Strategic wealth management for entrepreneurs and business owners

Volume 1 | Forming a business
Who should be on a business owner’s advisory team during the formation phase of his/her business, and what specific roles do they play in assisting the business owner?  pg. 6

What are some of the common business structures available for an entrepreneur who is forming a business, and what are the key advantages and disadvantages associated with each of them?  pg. 12

Are there insurance needs that are unique to business owners during the formation phase of their businesses?  pg. 24

What specific opportunities can be captured when business owners coordinate their estate plans with the formation of their businesses?  pg. 27

How should business owners orient themselves for the subsequent phases of their companies’ life cycles?  pg. 32
"The secret to getting ahead is getting started."

Mark Twain
Perspective – entrepreneurialism and wealth management

Although the attribution of the above quote to Mark Twain is disputed by those who claim that Agatha Christie was, in reality, its true author, the inherent practicability of the statement is inescapable regardless of whether one is an entrepreneur or an investor.

In either case, an individual should be mindful of the statement’s lesser known coda: The secret to getting started is breaking your complex and overwhelming tasks into small, manageable components, and starting on the first one. Sound advice. However this, of course, begs the question, “Where to start?”

Challenge and opportunity – a way forward

This publication – Strategic wealth management for entrepreneurs and business owners (Volume 1: Forming a business) – seeks to answer the question of “Where to start?” by serving as an informative yet practical guide detailing how best to align the establishment of a business owner’s entrepreneurial ventures with the development of an effective wealth management plan.

Such alignment is essential as the “formation phase” of a company’s life cycle presents the business owner with many of the greatest entrepreneurial challenges and, paradoxically, many of the greatest opportunities for strategic wealth management.

Holistic wealth management – the Barclays approach

Unfortunately, many business owners have neither the time nor the guidance to undertake the type of integrated wealth planning that can allow them to effectively monetize the inherent value of the companies that they work so diligently to build. Indeed, in many instances, their fragmented, siloed, or compartmentalized wealth structuring can serve to erode the very wealth that they have sacrificed so much time and energy to create.

At Barclays, we understand that the wealth management needs of entrepreneurs and business owners require bespoke, thoughtful, and holistic solutions. Further, we believe that the best way to educate clients in their wealth management decisions is to aid them in understanding their wealth, and to use this as a foundation to organize their wealth in an optimal manner. This balanced and integrated approach ensures that deciding how ultimately to invest becomes a logical by-product of understanding an individual’s wealth management goals and personal circumstances.

We look forward to working with you now and throughout the growth of your business.

Christopher Johnson

Head of Wealth Advisory and Strategic Solutions, Americas
Six-volume series: Strategic wealth management for entrepreneurs and business owners

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About this volume

The “formation phase” of an organization’s strategic life cycle can be among its most challenging. In terms of entrepreneurial demands, business owners must normally address an intricate web of complex commercial, legal and financial decisions as they assemble the foundations upon which their ventures will ultimately be established.

Figure 1: Strategic life cycle of business ownership

“What will the business be positioned to grow?” “What is my ideal exit strategy?” “How can I best monetize the wealth that will accrue from my endeavors?” The answers to these and other questions are confronted, often inadvertently, even as an entrepreneur takes his or her first tentative steps toward establishing a business.

Unfortunately, the demands of business ownership are such that entrepreneurs are often so focused upon the oversight and growth of their business that they fail to acknowledge that even minor missteps within the context of their wealth structuring can effectively sabotage the wealth-creation momentum of their entrepreneurial pursuits. Conversely, with even a few small tweaks to their wealth plans, entrepreneurs and business owners can position themselves to become significant beneficiaries of the practice of strategic wealth planning.

From a wealth management perspective, the key strategic considerations to bear in mind when forming a company include:

- Assembling an advisory team
- Selecting a business structure
- Determining one’s insurance requirements
- Reviewing trust and estate planning needs
- Considering “next steps”

Each of these will be addressed in turn.
Step 1
Select an advisory team
Assembling an advisory team can provide a business owner with critically needed expertise and an ability to leverage limited time effectively.

An advisory team is a collection of advisors who – both individually and jointly – can provide business owners with the full spectrum of professional expertise required to align their business interests with their holistic wealth management needs.

**Q:** Who should be on a business owner’s advisory team during the formation phase of his/her business, and what specific roles do they play in assisting the business owner?

