Legacy M&A Advisors LLC

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The Qualified Longevity Annuity Contract

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

Introduction

Many people dream of the retirement that includes walking along the beach with a loved one, spending the nights in hotels, and eating dinners that include good food, wine, and candlelight. The reality can be that for some, at least for a while. On the other side of the coin, with people living well into their 80's, 90's and even the century mark, retirement funds run out eventually.

The good news is that people are living longer and enjoying retirement. Thousands of Baby-Boomers are entering retirement every day. Many retirements include budgets to travel, and spend rather lavishly. On the other hand, the bad news is that people are living longer and NOT enjoying retirement. Statistically, many people enter retirement with under $30,000 in assets and even if they begin retirement, cash heavy, if they live another 30 to 40 years, their assets are usually gone by that time.

The Issue with the Well Known Retirement Accounts

Unfortunately, the Internal Revenue Code itself contributes to the problem, even when people dutifully save. There are many qualified retirement plans out there for individuals including the 401k, IRAs and SEP's for instance that are set in place by the Code. The devices are useful in that they allow deductible contributions or non-taxable distributions in many different scenarios that individuals benefit from.

The problem with this is that along with the good, is the bad. A creature known as the Required Minimum Distribution (RMD) still exists. It is required once a person hits the age of 70 ½. The rule is generally that an individual MUST take an RMD or face tax consequence of 50% of the money required to be distributed in that year.

Continued on page 2

A CASE STUDY

Special Use Valuation

The IRS privately ruled that am extension of time should be granted in a farmland estate. In the scenario, the estate had an appointed executor who hired a professional to file the federal estate tax return. There was farmland involved; however, the estate did not make a Section 2032A special use election for the farmland. Once the successor executor took over the job, a second law firm was hired to handle the estate tax return.

The second firmed realized the omission and filed a supplemental estate tax return making an election for the special valuation for farmland. The IRS granted the request for extension, because the executor relied on professional advice that was reasonable, in good faith, and did not prejudice the interest of the government. The IRS did not comment on whether the election would be effective or not.

Continued on page 3

CoverStory

This, in the past, has led to many retirees taking the distributions well before they need the money. As we all know, once they money is out of the jar and into our pockets, it is much easier to spend. So too goes for retirees and unfortunately they run out of money with potentially decades in retirement to go.

The IRS's Response

In response to the issue, the IRS has come up with the Qualified Longevity Annuity Contract (otherwise known as the QLAC) through years of study and development. Many people tend to be upset with the IRS overall, but this is one thing they got right.

First a QLAC is an annuity contract that meets certain requirements and is purchased using funds from retirement accounts such as traditional IRAs, 403b plans, and eligible government plans. The advantage to the QLAC, compared to the IRA, is that Required Minimum Distributions (RMD) do not begin until the individual turns the age of 85. The maximum purchase price of the QLAC cannot exceed the lesser of $125,000 or 25% of the total assets of the retirement plan from which the assets are used to purchase the plan. The payments must be level and the must be in the form of a life annuity.

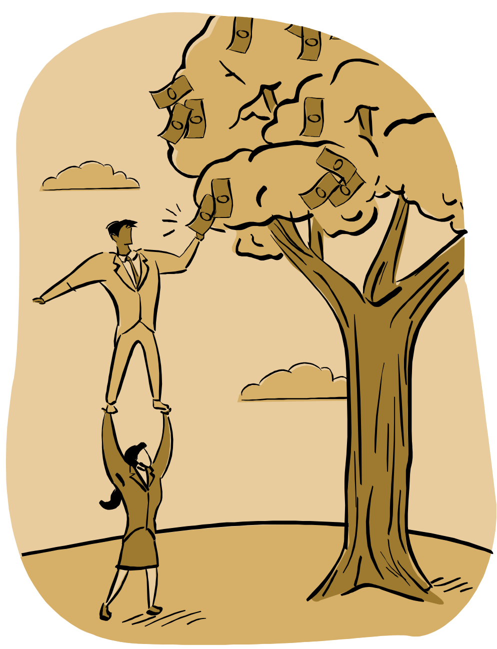
On the down side, there may be a small cash surrender value or no cash surrender value at all. For example, a 50 year old taxpayer purchases a QLAC and subsequently retires at the age of 65 planning on utilizing Social Security, an IRA, and this QLAC that he purchased 15 years ago. Upon walking out the door, on the last day at his job at 5:01 pm, he is hit by a bus and tragically dies of his injuries. While one tragedy is that he died, the other (much lesser of course) tragedy is that of his income. Not only will he lose most of his Social Security income, he will lose his QLAC as well.

