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Tax Concepts and the BP Gulf Disaster

Bart A. Basi, CPA/Attorney at Law

The Center for Financial, Legal & Tax Planning, Inc.

Introduction

We are all aware of the situation in the Gulf of Mexico. BP's "Deepwater Horizon" oil rig exploded and sank in late April, leaving on open well behind that has been a big challenge for everybody to handle. As a result of the environmental situation, many people living and conducting business on the Gulf Coast have lost their jobs and incomes. In response, the federal government and BP have embarked on measures to reimburse the victims and businesses. And of course, like any other time when there has been money exchanged, the IRS has shown up with its guidance.

Lost Wages

There are many people who have been put out of work over the Gulf oil spill. As such, many people are taking payments from BP to recover lost wages. The guidance issued by the IRS reminds the taxpayer that such wages are still taxable despite the disaster, just as the income would have been taxed had the spill not happened at all.

Lost Business Income

Fishermen, tourist resorts, hotels, retailers and other businesses on the Gulf Coast are taking a beating trying to endure the loss of tourism, fishing, and the loss of business. BP and the federal government are making payments for lost business income as well. Any payments made to the business must be reported as business income and reported on the applicable form per the entity requirements. Money received for lost income is still ordinary taxable income.

Payments for Lost or Damaged Property

Along with lost wages and profits, certain property damage has occurred. According to IRS guidance, any money received for damaged or lost property is subject to the tax rules that were in play previous to the oil spill. Specifically, money received for depreciable business property is not taxable to the extent of the adjusted basis in the property (meaning purchase value minus depreciation taken). Any money received beyond the adjusted basis is subject to tax as if the asset were sold.

A CASE STUDY

The Tax Court has disallowed a denial of fraud by a corporation. In the case, the corporation's president and sole shareholder was criminally convicted for willful failure to collect and pay employment and withholding taxes. The corporation wanted to claim that its temporary workers

were actually employees of its clients. However, the conviction of the president prevented the corporation from arguing the claim and denying fraudulent intent. As a result, the corporation was ordered to pay fraud penalties.

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If the taxpayer loses property to an “involuntary conversion” (meaning - destroyed, stolen, condemned or disposed of under the threat of condemnation) and the taxpayer receives money for the items replacement, the taxpayer can purchase another asset and delay the tax requirements until the new asset is sold. Remember, however, this only applies if the money received is used to purchase a replacement asset. Any excess money received is fully taxable.

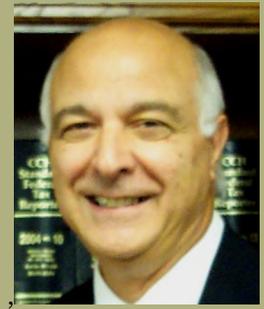
Casualty Losses

The rules on casualty losses remain the same as well. If a person receives money for property that has been lost or damaged as a result of the spill, taxpayers can claim casualty losses to the extent of loss suffered. The loss is determined by taking the adjusted value of the asset and subtracting any payments made by BP or other insurer for the event. For instance, if an asset with an adjusted basis of \$1,000,000 is damaged and a reimbursement of \$600,000 is settled upon, the taxpayer

could potentially claim a casualty loss of \$400,000, subject of course to the various other tax rules affecting the loss. Generally, fair market value must be determined by a qualified appraiser in order to substantiate such claim, if a challenge arises in the value and loss and something other than adjusted book value is used for the loss claimed.

Conclusion

While the payments from BP and the federal and state governments are payments that the victims deserve for their losses, the fact is that a lot of the payments made are still taxable as they would be had the spill not happened at all. It is advisable that when you or anyone you know is receiving payments from BP, a government or even if your payments are not related to the disaster, but are similar in nature, one must remember to pay the applicable taxes as required. Please call the professionals at The Center for all of your tax planning and business appraisal needs at (618) 997-3436.



Dr. Bart A. Basi is an attorney, CPA, and the Senior Advisor of The Center for Financial, Legal & Tax Planning, Inc, a full service company specializing in financial, legal & tax matters. Basi is a nationally recognized author, lecturer, and advisor on how to structure deals to minimize taxes. Tax structure makes the difference between getting the deal done and watching the deal fall apart. Many of you may be familiar with Basi and the topics he covers in the Financial, Legal & Tax Advisory which may be read in various industry-specific trade publications.