When selecting an advisory team, it is important to identify organizations and individuals who have the appropriate industry and sector expertise. A history of intergroup cooperation and coordination is also of great value as this can result in a more cohesive and integrated wealth management undertaking.
Although the specific configuration of the team will vary depending upon the circumstances, the advisory team of an entrepreneur who is forming a business will normally consist of some mixture of the following advisors:

The Investment Representative ("IR")
The purpose of the Investment Representative is to work with clients in order to understand and organize their wealth. Additionally, Investment Representatives can provide investment solutions that fulfill a client’s particular goals and aspirations while also serving as a “gateway” into the various services offered by the IR’s organization.

The Wealth Advisor
A Wealth Advisor is normally a trained tax or trust and estate attorney who works with an Investment Representative to ensure that a client’s “asset allocation” is driven by his or her “asset location” (in short, that the various facets of holistic wealth management are optimized).

The Investment Banker
Although Investment Bankers normally become more relevant to business owners in the period leading up to an IPO, merger or acquisition, business owners should work with their advisory team from an early stage to prime and position the company for those exit strategies (should that be their ultimate goal).

The Corporate Trustee
Corporate Trustees can serve a valuable role for entrepreneurs by combining the benefits of trusts (e.g., tax minimization, estate planning, creditor protection) with the key advantages offered by a corporate trustee (e.g., objectivity, continuity, professional oversight).

The Corporate Attorney
The Corporate Attorney is normally enlisted in order to assist in the establishment and maintenance of the business enterprise’s corporate structure. Their role will normally also encompass the filing of regulatory and state documents as well as the review and drafting of key contracts and commercial arrangements.

The Valuation Consultant
Valuation experts can provide a business owner with specialized expertise for a variety of undertakings including business sales, IPOs and tax-efficient gifting.

The Trust & Estate Attorney ("T&E Attorney")
Many business owners overlook the need to effectively plan for their estate – a significant portion of which is normally comprised of their business holdings. Engaging a T&E Attorney early in the process can provide significant opportunities to minimize estate and gift taxes and to appropriately prepare for the adoption of an integrated wealth management plan.

The Certified Public Accountant ("CPA")
CPAs can provide a variety of services to an entrepreneur – including tax compliance, bookkeeping, and the provision of audited financial statements. In many instances, other accountants who specialize in personal planning may assist business owners in managing their personal wealth in addition to their commercial affairs.

The Insurance Agents
A business owner may require the assistance of multiple Insurance Agents in order to obtain guidance on a range of insurance products, including: (i) property and casualty insurance; (ii) directors and officers liability insurance; (iii) liability insurance for employees; (iv) errors and omissions insurance; and (v) life insurance.

Investors
From friends and family members to initial investors, banks, venture capital and private equity firms, investors can provide the financing necessary to nourish a firm from establishment through to the end of its life cycle.1

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1. A special note to female entrepreneurs: Female entrepreneurs who are seeking additional advice and support (in the United States) may wish to contact the Office of Women’s Business Ownership. This federal organization has been established to support female entrepreneurs by providing access to financing as well as technical assistance. Those individuals seeking additional insight into some of the current developments within the evolving landscape of female entrepreneurship may wish to request a copy of the Barclays publication entitled, Unlocking the Female Economy: The Path to Entrepreneurial Success (2013).
Figure 2: Business owners should leverage a core advisory team to resolve key business issues.
Issue spotting
A primary benefit of an advisory team is that it can provide holistic, integrated and thoughtful advice to a client in an enduring fashion. As such, business owners should strive to establish a team that can spot issues and opportunities (and involve other advisory members as required).

Hypothetical example
Mary (a business owner) is working with her IR in order to help optimize her investment portfolio. The IR asks whether or not Mary has recently reviewed her trust and estate planning (given that her wealth profile has changed drastically over the past year). Mary notes that she has not spoken to her estate planning attorney since the birth of her first child ten years ago. The IR makes a quick call to his Wealth Advisor who subsequently reviews Mary’s existing plan and works with her estate planning attorney to revise and refine her trust planning to reflect her current wealth goals and concerns.

Q: What are some of the key elements of a successful advisory team?

The key to a strong advisory team rests not only upon the practical skills and expertise of its members but also in their ability to work in a coordinated fashion (i.e., with the business owner and with one another). As such, business owners should strive to surround themselves with professionals who have the ability to work together as a cohesive and responsive team.
Q: Will the makeup of an advisory team differ depending upon whether one is a ‘first-time entrepreneur’ or a ‘serial entrepreneur’?

