
Date: Saturday, October 10, 2015
Time: 3:00 pm – 4:30 pm
Location: Gaylord National Harbor Resort and Convention Center, Chesapeake 7/8/9

Title: How to Build the Value of Your Investment for Retirement and Protect Your Legacy for the Future
ACPE # 207-000-15-113-L04-P · 0.15 CEUs
ACPE # 207-000-15-113-L04-T

Activity Type: Application-based
Speaker: Lawrence Barrett, CLU, ChFC, Independent Pharmacy Consulting Group, LLC
Thomas Craft, CPA, PFS, AEP, Independent Pharmacy Consulting Group, LLC

Pharmacist and Pharmacy Technician Learning Objectives:

Upon completion of this activity, participants will be able to:

1. Outline the effect of succession planning on taxes.
2. Discuss the necessary steps in the succession planning process.
3. Summarize the necessary components of these planning instruments: Buy-Sell agreement, Wills, Trusts.

Disclosures:


Lawrence Barrett is an employee of Independent Pharmacy Consulting Group, LLC. The conflict of interest was resolved by peer review of the slide content.

Thomas Craft is an employee of Independent Pharmacy Consulting Group, LLC. The conflict of interest was resolved by peer review of the slide content.

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**How to Build
the Value of
Your Investment
for Retirement
and Protect
Your Legacy for
the Future**

Recharge. Reimagine. Reinvent.

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Today's Presenters

Lawrence C. Barrett, CLU, ChFC, AEP®
Wealth Planner, Registered Representative

- 42 years of experience in financial services industry
- Graduated from Ohio Northern University in 1971
- Bachelor of Science in Business Management and Marketing
- Has worked with Independent Pharmacies since the late 1970s
- Speaks to pharmacy students on becoming a successful business owner
- Frequent CE speaker for Cardinal Health, NCPA, buying groups, and state pharmacy associations

Thomas H. Craft, CPA*, PFS, AEP®
Wealth Planner, Registered Representative

- 35 years of experience in financial services industry
- Graduated from Cleveland State University in 1979, Cum Laude
- Bachelor of Business Administration in Accounting specializing in Taxes
- Worked for Deloitte and held senior management position in industry
- Licensed as a Certified Public Accountant in 1982
- Frequent CE speaker for Cardinal Health, NCPA, buying groups, and state pharmacy associations

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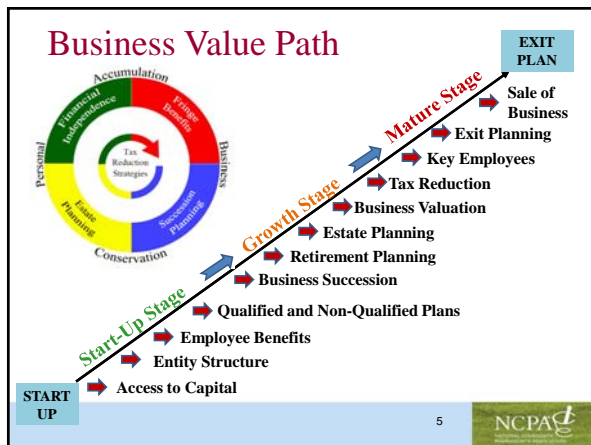
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Learning Objectives

1. Outline the effect of succession planning on taxes.
2. Discuss the necessary steps in the succession planning process.
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Business Value Path



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Business Succession Planning



A process designed to ensure the future success and continuity of your Pharmacy both while actively operating your business as well as planning for a successful exit whether intentional or unintentional.

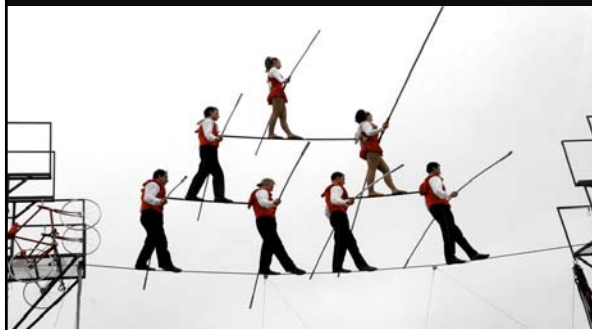


Having No Plan to Build Value and Protect Your Legacy is Like . . .



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And What if You Have One or More Partners. . .



