Legacy M&A Advisors LLC

M & A UPDATE®

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Disaster Planning in the Coming Year Part II

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Introduction

Last month, we went over the first part of disaster planning for your business. It is clear that the weather is more violent than what has been typically seen. This increase in severe weather means more damage to buildings and businesses as well. The loss of a business means a substantial loss for the owners and the community as well in terms of income, revenue, local vibrancy, and jobs. In short, businesses need a disaster plan. The basics are as follows:

1) Written Instruments and Communication

Along with any disaster plan, written instruments are a necessity. Reducing a plan to writing is a sure sign that the plan is being developed in a manner which is achievable.

Ready.gov provides a written form which your business can use to prepare and commit a plan to paper. Check signing authority in an alternative person is a must as well. If the key person is not available, there must be a back-up person.

2) Security

If you provide consumer goods such as groceries and other necessary supplies, security is a must. Over the past decades, whenever there is a natural disaster or riot, the first thing looted tends to be consumer goods stores. While it is illegal for the population to loot, police cannot always protect those businesses and prosecute the individuals responsible for the chaos. Reasonable measures must be taken in order to, if not defend the store; provide footage for law enforcement to catch the individuals responsible for the crimes there committed.

3) Finances

Without the proper finances in place, your business could be shut down. Modern day financing relies heavily on electronic mediums such as credit card readers and telecommunications. Bottom line, if there is no power, there is essentially no money. The solutions to the situation may not be easy.

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A CASE STUDY

"Interest Deduction"

A district court in Texas has held an estate may deduct interest on a loan from a Family Limited Partnership (FLP) used to pay the estate tax. The decedent, who wanted to protect family assets from former spouses and non-blood relatives, created an FLP. When the decedent died, her advisor's believed the FLP had not been completed yet and the estate paid $147.8 million in federal estate tax.

A year later the FLP was completed and funds loaned from the FLP to the estate and family trusts for the estate taxes. The court gave three reasons why the loan had economic substance, 1) liability was imposed on the family trusts in the event of default, 2) the applicable federal interest rate was used, and 3) millions of dollars of interest was paid to the FLP. The court also held the loan was necessary to preserve the liquidity of the estate.

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CoverStory

3) Finances (continued)

Two scenarios come to mind 1) either a back up generator or 2) A remote business location wherein company business can be conducted. A back up generator can be in the form of a portable generator or if you have the money and infrastructure to invest, you may be able to purchase and utilize a whole building back up.

Your employees will also need financial assistance during this time period as well. Two weeks of pay can ensure that employees 1) can pay their bills and endure, and 2) come back as they will be obligated to work for the pay advance you provided them with. This assurance is a good thing to have especially when key employees may be having second thoughts about returning after a large natural disaster.

Conclusion

Additionally a whole wealth of information is provided at ready.gov for individuals and businesses. Just remember that alongside the business, individuals must be taken care of as well. If the individual employees cannot endure their own personal situation, they will be unwilling to stay. Ready.gov provides insight for personal readiness as well and should be followed despite any situation

Conclusion (continued)

Every business should have a disaster plan in place in order to survive a natural disaster ranging from the smallest to devastating. People face challenges and businesses do as well. It is important that a natural disaster does not become a personal or business bankruptcy, where a continuation is possible and necessary.

LINK TO OUR WEBSITE

WWW.TAXPLANNING.COM

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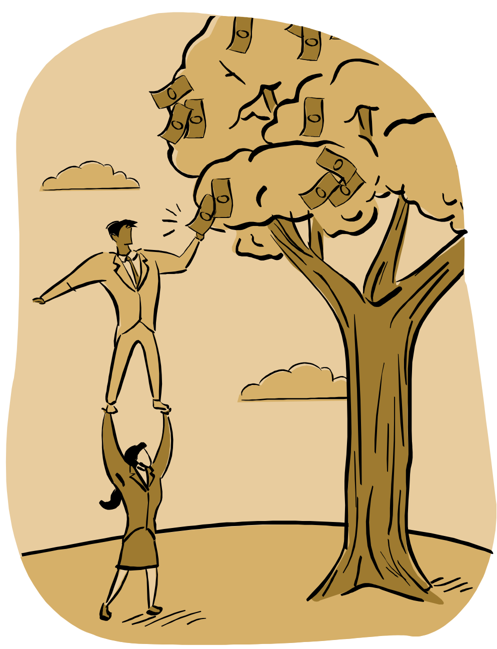
Points of Interest