There may be some differences in the team composition when assisting a first-time entrepreneur versus a serial entrepreneur. First-time entrepreneurs may – under some circumstances – not possess the investable wealth necessary to establish an account with an IR. However, an IR can still serve as an invaluable resource for information, advice or referrals for other advisory team members. Ideally, as entrepreneurs monetize the value of their businesses, their IRs can work with them to align their investment goals with their broader wealth management needs (e.g., by introducing them to investment bankers or other potential service and product specialists who may become essential as the business grows and matures).

By contrast, in the case of a serial entrepreneur, it may well be appropriate to incorporate an IR into the advisory team from the company’s inception. This is due to the fact that a serial entrepreneur may have been able to exit his or her earlier business with a fair degree of investable liquid wealth. If that is the case, an IR can immediately begin working with the business owner in order to help craft an optimized investment plan.
Step 2
Select a business structure
The choice of business structure is a critical strategic decision, with wide ranging impacts, including: the manner in which profits will be taxed; the degree of creditor protection afforded owners; and the range of exit strategies that will ultimately be available.

There are a variety of legal structures available for an entrepreneur and his or her advisory team to consider when establishing a business. Some of the more common business entities include:

> The Sole Proprietorship
> The General Partnership
> The Limited Partnership
> The C-Corporation
> The S-Corporation
> The Limited Liability Company (LLC)

Each of these will be reviewed in turn.

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**Figure 3: Business structuring options and characteristics**

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The Sole Proprietorship

The most basic form of business ownership is the sole proprietorship, which typically entails a single individual who owns, operates and controls the commercial enterprise.

**Figure 4: Owner invests personally in the business and is the only individual with a business interest**

**Q:** What are some of the advantages associated with sole proprietorships?

**Ease of implementation**
Under federal law, the default characterization of anyone forming a business is one of sole proprietorship. Although there can be additional fees and requirements at the state and local level for an entrepreneur adopting this business structure, the costs for establishing a sole proprietorship are generally quite low.

**Taxation**
Because sole proprietorships are “pass-through entities”, profits and losses from the business will be passed through to the ultimate owner of the business.² For many, the ability to offset business losses against income from other sources can also be attractive.

**Q:** What are some of the disadvantages associated with sole proprietorships?

**Liability**
The primary disadvantage associated with establishing a sole proprietorship stems from the fact that the owner of the business is subject to personal liability for any debts of the enterprise. From a holistic wealth management perspective, this exposure to liability generally makes sole proprietorships one of the riskiest business structures to use. This is due to the fact that a legal claim that arises within the business could ultimately place a client’s personal assets at risk.

**Hypothetical example**
Bill owns a widget company, structured as a sole proprietorship. One day, his delivery truck hits and injures a pedestrian. In the resulting lawsuit, Bill’s personal investment account, which is held in his name, is at risk of being seized.

² See IRS Form 1040, Schedule C. Sole proprietors must also file Schedule SE with their IRS Form 1040 in order to determine how much self-employment tax is due.
The General and Limited Partnership

In instances where more than one individual may wish to partake in a business venture, a partnership may be a commercial structure worth considering. Partnerships come in two forms – general partnerships and limited partnerships.

**Figure 5:** Two or more partners invest personally in the general partnership. General partners have unlimited liability.

**Figure 6:** One or more general partners maintain oversight over the business. Limited partners have limited liability.

**Q:** Why do general and limited partnerships normally merit consideration as potential business structures?

With general partnerships, the various partners control and manage the company. Further, each general partner assumes *unlimited* liability for the debts of the partnership and can incur obligations on its behalf.

In the case of limited partnerships, there are normally one (or more) general partners who maintain full oversight over the management of the business. In addition, a limited partnership will consist of limited partners who do not engage in the daily oversight of the business and who cannot incur obligations on the partnership’s behalf.
Q: What are some of the advantages associated with partnerships?

Ease of implementation
For partnerships, federal law stipulates that a partnership automatically arises when two or more people enter into business together. As such, no official actions are required from a federal law perspective other than obtaining an Employee Identification Number (“EIN”). In addition, for general partnerships, a Doing Business As (“DBA”) – or similar filing – will normally be required by either state or local authorities. 3

For many business owners, the primary advantage of a limited partnership is that it offers protection to limited partners while also granting the general partner a fair amount of autonomy in overseeing the business. However, limited partnerships normally entail a much greater degree of administrative and regulatory paperwork.

Hypothetical example
Bill and Sara own a widget making company (structured as a general partnership). In the event of an accident with the company’s delivery truck, an injured pedestrian may seek to seize Bill and Sara’s personal assets. If, however, Bill and Sara owned the company as a limited partnership (with Bill as the general partner and Sara as the limited partner), then an identical accident would permit the injured pedestrian to seize Bill’s personal assets while Sara would only be liable to the extent of her investment in the partnership. 4

Taxation
As a “pass-through” entity, partnerships can benefit from the fact that they pay no entity level tax on their income, but rather pass through any profits or losses to their partners. 5 Further, most income or deductions from the partnership will retain their tax characterization when passed through to partners.