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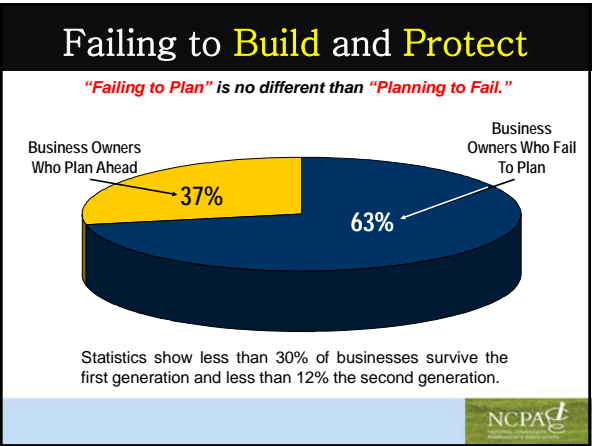
The **Independent** Community Pharmacy Marketplace in 2013

Independents <i>(1.3% decline since 2009)</i>	22,814
Traditional Chain	21,394
Supermarket	8,301
Mass Merchant	8,330

Independent community pharmacies are

- All privately-held small businesses
- Single and multiple store operations, regional chains, and franchises.
- 37% of all retail pharmacies in the U.S.
- \$88.8 billion marketplace

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When do You Start to Build Value and Protect Your Legacy?

GOOD	5 - 10 Years prior to Exiting Your Business
BETTER	Start today whether you plan to sell it, keep it or are uncertain what you will do
BEST	The day you purchase or start your business

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WHY?

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Are You **Successful**?



Achievement

vs.

Success



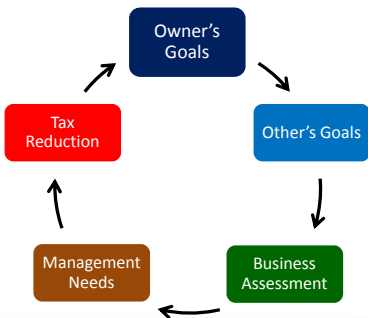



What is your **“Why”** ?



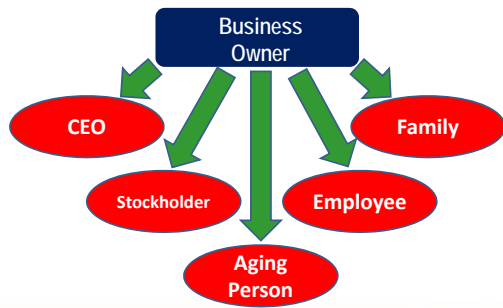


Five Steps to Building Value



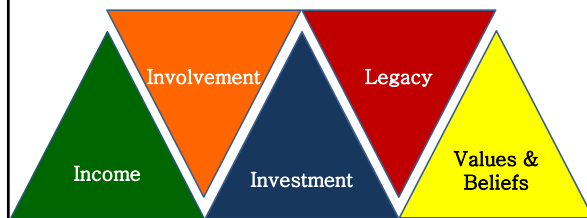


Step 1: Business Owner's Goals



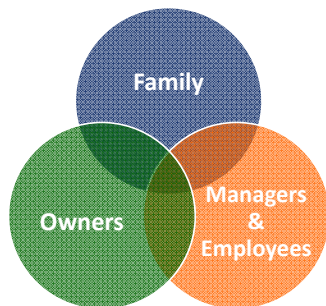
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Five Primary Owner Concerns



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Step 2: Other Stakeholder's Goals



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Step 3: Business Assessment

- SWOT Analysis
- Entity Selection
- Investor Ready Financials
- Business Valuation



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SWAT Analysis



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SWOT Analysis



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What are Your **Strengths**?

- What do you, your employees and business do well?
- What do you do better than your competition?
- What unique resources can you draw upon?
- What are your advantages over your competitors?
- What strengths do others see?



What are Your **Weaknesses**?

- What areas need improvement in your business?
- Do you have limited resources?
- What factors within your control detract from your ability to obtain or maintain a competitive edge?
- What does your business lack?
- What weaknesses do others see?



What are Your **Opportunities**?

- What opportunities can you identify are available to you?
- Are there any trends you can take advantage of?
- Are there any changes in your market or industry that may create new opportunities?
- Can you identify any strengths that can be turned into opportunities?



What are Your Threats?

- What threats have you identified which may harm your business?
- Do your competitors doing anything better than you do?
- What obstacles have been created by an unfavorable trend or development that may lead to deteriorating revenues or profits?
- Do your weaknesses expose you to new threats?



