much income can I expect from my pension arrangements?**

Current pension rules require that pension arrangements buy an annuity at some point to provide income in retirement. The rates payable depend upon a number of factors such as life expectancy and gilt yields. (The level of current interest rates is a good guide to the level of Gilt Yields). These rates appear low due to increasing life expectancy and current low interest rates. A male age 60 can currently expect a rate of around 6.5% whilst a female the same age could expect 6.1% (the difference is due to differing life expectancies).

- **Will retirement be the trigger to move house?**

Many individuals have ‘benefited’ from the recent surge in property values. Prices are generally driven by supply and demand, with demand being highest in those areas where

employment is expanding (attracting people seeking jobs) and where schools are good (attracting parents of school age children). In retirement these two main considerations may not be important, and so a move to a ‘cheaper’ area may be a prudent one. This could release equity, which, in turn, could be used to augment income.

- **If I need long-term health care, how will this be funded?**

The provision of state funded long-term care is now means tested. This means test takes into account all assets including the family home, if appropriate. Local Authorities can require the sale of the family home to allow for the payment of care home fees which can range from £25,000 per annum, upwards, depending upon the level of care required, location, facilities etc. Insurance can be taken out to cover the cost of these fees, although this can be expensive. The most prudent way to ‘allow’ for these fees, if they occur, is to structure assets in the most efficient way.

Business planning for retirement

Having spent years establishing and developing a business or company it is clearly advisable to consider what your wishes and options are for the future of the business. The two main options are to sell or pass it on to successors, albeit there are numerous variations on these themes. For example, a sale can be to a competitor (trade sale), a major player (e.g. a quoted company) or the existing management. Equally, passing the business to successors can mean gifting all or some of the ownership to children, grandchildren, nieces/nephews etc. The fundamental difference is essentially between selling and gifting the business, but both have numerous tax pitfalls for the unwary.

Selling your business

In order to give yourself the best chance of maximising the proceeds from the sale of your business, it is essential to discuss your options with an advisor who specialises in this field, such as Kingston Smith’s corporate finance team, which has many years of experience in helping clients to achieve the best price for their business.

What makes a business attractive to a prospective buyer is also fundamental to long term success as an independently owned company. The two are far from mutually exclusive, so planning to maximise the value of the business is a sensible move whatever your intentions.

Potential buyers will look at acquisitions for a whole range of reasons: increasing volume, geographical expansion, diversification, additional skills, acquiring profile, management expertise and many more. One of the major influences on the price they will pay will be their confidence in the underlying profits they are buying.

What gives them that confidence? Demonstrable evidence of certain inherent qualities within the business that attract high calibre staff and create more business from new and existing clients and customers, which indicates continued future growth. These qualities can be broken down into:

- Strong management team;
- A well spread, quality client/customer base;
- Good client/customer loyalty;
- A high quality profile for the business or its products;
- Historic growth indicative of future growth;
- Innovation in products and services.

Other factors buyers consider will be:

- Strategic fit;
- Size and profitability;
- Sector;
- Territory.

You may not be able to influence some of these but, if selling is a genuine goal, there is a lot you can plan for and control.

Management Buy-Outs (MBO) and Management Buy-Ins (MBI)

Another option is an MBO or MBI. An MBO is where a business is sold to members of the existing management team. An MBI is when an outside management team buys a stake in an existing business. The MBO process involves a great deal of negotiation with vendors and financial backers. At the same time the managers are still required to run the business. Likewise, the process for an MBI is equally time-consuming and complex. The management team will usually have existing commitments that will need to be considered.

As a result additional resources are essential to drive either process through to a successful conclusion. It is therefore strongly recommended that you appoint a professional advisor with the appropriate experience and expertise to provide innovative solutions to the issues that will arise during this complex transaction.

For more details of succession and exit routes contact Donna Makin on 020 7566 4000 for a free copy of our Topical Tips guides *Making your business valuable* and *MBOs and MBIs*.

Tax planning for the sale of your business

A sale is likely to involve a substantial capital gain and it is important to consider the availability of tax breaks such as:

- business asset taper relief which can mean that 75% of the gain is tax free, and the possibility of:
- becoming temporarily or permanently non-UK tax resident, in order to avoid capital gains tax (CGT) altogether,
- receiving the sales proceeds wholly or partly

- in shares or loan notes in order to defer the tax liability to a later date
- re-investment relief in order to defer tax liability.

The current tax regime is relatively generous in relation to the sale of a business by the well advised, but there are several issues that need to be carefully considered. For example, where a company owns investments or retains surplus cash, this can reduce the rate of CGT taper relief from 75% after two years ownership to a maximum of 40% after 10 years. The difference between business assets taper relief and non-business taper relief is illustrated in the table below.

Rate of CGT taper relief		
Number of whole years in qualifying holding period	Non-business assets %	Business assets %
0	0	0
1	0	50
2	0	75
3	5	
4	10	
5	15	
6	20	
7	25	
8	30	
9	35	
10 or more	40	

Passing on your business

Essentially, the business can be passed on by lifetime gift or via your will, or a combination of the two. In either situation it is important to consider who will run the business afterwards and what your involvement will be.

It is common for one or more of an entrepreneur's children to work in the business

and for others not to. This can sometimes lead to difficulties when ownership of the business is passed to this generation, as the children not involved in the business can be tempted to try to sell their interest in it, which can give rise to disputes and the breaking up of the business. One solution to this problem is to put all or part of the business into a trust, which provides for an income to the beneficiaries and preserves intact the ownership and capital of the business. There are various forms of trust, to suit most requirements, and they can be created by will or lifetime gift.

Whichever option is chosen, it is vital that the tax position is carefully considered as, whilst there are generous Inheritance Tax (IHT) and CGT reliefs potentially available, there are a number of areas that you need to be aware of. Failure to plan properly can lead to significant IHT and CGT liabilities, currently at rates up to 40%, and this can lead to a sale or break up of the business in order to pay the taxes.

Looking after your dependants

In drawing up your will you need to consider a range of questions. The first issue to consider is whether your surviving spouse will have sufficient income to live on, and if not what can be done. Other dispositions in your will can be considered afterwards. Your tax adviser can help you with determining the impact of inheritance tax on your estate, seeking ways to minimise any liability and ensuring that your testamentary wishes are achieved in the most tax efficient way. For example, by the simple act of leaving assets worth £250,000 to beneficiaries other than a surviving spouse, the overall IHT burden on a married couple can be reduced by £100,000.

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Conclusion

Different people have different aspirations and how you leave your business and personal assets will depend on what you want to achieve. But whatever you do, it will take time to plan the most tax efficient way to sell or pass on your business and personal assets and achieve the lifestyle you have worked hard for.

For further information contact:

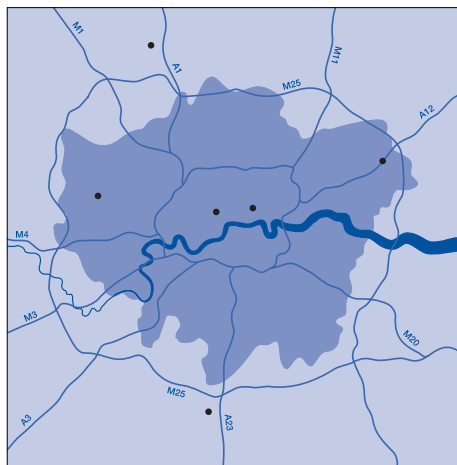
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