Q: What are some of the disadvantages associated with partnerships?

One of the primary disadvantages associated with partnerships stems from the possibility for disagreements between or among the members of the partnership.

Consult with your Corporate Attorney: Many partnerships encounter difficulty due to the fact that the partners have not adequately prepared for commonly occurring issues such as:

> How to deal with conflicts within the partnership
> How to divide partnership responsibilities and oversight equitably
> How to structure the terms of a potential “buy-out” scenario
> How to deal with the death of a partner

In order to avoid these (and other) challenges, partners should always work with their attorneys to draft a “partnership agreement” that clearly outlines how such issues will be addressed.

3. A limited partnership requires that a certificate of limited partnership (or equivalent) be filed with state authorities.
4. Although limited partners generally enjoy liability protection, this limited liability protection can be lost if it is determined that they participated in the ongoing management or oversight of the company in a proactive sense.
5. Partnership income and losses are reported on IRS Form 1065. Further, each partner’s respective share of income or loss will be reported on Schedule K-1 of Form 1065.
The C-Corporation

Corporations can exist as either C-Corporations or S-Corporations, with the primary difference between the two stemming from the method of taxation. When we speak of a C-Corporation, we are referring to a construct that consists of a separate legal entity that exists apart from its owners.

**Figure 7: An unlimited number of shareholders maintain an ownership interest in the C-Corporation. Double taxation.**

<table>
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<th>Shareholders (S)</th>
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C-Corporation

**Q:** What are some of the advantages associated with C-Corporations?

**Limited liability**

One of the primary advantages associated with the establishment of a C-Corporation is that its owners benefit from substantial liability protection.

*Consult with your Corporate Attorney:* Although much is made of the limited liability afforded to owners of corporations, there are instances where that protection may be undermined. Attorneys refer to this as “piercing the corporate veil,” and it applies in situations where the courts feel that the division between a corporate entity and its owners has become blurred. In those instances, the courts may permit a creditor or plaintiff to pursue the personal assets of the corporation’s owners. Some examples of factors that have allowed a court to “pierce the corporate veil” include:

> Corporate undercapitalization
> Lack of adherence to corporate formalities (e.g., lack of financial records, failure to hold shareholder meetings, etc.)
> Commingling of corporate and personal funds
Ability to attract investors
Corporations also benefit from the ability to attract external investors (e.g., through the issuance of stock).

Consult with your Investment Representative: For an introduction to the additional benefits afforded by investment in Qualified Small Business Stock, ask your Investment Representative(s) for a copy of the Barclays publication entitled Organizing Your Wealth – Understanding Qualified Small Business Stock (QSBS) and Associated Gain Exclusions.

Lifespan
Unlike many other forms of ownership, a corporation can continue to exist beyond the death, departure or incapacitation of its owners.

Q: What are some of the disadvantages associated with C-Corporations?

Double taxation
As opposed to “pass-through” entities (such as partnerships), the owners of a C-Corporation will be subject to taxation twice – once at the corporate level⁶ and then again when earnings are distributed to them in the form of dividends.

Consult with your Accountant: In order to minimize the impact of double taxation for C-Corporations, owners should work with their advisors to determine whether or not it would make sense to pay out a certain portion of funds in the form of a salary to shareholders who qualify for such. Corporations need not pay tax on earnings that are distributed as “reasonable” compensation (although owners should consult with their accountants in order to determine what qualifies as “reasonable” compensation).

Consult with your Accountant: In light of the differential in maximum tax rates for individuals (39.6%) and C-Corporations (35%) following the passage of the American Taxpayer Relief Act of 2012, business owners (or those considering establishing a business) may wish to revisit the costs and benefits of C-Corporations versus pass-through entities.

Costs and complexity
Establishing a C-Corporation normally requires the assistance of both an attorney (e.g., for state filings) as well as an accountant (for accounting and tax compliance).

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⁶ See IRS Form 1120.
The S-Corporation

As previously noted, there are two types of corporations – C-Corporations and S-Corporations. An S-Corporation is a C-Corporation that has made an affirmative election\(^7\) to alter its form and tax treatment.

