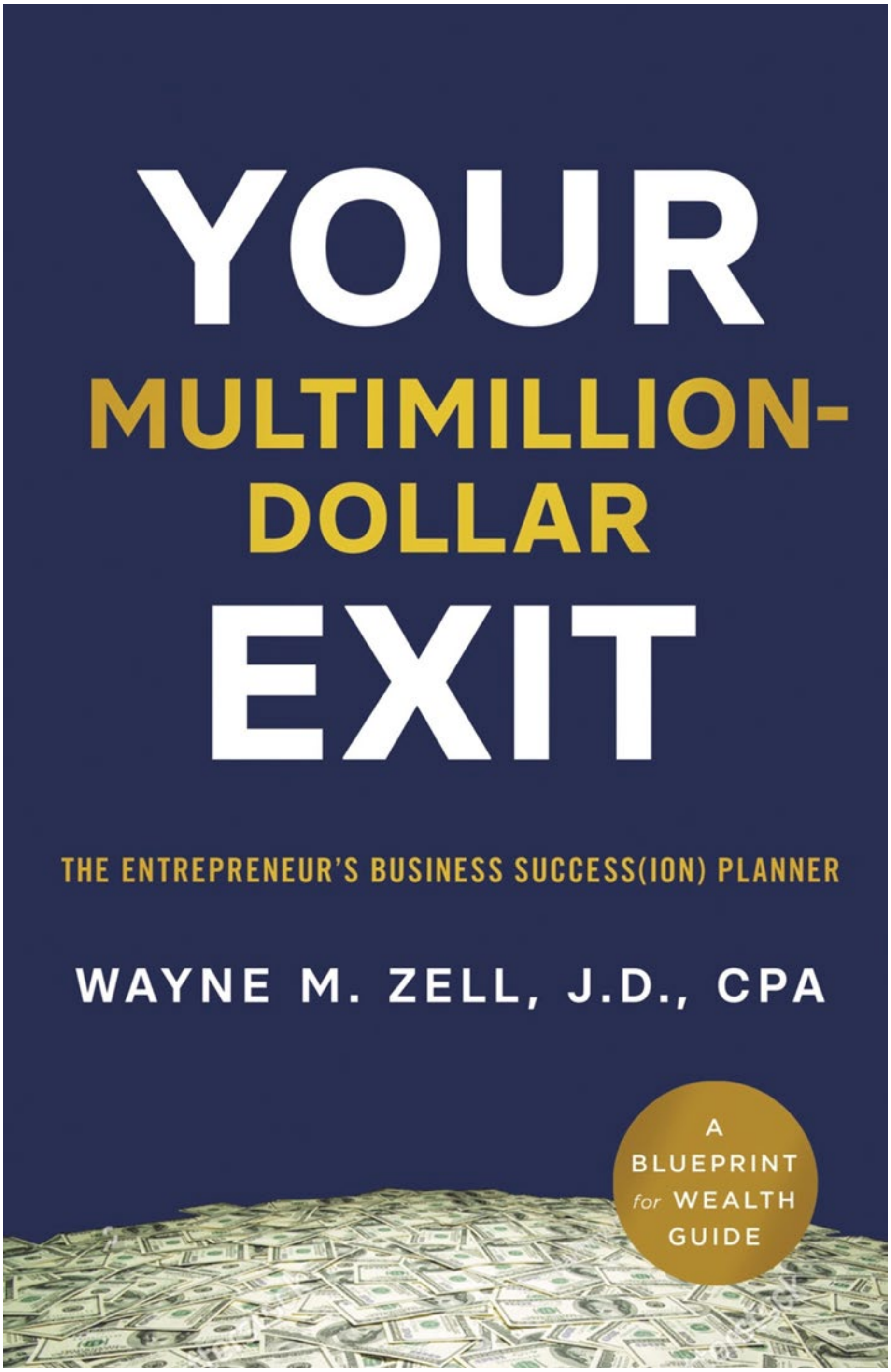
Glossary


YOUR
MULTIMILLION-
DOLLAR
EXIT
THE ENTREPRENEUR'S BUSINESS SUCCESS(ION) PLANNER
WAYNE M. ZELL, J.D., CPA
A
BLUEPRINT
for WEALTH
GUIDE

accounts receivable—Money owed to a business by its customers or debtors. A/R is reflected as a current asset on the accrual-basis balance sheet.

adjusted gross income—For federal income tax purposes, a taxpayer's adjusted gross income equals their gross income minus certain allowable deductions, including such items as educator expenses, student loan interest, healthcare insurance, and contributions to a retirement account.