P.E.S.T. Analysis



Entity Selection

S Corporation	53%
LLC	24%
C Corporations	17%
Other	6%

Question:

My Business is
a _____
because . . .



"I want you to find a bold and innovative way to do everything exactly the same way it's been done for 25 years!"



Corporations: “C” vs. “S”

C Corporation
↔
S Corporation

Liability

Taxation

Year-end


Shareholder Benefits

Types of Shareholders

3.8% Net Investment Income Tax

Stock Sale

Asset Sale



Limited Liability Company (LLC)

- Limited Liability
- Flexible
- Pass-through Taxation
- Guaranteed payments
- Single Owner –SMLLC (Sch. C)
- Profit/Loss Allocation
- Taxed as Partnership / Corporation



Best suited
for holding
Real Estate




Investor-Ready Financials



What is a financial statement or report?

A formal record of the financial activities and position of a business entity or individual that presents the financial information of the business entity or individual in a clear and concise manner that adheres to GAAP.

Financial statements include:


- Income Statement** (Profit & Loss Statement)
- Balance Sheet**
- Cash Flow Statement**



Do's and Don'ts


1. My accountant provides financial statements for my business _____
2. I review my financial statements _____
3. I **do** / **don't** thoroughly understand my financial reports
4. I have an A/R Aging Report and update it _____
5. I take a physical inventory every _____
6. I **always** / **sometimes** / **never** commingle personal expenses with my business expenses



Tracking Trends: All Pharmacies

Description	2012	2011	2010
Prescription Sales	91%	92%	92%
All Other Sales	9%	8%	8%
Total Sales	100%	100%	100%
Prescription Costs	71.0%	71.9%	70.5%
All Other Costs	5.8%	5.2%	5.5%
Total Cost of Goods Sold	76.8%	77.1%	76.0%
Gross Profit Margin	23.2%	22.9%	24.0%
Payroll Expenses	13.7%	13.4%	14.5%
Total Operating Costs	20.2%	20.0%	21.0%
Net Profit	3.0%	2.9%	3.0%

Source 2014 NCPA Digest



Managing Assets / Controlling Debt

Managing Cash Flow - 4.0% / 1.66%

- Current Ratio: (Current Assets ÷ Current Liabilities)
- Quick Ratio: (Cash + A/R ÷ Current Liabilities)

Inventory Control – 11.1 times / 33 days


- Inventory Turnover (Annual): (COGS ÷ Average Inventory)
- Inventory Turnover (Days): (365 ÷ Inventory Turnover)

Asset Efficiency - 4.9% / 20.2%

- Sales to Assets: (Total Sales ÷ Total Assets)
- Return on Investment: (Net Profit ÷ Net Worth)

Debt Management – 0.41%

- Debt to Equity (Net Worth): (Total Liabilities ÷ Net Worth)



Business Valuation



What would you **sell** your business for? \$ _____

Now, what would you **buy** it back for? \$ _____



What is Your Business Worth?

Depends on Who's Asking -

- **Owner Value** – what you think it's worth
- **Collateral Value** – what the bank thinks
- **Fair Market Value** – what the IRS says
- **Investment Value** – what an investor believes
- **Market Value** – what the open market [a **willing buyer** and **willing seller** agree to, both having full knowledge of all facts and circumstances] says its worth



What is a Buyer Looking For?

- | | | |
|------------------|---|-------------|
| ▪ Revenue | } | ▪ Cash Flow |
| ▪ No. of Scripts | | ▪ Cash Flow |
| ▪ EBITDA* | | ▪ Cash Flow |
| ▪ Inventory | | ▪ Cash Flow |

* Earnings before interest, taxes, depreciation and amortization



Step 4: Management Succession

Absolutely critical when the business owner intends to keep the business independent and closely-held, or has a continued interest in the business.

3 Questions:

- 1) What do I do?
- 2) Who can do what I do when I'm gone?
- 3) How do I get them ready?