**Figure 8: Multiple shareholders can maintain an ownership interest in the S-Corporation. Pass-through taxation.**

<table>
<thead>
<tr>
<th>Shareholders (S)</th>
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</thead>
<tbody>
<tr>
<td>S</td>
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<td>S</td>
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<td>S</td>
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<td>S</td>
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<tr>
<td>S</td>
</tr>
<tr>
<td>S</td>
</tr>
</tbody>
</table>

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Q: What are some of the advantages associated with S-Corporations?

**Taxation**

The primary advantage of S-Corporations is that they allow income and losses to be passed through to shareholders.\(^8\) Therefore, unlike C-Corporations, S-Corporations are only subject to one level of federal taxation.

Consult with your Accountant: One advantage of S-Corporations is that shareholders are not subject to self-employment tax on their share of business profits.

**Structure**

S-Corporations can have multiple shareholders (up to 100). This allows for easier access to capital.

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7. Using IRS Form 2553.
8. An S-Corporation will file its annual return on IRS Form 1120S. As with partnerships, Schedule K-1 outlines the allocation of income and deductions to various owners.
Q: What are some of the disadvantages associated with S-Corporations?

**Costs and complexity**
As with C-Corporations, S-Corporations are subject to a variety of establishment (e.g., the filing of articles of incorporation) and maintenance (e.g., the maintenance of corporate minutes) requirements that incur the need to hire accountants and attorneys.

*Consult with your Accountant:* Beyond the question of federal tax complexity, each state has its own rules regarding how an S-Corporation’s income may be taxed.

**Ownership limitations**
As opposed to C-Corporations, S-Corporations can only be owned by individuals, charities, estates and certain types of trusts. Corporations, partnerships and non-resident aliens are not permitted to own stock in S-Corporations.

*Consult with your Accountant:* In instances where S-Corporation shares are held by a prohibited entity, the entire S-Corp election can be vacated by the Internal Revenue Service (IRS). This will result in taxation at both the entity and individual levels.

**Stock structure**
S-Corporations can only issue one class of stock (which can, in turn, limit the ability to raise capital).

**Built-in gains**
In some instances, a company will begin its existence as a C-Corporation and then convert to an S-Corporation at some later point in its life cycle. When this happens, the company will be required to measure the amount of asset appreciation that is attributable to the period prior to the conversion. Upon occasion, where there is a sale of assets within a 10-year period following the C-Corp to S-Corp conversion, the asset appreciation valuation can lead to a “built-in” corporate tax on the gain.

*Consult with your Accountant and your Valuation Consultant:* When making a C-Corp to S-Corp conversion, an entrepreneur would be well advised to undertake a contemporaneous asset valuation for the business. Doing so will minimize the ability of the IRS to impose additional tax upon a subsequent sale of the business within the 10-year exposure period. (Absent an appraisal, the IRS will have additional latitude to argue that the appreciation present accrued before rather than after the conversion – thereby characterizing it as a taxable built-in gain.)

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9. For guidance regarding the suitability of Master Limited Partnerships (“MLPs”) as investments for S-Corporations, please refer to the Barclays publication *Organizing Your Wealth: Tax-Related Considerations and Strategies for Master Limited Partnerships* (Part II, section D).

10. Note that it is possible to have voting and nonvoting stock.

11. For additional guidance regarding the potential sale of a business enterprise, see *Strategic wealth management for entrepreneurs and business owners* (Volume 2: Growing a business).
The Limited Liability Company

Limited Liability Companies (also known as LLCs)\(^{12}\) are constructs that combine elements of corporations and partnerships.

**Figure 9: Members of an LLC have limited liability. An LLC can elect to be taxed as a corporation or as a pass-through.**

<table>
<thead>
<tr>
<th>Member</th>
<th>Member</th>
<th>Member</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Limited Liability Company (LLC)</td>
</tr>
</tbody>
</table>

**Q:** What are some of the advantages associated with LLCs?

**Tax treatment**
As a pass-through entity, LLCs normally pass earnings and losses through to owners in a manner akin to partnerships or sole proprietorships.

**Consult with your Accountant:** Occasionally, it may prove beneficial to have an LLC taxed as a C-Corporation rather than as a pass-through. In those instances, the LLC may file an IRS Form 8832 in order to opt for corporate tax treatment.

**Limited liability**
As with corporations, members of LLCs benefit from legal protection (in instances where the “corporate veil” is not pierced).

**Lack of ownership limitations**
Unlike S-Corporations, ownership of LLCs is not limited to 100 shareholders/members.

**Business participation**
Unlike limited partnerships, members of LLCs are allowed to participate fully in the operation of the LLC business.