advanced estate planning—Special estate planning techniques used for high-net-worth and ultra-high-net-worth individuals, some of which are described in Chapter 4.

appraisal and appraisal report—Valuation experts conduct appraisals to determine the value of a business or an asset and report their findings in a valuation or appraisal report. This is usually required to support a gift of an interest in a closely held business.

asset sale—A sale of a business's assets and selected liabilities that may be assumed by a buyer.

baby boomer—A person who was born between 1946 and 1964.

beneficiary—When referring to a trust, a person who is entitled to receive the benefits of the trust.

board of directors—The governing body with fiduciary responsibility for managing the affairs of a corporation for the benefit of the shareholders.

buy-sell agreement—An agreement among the shareholders of a corporation or owners of a business providing rules regarding the transfer or sale of stock or ownership interests, during life or upon death or disability.

C corporation—A corporation that is taxed under Subchapter C of the Internal Revenue Code and subjects the shareholders to double taxation on the earnings or sale of assets, followed by distribution of the proceeds or earnings.

capital gain—The difference between the amount realized and the income tax basis on the sale of a capital asset, such as stock or property.

Certified Financial Planner (CFP®)—An individual who is formally recognized as having expertise in the areas of financial planning, taxes, insurance, estate planning, and retirement. The designation is owned and awarded by the Certified Financial Planner Board of Standards, Inc. The CFP® designation is awarded to an individual who passes a rigorous exam and meets annual continuing education requirements.

certified public accountant (CPA)—A designation provided to licensed accounting professionals. The CPA license is provided by the Board of Accountancy for each state. The American Institute of Certified Public Accountants (AICPA) provides resources on obtaining the license. To gain the designation, individuals must pass a rigorous 4-part test and participate in continuing professional education.

Certified Valuation Analyst (CVA)—An individual with a specific certification from the National Association of Certified Valuators and Analysts (NACVA) trained to provide business evaluations.

charitable remainder trust (CRT)—A tax-exempt irrevocable trust designed to reduce an individual's taxable income and estate taxes by paying an annual annuity to the creator of the trust and leaving the remaining assets after a specified term to a charitable organization or organizations. It is subject to strict requirements imposed under the Internal Revenue Code. CRTs can be formed as charitable remainder unitrusts (CRUTs), which come in various structures, and charitable remainder annuity trusts (CRATs).

contingent note—Used in both sale transactions and gift planning, a promissory note whose principal adjusts based upon performance metrics specified in the note or a purchase agreement and is often used to cover earnout payments or indemnification obligations of a seller in a sale transaction.

cost of capital—The rate of return demanded by lenders and owners, consisting of the cost of debt and the cost of equity.

cost of debt—The rate of return demanded by lenders, typically based upon a business's commercial borrowing rate.

cost of equity—The rate of return demanded by an owner of a business, often determined using the capital asset pricing model.

disability—A physical or mental condition that limits a person's movements, senses, or activities and is usually defined under the terms of a contract or plan.

discount rate—The interest rate used to determine the present value of future cash flows in a discounted cash flow analysis.

discounted cash flow (DCF)—A valuation method that estimates the value of an investment or a business using its expected future cash flows, discounted back to the present using an appropriate discount rate.

due diligence—An investigation or a review performed to confirm facts or details of a matter under consideration. In a sale transaction, due diligence requires an examination of financial records, corporate books and records, contracts, and other items pertaining to the business before concluding a transaction with another party.

dynasty trust—An irrevocable trust designed to last for many generations and save estate and generation-skipping transfer tax.

earnout—A provision in a purchase agreement that may entitle a seller of a business to obtain additional purchase price consideration in the future if the business achieves certain financial goals, which are usually based upon achieving target revenues or profits.

EBITDA—Earnings before interest, taxes, depreciation, and amortization, usually determined in accordance with GAAP. A multiple of this measure serves as the basis for determining the value of most businesses in sale and M&A transactions.

employee stock ownership plan (ESOP)—A qualified employee benefit plan governed by ERISA and the Department of Labor that gives workers ownership in the company in the form of shares of stock and that provides significant tax benefits to the participants and the company that sponsors the plan.

Entrepreneurial Operating System®—An operating system designed to help entrepreneurs run their business as described in Traction by Gino Wickman.

equity-based incentives—Compensation incentives given to employees, managers, board members, and contractors that allow the recipient to participate in the growth in equity value of a business.

equity—Commonly referred to in the accounting sense as shareholders' equity (or owners' equity for privately held companies), it represents the amount of money that would be returned to a company's owners if all the assets were liquidated and all the company's debt was paid off in the case of liquidation. In the case of acquisition, it is the value of the proceeds received for a company minus any liabilities owed by the company not transferred with the sale.

