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M & A UPDATE®

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Mike Ertel is a Certified M & A Advisor and a Principal Broker with Legacy Advisors Group, a full-service M & A Advisory firm with an office in Tampa, Florida specializing in representing sellers and buyers of small- to mid-sized companies. Prior to joining Legacy Advisors Group, Mike's business career spanned 30+ years with Fortune 500 and Fortune 1000 Companies, with senior management roles in Marketing, Operations and Logistics. Mike also served as President, COO of a mid-sized Manufacturing company headquartered in Tampa. Mike also holds a BS in Electrical Engineering and an MS in Industrial Administration, both from Purdue.

Looking Ahead to Alternative Paths for Business Succession

Bart A. Basi, CPA/Attorney at Law
The Center for Financial, Legal & Tax Planning, Inc.

Introduction

How are you going to end the relationship with your business? Believe it or not, that day will come. Fortunately, you have a number of options to plan your exit and watch your legacy continue. Four good, viable options exist to spin off your business. These options involve selling to family members, selling to a key employee, selling to a competitor, or selling to an investor. Business succession and exit planning are somewhat different in concept, but will be used synonymously for the purpose of this article. Though containing important differences, succession planning and exit planning will not necessarily be differentiated for this article.

Family Involvement

Family involvement is often the simplest form of business succession planning. Knowing your successor creates a level of trust. Because family members are often involved and familiar with a family business, they can be called upon to either take over or purchase the business. Rendering the business in one form or another to a family member is often emotionally fulfilling because the owner can see the business and its benefits on their own families. The transaction can generally be done through either sale or gift. However, selling the business to the next generation will eliminate many uncertainties that can occur with gifting.

Key Employees

Selling your business outside the family is an option as well. On the positive side, key employees know the business, employees, suppliers, and the customers. They may also know the company overall including bank accounts, the financial situation, the equipment the company owns, and for that matter where the files and keys are kept. The business essentially becomes their turn-key operation. However, problems do exist in business sales to key employees. First, some key employees make "great employees", but terrible bosses and business people. There is also the problem of financing. Many employees are not wealthy people. A lot of their wealth is in the form of retirement accounts and home ownership. With this financial structure, it is nearly

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A CASE STUDY

In a Tax Court decision, it was decided that an individual was not eligible for losses stemming from an S corporation because he declared bankruptcy. In the case at hand, the taxpayer filled bankruptcy near year-end. The taxpayer then attempted to claim the losses from the S corporation on his personal tax return. The taxpayer claimed the Internal Revenue Code permitted losses on a per diem/ pre share basis. The Tax Court considered this and stated that the Bankruptcy Code is considered first before the per diem / per share rule is applied. Thus the court ruled against the taxpayer.

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impossible for them to get the full financing to take on the challenges of an acquisition. This often means the seller must finance the acquisition for the key employee. The seller must lend credit to the key employee to finance the purchase. On the upside of this, the owner retains an interest in the business for which he can retake the business if the key employee/buyer defaults.

Investors

An investor, for many smaller businesses is hard to come by. Many investors are happy to invest money, but typically they are seeking companies established and operating similarly to a publically held company. Many or most smaller companies operate for the benefit of the owners' and their families making them a less attractive option for investors.

Competitors

There is a clear advantage to selling a business to a competitor. Competitors generally know your suppliers and even your own customers on some level. Competitors also tend to have cash and liquid assets allowing them to be solvent and pay for things like other companies. On the down side, selling your life's work to a competitor or getting your business back in the event of a default can be impossible once it is combined with another operation.

Conclusion

Being aware of the possibilities concerning what type of successor you will have for your business can give you a clear vision of what your transition could look like. Not all people have families. Also, not every business has key employees who could take over the business. With the four options discussed above in mind, the business owner can now begin to think about implementing a succession plan.