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\(^{12}\) Because LLCs are constructs of state law, the specific rules governing their establishment and existence will be dependent upon the state in which they originate.
Q: What are some of the disadvantages associated with LLCs?

State compliance issues
In instances where the LLC will do business in a variety of states, it is normally necessary to consult with an accountant or lawyer in order to determine how best to qualify to conduct business in those jurisdictions.

Consult with your Accountant: Some states impose taxes upon the income of LLCs. Business owners should therefore work with their accountants to determine how they may be affected by such laws.

Consult with your Attorney: In instances where the LLC has more than one owner, business owners should work with their attorneys to draft an operating agreement. This document will assist in outlining how best to address issues such as:

> How conflict between LLC members can be effectively addressed
> The manner in which responsibilities will be divided
> The timing and allocation of profits
> How to address the departure of a member (e.g., through sale, death, etc.)
Figure 10: A summary comparison of the entity structures

<table>
<thead>
<tr>
<th>Elements</th>
<th>Sole Proprietorship</th>
<th>General Partnership</th>
<th>Limited Partnership</th>
<th>C-Corporation (C-Corp)</th>
<th>S-Corporation (S-Corp)</th>
<th>Limited Liability Company (LLC)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Implementation burden</td>
<td>Low</td>
<td>Moderate</td>
<td>Moderate</td>
<td>High</td>
<td>High</td>
<td>Moderate</td>
</tr>
<tr>
<td>Creditor protection</td>
<td>Low</td>
<td>Moderate</td>
<td>Moderate</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Exposure to liability</td>
<td>Unlimited liability for owner</td>
<td>Unlimited liability for each general partner</td>
<td>Unlimited liability for the general partner, limited liability for limited partners who do not take an active managerial role</td>
<td>Limited liability for all shareholders (including management)</td>
<td>Limited liability for all shareholders (including management)</td>
<td>Limited liability for all members (including management)</td>
</tr>
<tr>
<td>Federal tax treatment</td>
<td>Pass-through entity, profits and losses pass to business owner</td>
<td>Pass-through entity – partners pay taxes</td>
<td>Pass-through entity – partners pay taxes</td>
<td>Tax at entity level and shareholder level (double taxation)</td>
<td>Pass-through entity – shareholders pay taxes</td>
<td>Pass-through entity – members pay taxes</td>
</tr>
<tr>
<td>Primary form of management</td>
<td>Independent business owner</td>
<td>General partners</td>
<td>General partner(s)</td>
<td>Board of directors</td>
<td>Board of directors</td>
<td>Jointly by members unless a manager is appointed</td>
</tr>
<tr>
<td>Ownership restrictions</td>
<td>Independent business owner</td>
<td>No restriction</td>
<td>No restriction</td>
<td>No restriction</td>
<td>No pension plans, nonresident aliens, corporations or trusts (unless an S-Corp trust)</td>
<td>No restriction</td>
</tr>
<tr>
<td>Number of shareholders</td>
<td>Minimum of 1, maximum of 1</td>
<td>Minimum of 2, no maximum</td>
<td>Minimum of 2, no maximum</td>
<td>Minimum of 1, maximum of 100</td>
<td>Minimum of 1, no maximum</td>
<td></td>
</tr>
<tr>
<td>Cost of implementation</td>
<td>Low</td>
<td>Moderate</td>
<td>Moderate</td>
<td>High</td>
<td>High</td>
<td>Moderate</td>
</tr>
<tr>
<td>Compliance burden</td>
<td>Minimal requirements</td>
<td>Moderate requirements</td>
<td>Moderate requirements</td>
<td>Strict requirements</td>
<td>Strict requirements</td>
<td>Moderate requirements</td>
</tr>
</tbody>
</table>
Step 3
Determine your insurance requirements
Having addressed the question of how best to structure a business, an entrepreneur should then turn his or her attention to the question of insurance. There are some insurance needs that are specific to the formation phase of a business.

Q: Are there insurance needs that are unique to business owners during the formation phase of their businesses?

In many instances, banks will require that any individual receiving a business loan purchase term life insurance. In the event of premature death, the proceeds of the policy will accrue to the bank and cover the value of the loan. In addition to this, many business owners will purchase “key man” (more appropriately, “key person”) insurance. With that type of policy, the company serves as the beneficiary of any life insurance proceeds that are ultimately distributed. This allows remaining owners or key stakeholders to obtain the cash necessary to purchase the shares that once belonged to the deceased. If this was not the case, the shares of the deceased might pass (for example) to his or her family members via the estate and create a new and unexpected ownership structure.