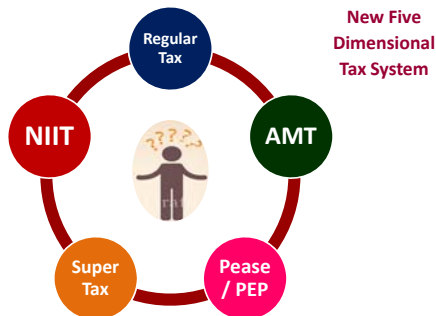
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Management Succession: 5 Step Process

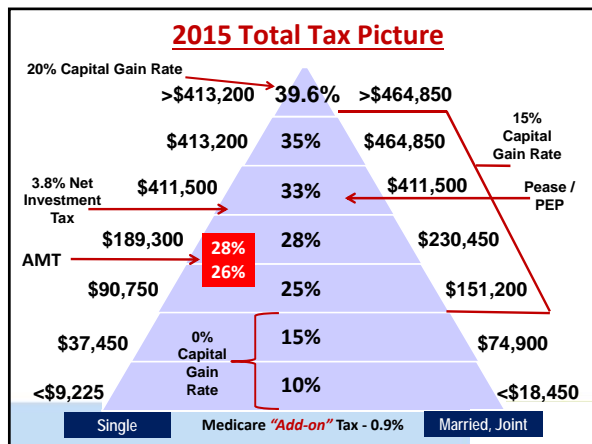
1. Assess responsibilities, skills and relationships of the current owner
2. Assess the skills and abilities of the management team – especially a potential successor
3. Ask successor(s) and the management team what they would like to do in the future
4. Determine what the management team will need to help train the successor(s)
5. Combine the needs of managers and any new responsibilities they will take on

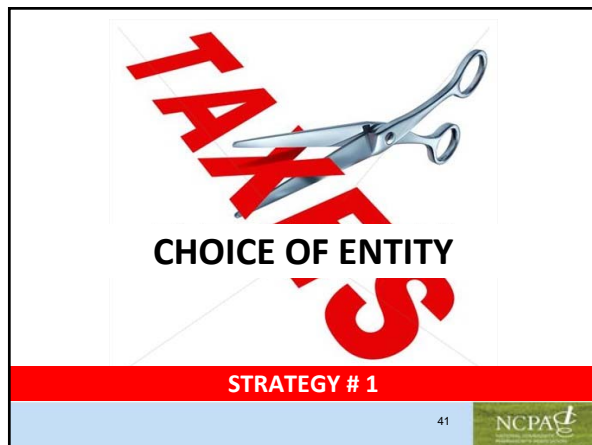
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Step 5: Tax Reduction Strategies



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S-Election to Medicare Tax


A business organized as a Sole Proprietor, LLC, LLP, LLLP, or other pass-through entity must pay employment taxes of 15.3% up to 16.2% on all earnings in addition to income taxes.

Mike is 100% owner and active in running his pharmacy. He has 7 employees and is organized as an LLC. He reports \$450,000 in net profit on which he pays Social Security and Medicare taxes



Active Owner

\$450,000 annual profit



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S-Election to Medicare Tax

Establishing a fair wage

- Determine a fair wage for Mike assuming he was an employee rather than a business owner
- Mike allocates \$120,000 of his profits to wages based on industry averages
- Remaining \$330,000 is treated as a dividend/ distribution



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S-Election to Medicare Tax

	No S-Election	S-Election	Difference
2015 Medicare Tax Liability	\$14,850	\$3,480	\$11,370
2016 Medicare Tax Liability	\$15,363	\$3,480	\$11,883
2017 Medicare Tax Liability	\$15,891	\$3,480	\$12,411
2018 Medicare Tax Liability	\$16,436	\$3,480	\$12,956
2019 Medicare Tax Liability	\$16,996	\$3,480	\$13,516
Total Medicare Taxes	\$79,536	\$17,400	\$62,136

Assumptions:

- 1) Net profit is \$450,000 growing at a 3% annual rate
- 2) Wages are \$120,000 in S-Election column with 0% adjustment
- 3) Social Security tax not considered in calculation
- 4) Medicare Tax is 1.45% for the employee and the employer
- 5) Medicare add-on tax is 0.9% for wages above \$250,000 (MFJ)





STRATEGY # 2

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Corporate vs. Personal Tax Rates

A-1 Pharmacy

- C Corporation
- Andy Salary = \$120,000
- S/H Loan = \$155,000
- Net Loss = (\$3,500)

Corporate Tax Brackets		
Over	But Not Over	% on Excess
\$0	\$50,000	15%
50,000	75,000	25%
75,000	100,000	34%
100,000	335,000	39%
335,000	10M	34%

Andy & Annie

- MFJ filing status
- Andy - 71 / Annie - 68
- Andy Salary = \$120,000
- All income = \$345,678