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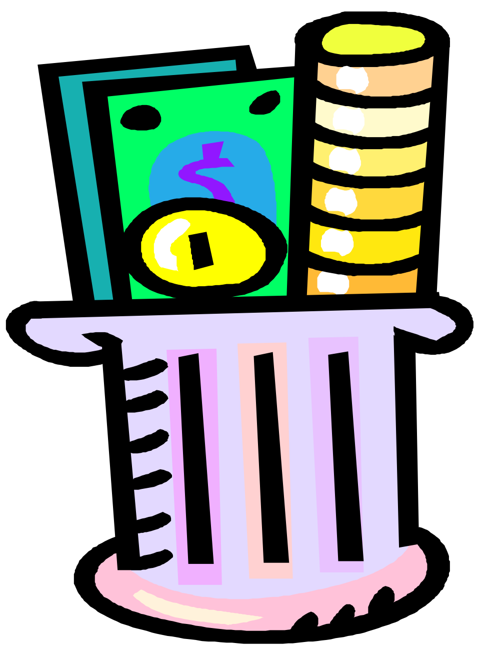
Dr. Bart A. Basi is an attorney, CPA, and the Senior Advisor of The Center for Financial, Legal & Tax Planning, Inc, a full service company specializing in financial, legal & tax matters. Basi is a nationally recognized author, lecturer, and advisor on how to structure deals to minimize taxes. Tax structure 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.

Points of Interest

- **Family involvement is often the simplest form of business succession planning. Knowing your successor creates a level of trust.**
- **. . . some key employees make "great employees", but terrible bosses and business people.**
- **Being aware of the possibilities concerning what type of successor you will have for your business can give you a clear vision of what your transition could look like.**



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A CASE STUDY CONTINUED:

Editor's Comment: Under the US Bankruptcy Code, the debtor's estate includes everything the debtor owns. Included in this are gains and losses from an S Corporation. The result in this case is somewhat harsh given that the taxpayer filed bankruptcy one month too early. Tax planning is key during bankruptcy cases. When dealing with sensitive tax situations, be sure that your bankruptcy attorney is well versed in taxes or another tax professional is employed to deal with the situation(s).

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Avoid the Major Pitfalls in Selling A Business – No. 1 – Not Allowing Sufficient Time

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

Selling a business is something that most business owners will only attempt once in their career. With an estimated 70% - 90% of their total net worth tied up in their business, they can't afford to make a costly mistake, but their success in running their own business generally doesn't prepare them to handle one of the largest and most crucial financial transaction in their life.

This is the first in a series of articles exploring some of the common pitfalls in selling a business.

Major Pitfall No. 1 -- Not Allowing Sufficient Time

Many sellers put off planning for the sale of their business until close to the time they want to retire/leave. Given the complexities involved, and the frequent need to continue working in the business for a time after the sale to insure a smooth transition, the time to start planning is typically 2-3 years in advance of the proposed sale, to get the best possible price & terms for the business.

During that time business operations can be tweaked to build up value and financial records can be put in order, not only to be accurate and up-to-date, but also to present the business in its best light. These steps will not only increase the value of the business, but will identify/remedy any potential problems that would otherwise be discovered in due diligence and potentially kill the sale or significantly reduce the purchase price & terms.

Another problem with not allowing sufficient time is that it puts the seller in a poor negotiating position. Waiting until health or other issues force the sale of a business inevitably lessens the amount of time the seller can wait for the right buyer and the right deal. Generally speaking, the less time the seller can afford to stay in the business, the more negotiating power the buyer will have over price & terms.

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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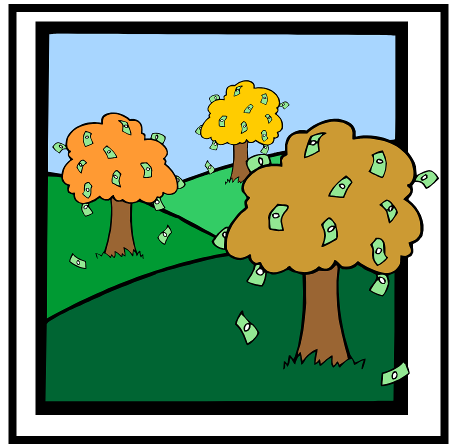

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Frequently Asked Questions…

Q: I am planning on buying a large piece of equipment, is there anyway I could deduct the cost of this equipment rapidly?

A: Yes. If the equipment is new, "bonus" depreciation can be taken against the asset. Additionally, regardless of whether the asset is brand new or not, section 179 depreciation also applies which generally allows a business to deduct up to $500,000 worth of depreciable expenses in 2011. The same rule applied in 2010.

Q: I am interested in having my business valued for a number of reasons. Is a valuation done for estate planning purposes effective for other purposes such as financing as well?

A: Generally, you would want to have your valuation reviewed or updated to reflect accurate value to a bank or when using the valuation for other purposes.

Q: I am selling my house. Does the primary residence exclusion still apply?

A: Absolutely. Under section 121 of the Internal Revenue Code home sellers can exclude up to $250,000 individually or up to $500,000 jointly on their tax returns.