Consult with your Accountant and your licensed Insurance Representative: If the company has been structured as a limited partnership or has a small number of stock owners, any buy-sell agreement that is drafted should specify that this type of insurance be purchased in order to fund the resultant buyback. Without adequate insurance in place, the buy-sell agreement may not realistically be enforceable.
Business owners should work with their licensed insurance representatives to discuss the range of suitable insurance products.\textsuperscript{13}

**Figure 11: Various types of insurance coverage for business owners**

- **Term Insurance**: Temporary life insurance coverage for a period of years – typically used for income replacement purposes in the event of an unforeseen death.
- **Whole Life, Universal and Variable Life Insurance**: Permanent life insurance coverage to fulfill long-term estate planning needs.
- **Key Man Insurance**: Insurance protection on a key individual(s) within a business (i.e., business owner or key employees) with the business named as the beneficiary.
- **Property & Casualty Insurance**: Insurance to protect against losses to property and other tangible assets – types of coverage may vary depending upon the type of business engaged in.

\textsuperscript{13} In the event that adequate life insurance is not purchased, the beneficiaries of a deceased entrepreneur may find some relief in the application of sec. 303 and sec. 6166 of the Internal Revenue Code.

**Sec. 303 Redemption**: This section of the Code allows for distributions in redemption of a deceased shareholder’s stock to be treated as a capital transaction rather than as a dividend. This can eliminate much (if not all) of the tax that would normally be due upon redemption if the sec. 303 election was not available.

**Sec. 6166 Estate Tax Deferral**: This section of the Code allows for an extension of the period available to pay estate taxes. When utilized, payments can be deferred for up to five years and then undertaken in up to 10 equal installments.

Although both provisions can prove to be a valuable “fallback” planning tool, they do have certain restrictions. For example, both provisions generally require that an owner’s interest in his or her business exceed 35% of the value of the adjusted gross estate. Further, while sec. 6166 elections can be used for sole proprietorships, partnerships, LLCs or corporations, sec. 303 relief is only available for corporations.
Step 4

Review your trust and estate planning needs
There are specific opportunities that can be captured when the business owner coordinates his or her estate plan with the formation of the business.

Figure 12: Building a comprehensive plan adds value at all stages of the development of a business

<table>
<thead>
<tr>
<th>Time</th>
<th>Value of business</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Business owners who take the time to ensure coordination of their estate plans with the establishment of their businesses may potentially realize at least five tangible benefits:

- Lower estate tax burdens
- Lower gift tax burdens
- Greater wealth planning flexibility during the lifetime of the business
- Fewer barriers during the “exit” phase of the business
- Increased likelihood of achieving their familial, financial and professional goals
Q: How can the establishment of an estate plan reduce estate and gift tax burdens?

One of the greatest challenges that a business owner may face is how best to transition the wealth accumulated from his or her business to subsequent generations. In this context, a primary erosive force to familial wealth stems from the imposition of estate and gift taxes. This is due to the fact that as the value of a business grows within the hands of a business owner, so too does his or her exposure to estate and gift taxes. Fortunately, establishing an estate plan early in the life cycle of the business allows proactive businessmen and women the opportunity to sidestep many of these taxes by selectively and creatively redistributing ownership interests to family members at a time when valuation levels are minimal.

If properly undertaken (e.g., via the use of an appropriate trust and entity holding structure), the business owner can retain control of his or her company while still minimizing the frictions (both commercial and emotional) that can arise when exiting a business (either by transferring it to family members, selling it or proceeding via an initial public offering).

Consult with your Wealth Advisor and your Investment Representative: A Wealth Advisor can outline the range of planning options available and can then work in conjunction with the rest of the advisory team to ensure alignment and integration across all facets of the wealth management plan.

Preliminary trust and estate review: Key documents

Below we outline some of the basic estate planning documents that a business owner requires in order to engage in effective estate planning.

Figure 13: Verify your checklist of estate planning essentials

<table>
<thead>
<tr>
<th>Document Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic will</td>
<td>Outlines distribution of estate upon death</td>
</tr>
<tr>
<td>Revocable or living trust</td>
<td>Avoids the time-consuming probate process (upon death)</td>
</tr>
<tr>
<td>Durable power of attorney</td>
<td>Appoints an agent to act on your behalf (when necessary)</td>
</tr>
<tr>
<td>Healthcare proxy</td>
<td>Appoints an agent to make healthcare decisions on your behalf (when necessary)</td>
</tr>
<tr>
<td>Listing of financial records</td>
<td>Provides a clear listing of financial information to assist trustees (upon death)</td>
</tr>
<tr>
<td>Irrevocable life insurance trust (if life insurance is owned)</td>
<td>Removes insurance proceeds from your taxable estate</td>
</tr>
</tbody>
</table>
Q: What mechanisms should an entrepreneur consider for creditor protection purposes?