Conclusion

When Congress enacted the legislation that begat the Individual Retirement Account and many other retirement plans, the average life expectancy was around 70 years of age. The fact is many retirees run out of money during retirement If you have any questions please call the professionals at The Center at (618) 997-3436.

Points of Interest

- **With Thousands of Baby-Boomers are entering retirement every day. Many retirements include budgets to travel, and spend rather lavishly.**
- **On the other hand, the bad news is that people are living longer and NOT enjoying retirement.**
- **It is required once a person hits the age of 70 ½.**
- **Many people tend to be upset with the IRS overall, but this is one thing they got right.**



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.

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A CASE STUDY CONTINUED:

Editor's Comment: This case is important because many farmers and their attorneys do not know about this part of the tax code. Section 2032A requires that if a special use valuation for farmland is made, then the heirs of the estate must agree to carry on the farm activity for ten years OR be subject to the estate tax that was due upon the due date of the estate tax return. In this case, the opportunity was passed up to get the special use value, but the estate was granted an extension of time in order to take the special use election.

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Will Your Business Be More Valuable Next Year?

For many business owners August is the time to take a vacation, as well as a time to reflect on this year's achievements and to set goals for the year ahead.

Most business owners will set goals to hit certain revenue or profit objectives. But if your goal is to own a more *valuable /saleable* business, consider adding one or more of the following goals:

- Get your Sellability Score. All goals start with a benchmark of where you're at today, and by understanding your company's Sellability Score, you can pinpoint how you're doing now and which areas of your business are dragging down your company's value. (Follow this link to the 13-minute survey: www.lmaallc.com/sellers)
- Companies that can perform well without their owner are more likely to get an offer to be acquired when compared to more owner-dependent businesses. So consider taking a two-week vacation without checking in with the office, to see how well the business performs without your daily intervention. When you return, you'll see how well your company performed and where you need to make a key hire, create a new system, or delegate more authority.
- Document at least one process per month. You know you need to document your key systems and procedures, but you may be overwhelmed by the task of taking what's inside your head and putting it down in writing for others to follow. Commit to documenting one system a month and within a year you'll own a more sellable company.
- If you're like most business owners, you're still your company's best salesperson, but this can be a liability in the eyes of an acquirer. By the time you sell, none of your key customers should think of you as their primary point of contact. Commit to offloading at least one customer relationship going into 2015.
- Check your contracts and make sure they would survive the change of ownership of your company. If not, talk to your lawyer about adding a line to your agreements that states the obligations of the contract "surviving" in the event of a change of ownership of your company.
- Find your lease (and any other key contracts). When it comes time to sell your company, a buyer will want to see your lease and understand your obligations to your landlord. Having your lease handy can save time and avoid any nasty surprises at the eleventh hour in the process of selling your company.

Instead of just building a bigger company, also consider making this the year you build a more *valuable /saleable* one.

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@lmaallc.com

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Frequently Asked Questions…

Q: Can the Section 179 expenses be carried forward into future years if all of the deduction cannot be used in the current year?

A: Yes, 179 expenses can be carried forward if enough income is not present to be used in the current year.

Q: I am a businessperson with accounts receivable owed to my business. If my clients do not pay their obligations, can I "write off" the amounts clients do not pay?

A: This depends on whether you are a cash basis or accrual basis taxpayer. If you are an accrual basis taxpayer, then yes, you may charge as an expense, the amount customers default on once it is certain they will default. If you are a cash basis taxpayer, then the receivable is not booked until money is received. It is therefore, not "written off", but merely never booked to start with. For these reasons, it is important that business not allow receivables to go much beyond the standard 10 or 30 day window in which they are due.

Q: My business is in arrears on its payments to creditors. What is my best course of action?

A: There is no one standard answer for this situation. With that said, generally it is best to not ignore the obligations in which you may be in default of. Calling the creditor, being forthright, and knowing your rights are tantamount to survival and recovery in the process. If a creditor does not know you're willing to work with them, they have no choice but to pursue other legal options against you.