- **It is clear that the weather is more violent than what has been typically seen.**
- **… The loss of a business means a substantial loss for the owners and the community as well in terms of income, revenue, local vibrancy, and jobs.**
- **. If the individual employees cannot endure their own personal situation, they will be unwilling to stay.**



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A CASE STUDY CONTINUED:

Editor's Comment: Unlike a previously reported case at around this time in the Tax Court, the taxpayer won and was able to deduct the interest on the loan. It is not uncommon in our judicial system to have different outcomes with cases that are similar. A slight difference in the facts of a case may turn one from a loser for the taxpayer to a winner. It should also be noted that the two cases were from different courts, a district court in Texas and the U.S. Tax Court. Different courts sometimes see facts and interpret the law in different ways.

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Segregating the Sale of the Business from the Sale of the Real Estate

If you lease the commercial real estate your business operates from, this might be a good time to re-negotiate a lower lease rate in exchange for a longer lease term. Also, consider negotiating several short options to renew your lease so that the total term equals or exceeds ten years. Most commercial lenders will cap the buyer's loan term at ten years, or the maximum remaining term of the lease. Having ten years to pay it off makes the monthly payment that much more affordable for the buyer.

If you own the real estate inside your business, this would be a good time to segregate the real estate into a separate entity still owned by you, and have the business pay fair market rent to the new entity. While this will lower the business' cash flow - and the business' selling price - it will substantially raise the combined value, since the current selling price multiple for $100,000 of business cash flow is ~2-5x, while the current multiple for the same amount of net operating income from real estate is ~10-12 times.

Separating the real estate and offering the business for sale with the option of either renting or acquiring the real estate at its current fair market value will also substantially increase the pool of buyers who might be interested in your business. Some buyers will be more interested in acquiring your business if the real estate can be acquired as well, while other buyers will be more interested in acquiring just the business and continuing to rent the real estate.

Continuing to rent the real estate under favorable terms to the buyer of your business can also be an excellent way to supplement your retirement income. As noted above, the current capitalization rate – or "cap" rate – on commercial real estate is in the range of 8% - 10%, which means that commercial real estate with a fair market value of $1M should yield $80,000 to $100,000 annually in net operating income to the owner; a far better return than can be realized from investing the after tax proceeds in a Certificate of Deposit, for example.

In the event you sell the real estate with the business, having the real estate in a separate entity facilitates your option to do a 1031 exchange for a like-kind, income producing property, thus deferring taxes and maximizing your near term retirement income.

If you know of someone who's thinking of selling or buying a business and who might benefit from a free, confidential, consultation, have them contact me directly at 813.299.7862, or mertel@lmaallc.com

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Frequently Asked Questions…

Q: In 2014, the new healthcare mandate will begin. How will this affect my business?

A: This is not a one size fits all answer. Some employers will be unaffected, while others will see substantial changes. Generally, those with over 50 full-time equivalent employees will have to address these concerns.

Q: What is a "full-time equivalent" (FTE) employee?

4: An FTE is the number of hours every person in the business works added together. This sum is divided by 2080. The resulting number reveals the number of FTE's and therefore whether the employer is considered a "large" employer or not.

Q: If I am a large employer, can I eliminate the need for employee healthcare by reducing everyone to 30 hours per week?

A: No, if an employer has over 50 FTE employees by calculation, the employer must generally provide healthcare for their employees at an affordable cost to the employee.