A key consideration for any entrepreneur stems from the desire to protect his or her assets from potential creditors. The illustration in Figure 14 outlines some of the more common asset protection approaches that such an individual may wish to consider, including:

**Retirement planning**

Retirement plans are often protected from creditor claims by either state or federal law.\(^{14}\)

**Exemption planning**

Various states provide protection for a limited amount of personal and real property (such as the liberal exemptions for a debtor’s real property (e.g., homes) in Florida and Texas).

**Insurance**

Some states permit insurance policy proceeds and cash values to be protected from seizure and to remain exempt from bankruptcy proceedings.

**Titling**

Several states offer creditor protection for married couples who hold property in the form of “tenancy by the entirety”.

**Entity structuring**

Certain entities (e.g., LLCs) offer protection for assets that are transferred to them by members (as they are legally characterized as the property of the LLC and therefore not subject to the creditor claims of individual members).\(^{15}\)

**Self-settled trusts**

In some instances, a business person may wish to create a trust for his or her benefit. If appropriately drafted, funded and supervised, such a vehicle can afford a degree of creditor protection.\(^{16}\)

**Gifting**

A popular method of creditor protection stems from the redistribution of wealth to children or loved ones in the form of a completed gift (thereby removing it from the reach of creditors).\(^{17}\)

**Other trusts**

Spendthrift trusts limit the ability to transfer the interest that a beneficiary has in the income or principal of a trust (other than what is provided by the trust’s terms). Discretionary trusts provide the trustee with absolute discretion to determine the timing and amount of income or principal distributions made to a beneficiary. (In general, property held within the trust cannot be seized by creditors until distributed to beneficiaries.)

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15. Business owners should, however, note the distinction courts have made in the protection offered by multi-member and single member LLCs.

16. This assumes that the transfer is not viewed as a fraudulent conveyance.

17. This assumes that the transfer is not viewed as a fraudulent conveyance.
Figure 14: Creditor protection mechanisms

- Trusts
- Entity structuring
- Gifting
- Exemption planning
- Title insurance
- Self-settled trusts
- Retirement planning

Business owner’s assets
Step 5

Consider “next steps”
Q: How should business owners orient themselves for the subsequent phases of their companies’ life cycles?

Entrepreneurs can normally embark upon the journey of successful wealth management by:

> Assembling an advisory team
> Selecting a business structure
> Determining insurance needs
> Reviewing trust and estate plans

Figure 15: Post-formation phase wealth planning

What is the next step in the strategic life cycle of business ownership?

Once business owners have successfully navigated the steps above during the “formation phase” of their business ventures’ life cycles, they should then prepare for the “growth phase” of their companies’ development. Throughout that period of time, other planning considerations will take on an increasing degree of strategic relevance.

These include:

> Planning for unforeseen events (e.g., divorce)
> Aligning business, personal and familial priorities
> Developing an integrated wealth management plan

Consult with your Investment Representative: For an introduction into the planning considerations discussed above, ask your Investment Representative(s) for a copy of the Barclays publication entitled Strategic wealth management for entrepreneurs and business owners (Volume 2: Growing a business).
“Well begun is half done.”

Aristotle
Conclusion

Focus and form
As Aristotle once noted, “Well begun is half done.” In this regard, the “formation phase” of a business enterprise provides entrepreneurs with a unique opportunity to optimize their strategic wealth structuring from the outset.

Of course, this is not to imply that the journey ends here. As any entrepreneur will attest, a company’s path from launch to exit can often be characterized as circuitous if not tumultuous.18 Despite this, the implementation of a coherent and logical wealth management plan can greatly augment an individual’s chances of maximizing the wealth-creation potential of any business enterprise.

Alignment and enlightenment
The guidance outlined in this document seeks to provide entrepreneurs and business owners with an enriched understanding of how best to address their wealth management needs holistically. We understand that few things are as inherently daunting as building a business. Even in the face of these challenges, however, there exist remarkable opportunities for those individuals who work in concert with their advisors to craft a plan of action that is strategically aligned with their particular needs, goals and circumstances.

We look forward to working with you as you establish your business.

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18. For insight regarding how many entrepreneurs react to these challenges, see Wealth Insights – If at First You Don’t Succeed . . . Mapping Global Attitudes to Adversity.
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