ERISA—The Employee Retirement Income Security Act of 1974, as amended, which provides detailed rules governing qualified retirement plans and welfare benefit plans.

estate and gift tax—Transfer taxes imposed at the federal level (and in some states) at a rate of 40% on transfers of assets in excess of the allowable lifetime exemption, which is $12.06 million in 2022 and $12.92 million in 2023.

estate planning—The process of arranging who will manage your assets for your benefit if you become disabled and who will receive your assets when you die.

family office—A private wealth management advisory firm, often consisting of family members who have sold a business or inherited the proceeds from a business exit, that serves ultra-high-net-worth individuals.

fiduciary—A fiduciary is a person or an entity that acts on behalf of another person or persons, putting the beneficiaries' or clients' interests ahead of their own, with a duty to preserve assets for their benefit in good faith with legal duties of care, loyalty, and diligence.

generally accepted accounting principles (GAAP)—Financial accounting rules, standards, and procedures issued by the Financial Accounting Standards Board (FASB) in the United States and binding upon CPAs.

generation-skipping transfer tax (GSTT)—A separate federal transfer tax system imposed, in addition to estate and gift tax, on the transfer of property to a person other than a spouse who is 2 or more generations removed from the transferor.

goodwill and personal goodwill—An intangible asset that represents the portion of the purchase price in an acquisition that is higher than the sum of the net fair value of all the assets purchased and the liabilities assumed. Personal goodwill arises from the personal expertise or business relationships of an individual employee or shareholder and has value separate from the business.

grantor retained annuity trust (GRAT)—An irrevocable trust that receives assets from a grantor and pays an annual annuity to the grantor based upon the IRS's Section 7520 rate over a specified term (usually 2 to 10 years in duration). At the end of the term, any remaining assets are distributed to the trust beneficiaries or to a trust for the benefit of named individuals. It can achieve significant estate and gift tax savings when interest rates are low and assets in the GRAT are appreciating in value.

grantor trust—Either a revocable or irrevocable trust, the income of which is taxable to the grantor (i.e., creator) of the trust.

Great Recession—The economic downturn from 2007 to 2009 after the bursting of the US housing bubble and the global financial crisis.

gross income—For federal income tax purposes, gross income includes your wages, dividends, capital gains, business income, and retirement distributions, as well as other income.

Hart–Scott–Rodino Act (HSR Act)—Legislation that provides the Federal Trade Commission and the Department of Justice with information about large mergers and acquisitions before they occur.

Indication(s) of interest (IOI)—In the context of an acquisition, IOI refers to a buyer's nonbinding interest in buying a business, citing a range of potential values the buyer may be willing to pay for the business.

initial public offering (IPO)—The process of offering shares of a privately held corporation to the public in a new stock issuance for the first time.

intentionally defective grantor trust (IDGT)—An irrevocable grantor trust that taxes the income of the trust to the grantor but is designed to exclude the appreciation on the assets in the trust from the grantor's estate, thereby saving gift and estate taxes.

irrevocable trust—A trust that technically cannot be changed or revoked by the grantor unless it is amended or modified in accordance with the state law governing the trust (i.e., through a nonjudicial settlement agreement, through decanting, or with court approval.)

letter of intent (LOI)—A letter agreement that contains nonbinding provisions regarding the structure, pricing, and other relevant terms of an acquisition, and binding provisions that prohibit disclosure of the terms of the buyer's offer and grants the buyer a period of exclusivity to conduct due diligence before a definitive agreement is reached to purchase the seller's business.

leveraged buyout (LBO)—The acquisition of another company using a significant amount of borrowed money to pay for the acquired company or its assets.