A CASE STUDY CONTINUED:

Editor’s Comment: This case is extremely important for all closely-held, private companies. Owners of such companies must realize the importance of collecting and paying employment and withholding taxes. Even if the court had not prevented the corporation from denying fraud, it still would have held the workers as common law employees or statutory employees. This would still have resulted in liability for the unpaid employment taxes. However, a fraud penalty may have been avoided. The penalty for fraudulent intent can be quite substantial making it beneficial for taxpayers to be honest and straightforward in their dealings with the IRS.



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Points of Interest

- Fishermen, tourist resorts, hotels, retailers and other businesses on the Gulf Coast are taking a beating trying to endure the loss of tourism, fishing, and the loss of business.
- The guidance issued by the IRS reminds the taxpayer that such wages are still taxable despite the disaster, just as the income would have been taxed had the spill not happened at all.
- While the payments from BP and the federal and state governments are payments that the victims deserve for their losses, the fact is that a lot of the payments made are still taxable as they would be had the spill not happened at all.



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What Is Your Game Plan for Retiring from Your Business?

Mike Ertel, CBI/ M&AMI/ CM&AA

In their book, *The \$10 Trillion Opportunity*, Richard Jackim and Peter Christman note that: "...Within the next 20 years, more than 90 million people in the US and Canada will be retiring. These are the "baby boomers," the generation born between 1946 and 1964...Baby boomers have been the most affluent and influential population group in the history of mankind, and now they're getting ready to retire.

Economist and demographic expert Robert Avery at Cornell University predicts baby boomers will transfer 10 trillion dollars to later generations -- the largest generational transfer of wealth in the history of humankind. The vast majority of this wealth is held as stock in more than 12 million privately owned businesses, and during the next 10 - 15 years, more than 70 percent of these companies are expected to change hands."

Yet, according to the authors, in spite of overwhelming evidence that exit planning is a vital part of business ownership, most business owners don't create an exit plan.

"Due to lack of good planning, only 30 percent of family-owned businesses survive through the second generation. A study of 300 former business owners who sold their companies within the last 12 months showed that 75 percent of the respondents felt the sale did not accomplish their personal or financial goals. These statistics suggest too few business owners are proactively planning for the inevitable exit process."

If you know of a business owner who's thinking of selling or buying a business and who might benefit from a free, confidential, consultation with us, have them contact me at mertel@legacyadvisorsgroup.com

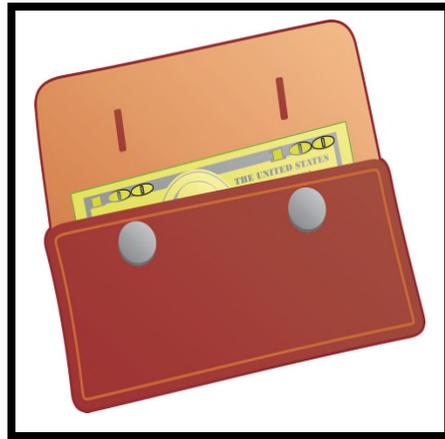
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Frequently Asked Questions...



Q: Recently I have heard that Congress and the Obama Administration have enacted a law (known as the HIRE Act) encouraging employers to hire unemployed workers. How does this new law work?

A: Employers hiring unemployed workers between Feb. 3, 2010, and before Jan. 1, 2011) generally qualify for a 6.2 percent payroll tax discount (on the employer's end). The employee's share must still be paid. The 6.2 percent share of Social Security tax and the employer and employee's shares of Medicare tax still apply to all wages.

Q: In addition to the HIRE Act, the Business Retention Credit has been enacted as well. Can you tell me about it?

A: The HIRE retention credit is claimed on the employer's income tax return for qualified employees, hired under the HIRE act for 52 consecutive weeks. Per definition, "The amount of the credit is the lesser of \$1000 or 6.2 percent of wages (as defined for income tax withholding purposes) paid by the employer to the retained qualified employee during the 52 consecutive week period."

Q: I have hired employees under the intention of utilizing the HIRE Act. If the employee takes unpaid sick leave, or vacation pay during the consecutive 52 weeks, does such employer-employee relationship still fall within the intent and usage of the HIRE Act?

A: Each case is fact specific; however, if the employee is retained for 52 weeks AND the total compensation for the last 26 weeks is equal to or greater than 80% of the first 26 weeks, said employee will still qualify for treatment.

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