Married Filing Joint Tax Brackets		
Over	But Not Over	% on Excess
\$0	\$18,450	10%
\$18,450	74,900	15%
74,900	151,200	25%
151,200	230,450	28%
230,450	411,500	33%
411,500	464,850	35%
464,850	39.6%



Corporate vs. Personal Tax Rates

Personal (MFJ)

Wages & Salary	\$120,000
Other Income	225,678
Adj. Gross Income	\$345,678
Itemized Deductions	44,763
Personal Exemptions	5,600
Taxable Income	\$295,315
Federal Income Taxes	\$66,494
3.8% Medicare Surtax	2,441
Employment Taxes	9,180
State Income Tax	12,853
Total Personal Taxes	\$90,968

Pharmacy (C Corp.)

Corporate Income	(\$3,500)
Federal Corporate Tax	\$0
Employment Tax	9,180
Total Corporate Taxes	\$9,180
Total Taxes Paid	\$100,148



Corporate vs. Personal Tax Rates

A-1 Pharmacy -

C Corporation	Before	Adjustment	After
Andy's Salary	\$120,000	(\$53,500)	\$63,500
S/H Loan Payable	(\$155,000)	\$53,500	\$101,500
Net Profit	(\$3,500)	\$53,500	\$50,000

Andy & Annie -

MFJ	Before	Adjustment	After
Andy's Salary	\$120,000	(\$53,500)	\$63,500
S/H Loan Receivable	(\$155,000)	\$53,500	\$101,500
All Income	\$345,678	(\$53,500)	\$292,178



Corporate vs. Personal Tax Rates

MFI (Personal)	Original	Amended	Difference
Federal Income Taxes	\$66,494	\$47,945	(\$18,549)
3.8% Medicare Surtax	2,441	1,489	(952)
Employment Taxes	9,180	4,858	(4,322)
State Income Tax	12,853	9,965	(2,888)
Total Personal Taxes	\$90,968	64,257	(\$26,711)
Pharmacy (C Corp)	Original	Amended	Difference
Federal Income Taxes	\$0	\$57,500	\$7,500
Employment Taxes	9,180	4,858	(4,322)
Total Personal Taxes	\$90,968	64,257	\$3,178
One Year Tax Savings			\$23,533

Total Tax Savings over 3 years = **\$70,599**



STRATEGY # 3

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Cash Balance Plan: Hybrid

Example -

- Sam receives compensation of \$260,000 from his pharmacy
- Sam's 401(k) allows a maximum salary deferral of \$24,000 (\$18,000 plus \$6,000 catch-up contribution)
- Sam would like to put more money away for his retirement

Participant	Age	Compensation	401(k) Plan		401(k) Plan	Total
			Employee Deferral	Employer Contr.	Cash Balance Contr.	
Owner	58	\$260,000	24,000	\$13,000	\$193,000	\$230,000
EE #1	24	25,000	as elected	1,875	-	1,875
EE #2	31	38,000	as elected	2,850	-	2,850
EE #3	34	40,000	as elected	3,000	-	3,000
EE #4	43	50,000	as elected	3,750	-	3,750
				\$24,475	\$193,000	\$241,475





TAX-FAVORED CASH ACCUMULATION

STRATEGY # 4

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Employer-Sponsored Plan

For successful business owners looking to mitigate income taxes and appreciate assets

- Employer fully deducts annual plan contributions
- Participant includes only 30% in income (70% of employer contribution is excluded from income)
- Employer may discriminate as to who participates
- Contribution does not affect other retirement contributions
- Tax-favored long-term cash value accumulation

