SUDDEN WEALTH CAN BE OVERWHELMING. BE PREPARED.

By Michael Joyce
Special for Lehigh Valley Business

Executives and business owners often work for years to best position themselves for professional and financial success. That success often culminates in a sudden wealth event, such as selling a business, receiving a large stock award or gaining access to deferred compensation. To ensure that a sudden wealth event is as beneficial as possible, sound financial planning is required.


Michael Joyce

First, let's talk about structuring the sale of a business in the most advantageous way. While a business sale can be a significant tax event, it is advisable for business owners to accept the optimal financial payout for a company sale and not just the one that results in the lowest tax liability. Getting paid a lump sum (the bird in hand) will reduce the financial risk in the transaction even if it isn't the most tax-efficient scenario.

The cash offer is often the best option for a business owner because she will go from having a controlling interest in the company, with the power to steer decision-making, company initiatives and investments, to having a minority interest without much of a say in the future direction of her enterprise. It is better to get the cash out upon the sale of the business in case the company's value diminishes under new management.

Sometimes, a business owner may also own her company property – the site of her office, retail store space or warehouse. Before selling the business, it is prudent to separate the ownership of the business from that of the property. That way, the business owner can continue to earn income by arranging a long-term lease with the private equity firm or other entity that buys the company.

One final word of caution for someone selling her business is that she should remember that she is probably not going to get another bite of that apple. Therefore, from an investment standpoint, she should be more conservative with this new wealth than her personal risk tolerance might otherwise indicate. Since this is a unique wealth-building event, rather than investing this new wealth in the same way she would otherwise invest personally, business sellers should focus on preservation with some growth.

In another type of sudden wealth event, how can executives prepare to receive a large stock award or to gain access to deferred compensation? For these lucky individuals, the best advice is to prepare ahead of the event and structure the rest of their financial world appropriately, ideally with the help of a trusted financial adviser.

If an executive has a restricted stock award that vests, it is a taxable event. There is nothing the executive can do to prevent this: The day stock vests, it generates taxable income. A few ways to mitigate the impact of the taxable event are to take fewer capital gains that year, bunch up charitable contributions, harvest tax losses or push other gains into a future year.

Non-qualified stock options also produce a taxable event; however, an executive has more control over the timing of the income involved. Stock options are taxable upon exercise, and generally have a long window (often as long as 10 years) in which they can be exercised. Balancing the timing of stock-option exercise with other sources of income can go a long way towards minimizing taxes. However, if the stock price is at an all-time high, it might be wiser to exercise the options and take the tax hit. (A trusted financial adviser can also offer recommendations in this situation).

With deferred compensation, the executive typically makes his election about how to receive the funds when he is offered the plan. From a tax perspective, it often makes sense to take a payout over several years so that the tax burden is spread out over time. If an executive elects to take the lump sum of deferred compensation, he may move into a higher tax bracket and will likely pay more taxes than if he'd chosen the payout option.

Of course, in all of these cases (as in all things financial), business owners and executives alike should be careful not to spend it before they get it. No good ever comes from that. $

Michael Joyce is founder and president of Agili, which has offices in Bethlehem and in Richmond, Virginia. He is responsible for overall investment strategy, management of investment portfolios and financial counseling services. He can be reached at mjoyce@agilipersonalcfo.com.