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limited liability company (LLC)—A hybrid entity formed under state law that provides limited liability protection to its owners while providing flexibility in the way the entity may be taxed for federal or state income tax purposes.

liquidation value—The value of assets minus liabilities upon the winding up and dissolution of a company's business.

liquidation—Winding up and dissolution of a company's business.

management buyout (MBO)—A transaction where a company's management team purchases the assets and operations of the business they manage.

management succession plan (MSP)—A plan anticipating the shortterm and long-term management of a closely held business in the event of the death or disability of the primary business owner.

membership interest—The ownership interest in an LLC.

merger and acquisition (M&A)—A general term that describes the consolidation or reorganization of companies or assets through various types of financial transactions, including mergers, acquisitions, consolidations, tender offers, stock purchases, asset purchases, and management acquisitions.

net promoter scoreSM (NPS®)—A measurement of customer loyalty to a company based upon responses to a single survey question on a scale of –100 to 100, with 100 being the highest rating.

noncompetition agreement—Also referred to as a noncompete agreement, an agreement or contract not to interfere or compete with a former employer or buyer (by working with a competitor).

nondisclosure agreement (NDA)—An agreement not to disclose or use the confidential information or trade secrets of a disclosing party.

ordinary income—Income from earnings, interest, rents, royalties, and other sources that may be taxed at the highest tax rates under current federal income tax law, as distinguished from dividends and long-term capital gains that may be taxed at lower federal rates.

phantom stock/equity—A nonqualified deferred compensation plan or agreement that allows participants to receive net profits from operations or an M&A transaction.

private annuity—An agreement in which an individual transfers property to a person who must pay an annuity to the transferor based on an agreed-upon schedule in exchange for the property transfer.

private equity—An alternative investment class that invests in or acquires private companies that are not listed on a public stock exchange.

probate—A court-supervised process at the state level where a deceased person's assets pass by will or intestacy to designated beneficiaries or heirs.

profit or income—The difference between a company's revenues and expenses.

promissory note—A signed document containing a written promise to pay a stated sum to a specified person or the bearer of the note at a specified date or on demand.

recapitalization—A process for restructuring a company's debt and equity mixture by exchanging one form of financing for another, such as removing or adding preferred shares from the company's capital structure.

registered investment advisor (RIA)—A firm that advises clients on securities investments and may manage their investment portfolios. RIAs are registered with either the US Securities and Exchange Commission (SEC) and/or state securities administrators and have fiduciary obligations to their clients.

reorganization—Under Section 368 of the Internal Revenue Code, there are 7 types of reorganizations: (A) a statutory merger or consolidation; (B) an acquisition of one company's stock by another corporation, with the acquired company becoming a subsidiary of the acquiring corporation; (C) an acquisition where the acquired corporation must liquidate, with shareholders of the acquired corporation becoming shareholders in the acquiring corporation; (D) spin-offs or split-offs; (E) recapitalizations; (F) a change in identity, form, place, or organization ("F Reorganization"); and (G) a Chapter 11 asset transfer. These transactions can be tax-free if formalities are followed and cash is not exchanged in the transaction.

residency and domicile—A concept that defines where a taxpayer is required to report income and pay income tax or be subject to state estate or inheritance taxes.

revocable trust—A trust that can be revoked, amended, modified, or terminated at any time by the grantor. This is frequently used to avoid probate.

rollover equity—This results when a seller reinvests a portion of the proceeds from a sale into equity of the acquisition company that is formed to buy the seller's business.

rule against perpetuities—An arcane but still valid common law property rule that states that no interest in land is good unless it must vest if at all, not later than 21 years after some life in being at the creation of the interest. This rule has been modified by statute in many states.

S corporation—A corporation or LLC that elects to pass income, losses, deductions, and credits through to its shareholders/members for federal income tax purposes.

security interest—An enforceable legal claim or lien on collateral that has been pledged, usually to obtain a loan or secure obligations arising under a promissory note.

self-canceling installment note (SCIN)—An installment obligation in the form of a promissory note that is extinguished automatically on the death of the lender and is typically used in family estate planning situations.

small business set-aside—Contract reserved by the federal government and administered under rules established by the Small Business Administration, which limits competition to qualifying small businesses.

special purpose acquisition company (SPAC)—Also known as a "blank check company," a shell corporation listed on a stock exchange with the purpose of acquiring a private company, making it public without going through the traditional initial public offering process.

spousal lifetime access trust (SLAT)—An irrevocable trust for the benefit of the spouse of the grantor of the trust, with the intent of excluding appreciation on assets in the trust from estate and GSTT taxation of the grantor and the spouse.

stagflation—Persistent high inflation combined with high unemployment and stagnant demand in a country's economy.

SWOT analysis—A study undertaken by an organization to identify its internal strengths and weaknesses, as well as its external opportunities and threats.

trust—An arrangement whereby a person (a trustee) holds property as its legal title holder for the good of one or more beneficiaries.

trustee—An individual person or entity given control or powers of administration of property in trust with a legal obligation to administer it solely for the purposes specified.

value gaps—These occur when the amount of money an owner needs or wants from the sale of their business will not be matched by prospective buyers.