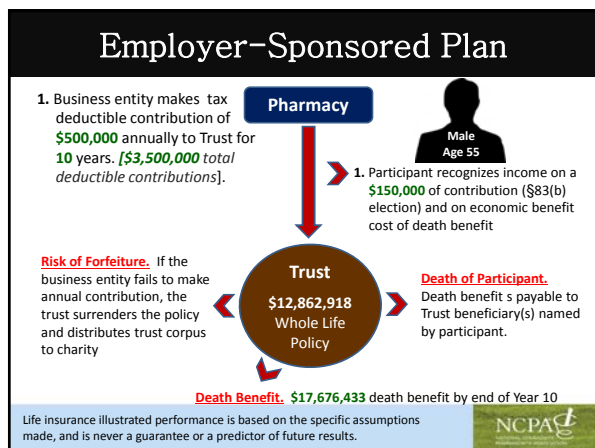
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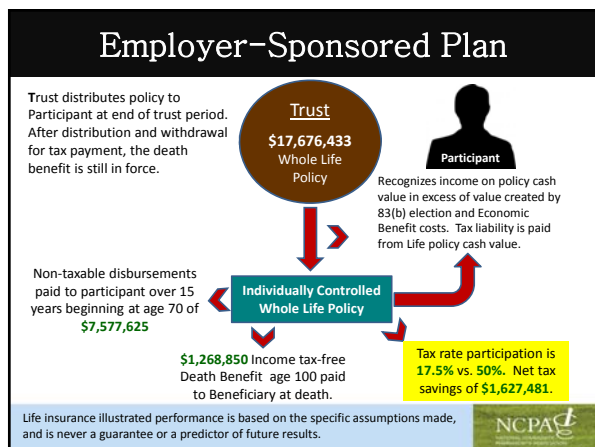
Employer-Sponsored Plan

Restrictions are required to qualify for special tax treatment

- Annual contributions made for a minimum of 5 years
- Annual contributions cannot be altered once elected
- Conservative vehicle – tax-deferred cash value is accumulated in a whole life insurance policy with future tax-advantaged distributions at retirement
- Risk of forfeiture rules cause policy to lapse and the cash value to be donated the charity of your choice
- Policy held in a Trust during funding

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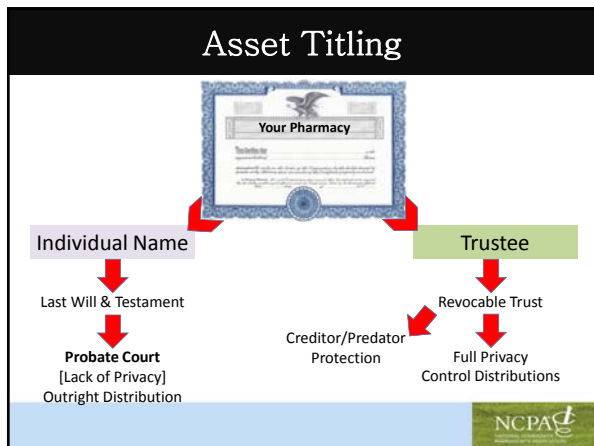
Protecting Your Legacy

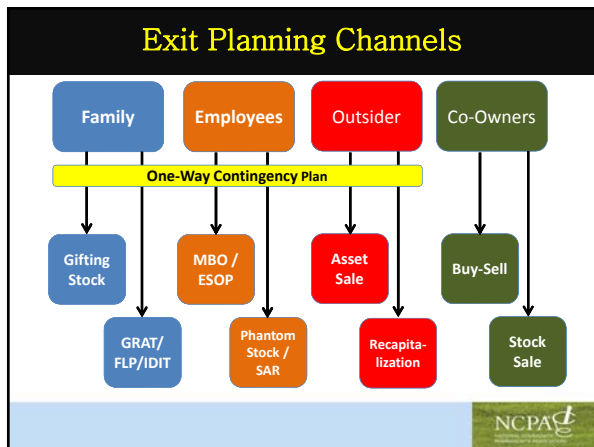
You only sell your business once
Do it right!

Exit Planning

Every exit is an entry somewhere else.
~ Tom Stoppard

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One-Way Contingency Plan

When a business owner dies or becomes permanently disabled, the business itself may die or become permanently disabled on the same day – not because something wrong was done – but because nothing was done! ~ Ben Feldman

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Problems of No Contingency Plan

- No successor identified
- Significant drop in value of business (often immediately)
- Loss of income and security for family
- Spouse / children unprepared to run business
- Management and employees are prone to leave
- Customers loyalty wanes with uncertainty
- Creditors or vendors unwilling to extend credit



Protecting Your Legacy



Keeping It in the Family

Bob is 100% owner of Family Pharmacy valued at \$2 million. Bob and wife Sheila want to leave the business to their daughter, Sandra. Eric is a partner in a local law firm and has no interest in the family business.



\$1.52
per dollar



\$14,000
\$28,000
\$5,430,000



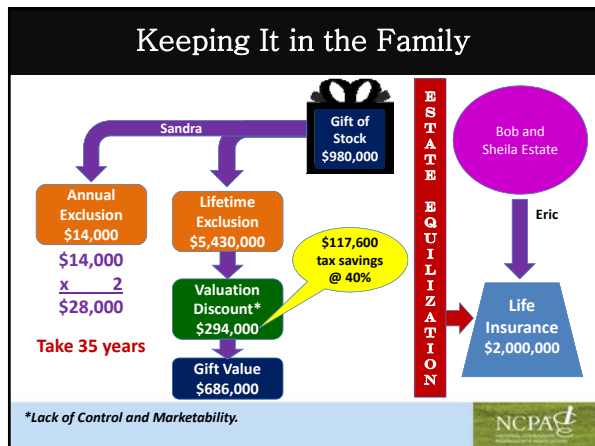
GRAT
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Stepped-up
basis

*IRS attributions rules requires a realistic, legally defensible value for the business supported by an independent qualified appraisal.





Management Buyout / ESOP

An Employee Stock Ownership Plan is a retirement plan designed to provide employees with an ownership interest in the company by investing primarily the stock of the employer.

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Management Buyout / ESOP

Employee Stock Ownership Plans (ESOPs)

- Defined-contribution / tax-qualified plans
- ESOP may borrow funds to purchase stock of the owner (must buy at least 30%) and principal payments are paid with pre-tax dollars
- Owners may sell a portion or all of the stock to the ESOP (§1042 rollover) on a tax-deductible basis (*avoiding capital gains if proceeds reinvested*)
- Can be either a C Corporation or S corporation
- Costs are \$10,000 and up for plan documents, legal fees, government filings, valuation, administration, loan commitment fees, financial consulting, etc.

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Selling to an Outsider



*Most Likely
Your Pharmacy
Sale to an
Outsider Will Be
Structured as an
Asset Sale*



Tax Impact of a Asset Sale

S Corporation

- Capital gains on Goodwill
- Depreciation recapture subject to ordinary income tax rates
- Ordinary income on equipment
- Restricted covenant subject to ordinary income rates

C Corporation

- **Tier 1:** Gains taxed at corporate tax rates (no capital gains)
- **Tier 2:** Capital gain or loss on shareholder's liquidation of corporation



Tax Impact of a Asset Sale

The Seller's Perspective – S Corporation

- Cash & Receivables retained
- Saleable Inventory – usually sold at cost
- Furniture & Equipment - ordinary income taxes / depreciation recapture
- Files & Scripts (Goodwill) - capital gains treatment
- Retain all liabilities
- Pass-through entity – taxes paid at individual level



Tax Impact of a Asset Sale

The Seller's Perspective – C Corporation

- Cash & Receivables retained
- Saleable Inventory – usually sold at cost
- All other assets including Goodwill taxed at corporate rates of 34%/35% - no capital gains
- Retain all liabilities
- Double Tax – Shareholder must pay capital gains tax on liquidation of corporation



Tax Impact of a Asset Sale

Example of an Asset Sale

Purchase Price: \$1,000,000

Pharmacy Rx	Balance Sheet
ASSETS	
Accounts Receivable	\$150,000
Inventory	200,000
Equipment	100,000
Total	\$450,000
LIABILITIES & EQUITY	
Bank Loan	\$20,000
Stock	5,000
Owner's Equity	425,000
Total	\$450,000

S Corp.	Ordinary Tax	Capital Gain
A/R & Inventory	\$0	N/A
Equipment	28,000	N/A
Goodwill	N/A	90,000
C Corp.	Ordinary Tax	Capital Gain
(1) A/R & Inventory	\$157,500	N/A
(2) Liquidate Corp	N/A	163,500
[Lost \$183,000]		



Built-In-Gains Tax (B.I.G.)

Converting from a C Corp to an S Corp

- Must calculate "unrealized built-in-gains" or appreciation on assets from inception of C Corp.
- 10-year look-back period
- Sale proceeds paid at highest corporate tax rate
- Built-in-gains tax is the lesser of the corporation's net recognized BIG or corporation's taxable income
- Congressional action to shorten look-back period?



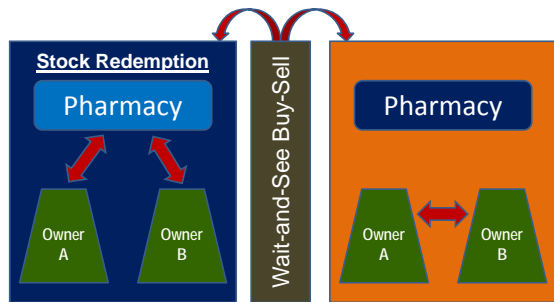
Selling to an Co-Owner



A Buy-Sell is a legally binding agreement between or among shareholders and the company requiring the shareholders or company to purchase the stock of the business owner based on “triggers”.



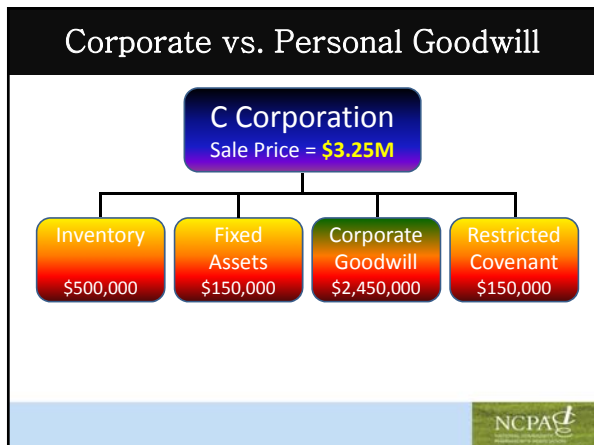
Buy-Sell Agreements

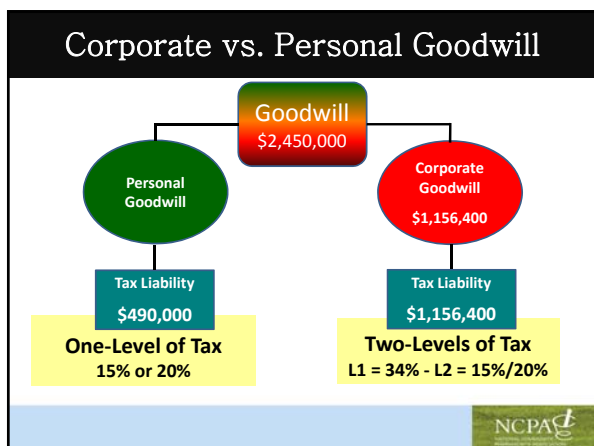


Buy-Sell Triggers(Clouds)









Personal Goodwill in a C Corporation

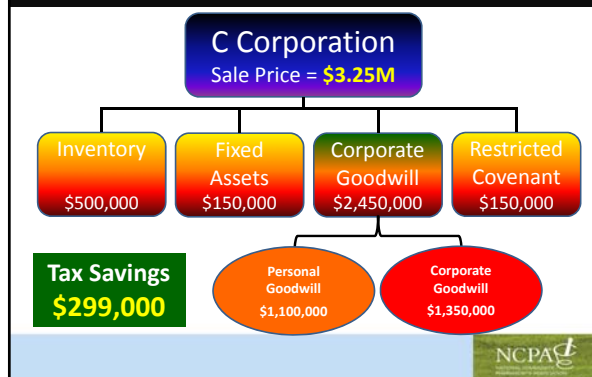
2-Step Process

Personal Goodwill Appraisal
\$1,100,000

Personal Goodwill
Purchase Agreement



Corporate vs. Personal Goodwill



§ 1031 LIKE-KIND EXCHANGE

STRATEGY # 6





§ 1031 Like-Kind Exchange

Property Not Qualifying for a §1031 Exchange

- **Personal residence**
- Land under development for resale
- **Construction or fix/flips for resale**
- Property purchased for resale
- Inventory
- **Corporation common stock**
- Partnership or LLC member interests
- Bonds or Notes




§ 1031 Like-Kind Exchange

Property Qualifying for a §1031 Exchange

- **Improved real estate** for **unimproved real estate**
- **Commercial building** for **vacant land**
- **100% interest** for an **undivided percentage interest with multiple owners**
- **One property** for **two or more properties**
- **Industrial property** for **rental resort property**
- **Investment property** for **business property**



§ 1031 Like-Kind Exchange




Sale price: \$500,000
Depreciation: \$120,000
Cost Basis: \$200,000


Proceeds from sale held by QI until the replacement property is purchased

Qualified Intermediary (QI)

45 days to identify replacement property
 180 to purchase replacement property



Purchase price: \$600,000
Depreciation: \$120,000
Cost Basis: \$300,000




Summary

Are You On Track to Building the Value of Your Investment for Retirement and Protecting Your Legacy for the Future?











Thank You

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