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The Importance of Corporate Records

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

Introduction

Thousands of people own corporations for the purpose of conducting business while limiting liability. What many people don't realize is that the limited liability is effective only if certain requirements are met. One of the requirements to avoid losing the protection of limited liability, also known as piercing the corporate veil, is to hold meetings and keep accurate records. Failure to keep records does not mean certain failure in court or the IRS, but it is definitely a strike against you while defending yourself.

Definition and Requirements

Corporate records are documents prepared by a business to fulfill requirements imposed by law. Under the Model Business Corporation Act, a corporation shall keep as permanent records, minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation. Records must also be kept of resolutions creating all classes of stock, all written communications to

the shareholders, the most recent annual report, and names of shareholders. The form of the requirements require that the records be kept in written form or in a form that can be reduced to writing in a reasonable time and be made available to shareholders or the government, upon request.

Meetings can be held on a regular basis or a special meeting can be called. Regular meetings can have their notice requirement waived. Special meetings require notice generally and that must be shown in the corporate records. At a minimum, corporate meetings are required to be held once per year.

Discussion

After reviewing the above requirements, are your records up to par? If you've been in business for 12 years, can you count 12 sheets of paper in your records? If not, let me use an example to illustrate just how the lack of them can be used to cause you problems.

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A CASE STUDY

The IRS disallowed a taxpayer ordinary and necessary business expense deductions because the business was not actually operated in the year for which the expenses were claimed. The taxpayer indicated expenses were incurred in carrying on a software business.

However, there was no evidence of business activity during the year in question. As a result, the expenses were not allowed and the IRS imposed a negligence penalty on the taxpayer for his failure to keep adequate books and records to substantiate the claimed expenses.

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Oftentimes, business owners will use their own personal property for business use. Being that it is used for business, it is often indecipherable who owns the property. During a lawsuit to seize assets, any assets contained in the building can be presumed to be business property. In this case, unless the business owner has a corporate record of his personal property being authorized for use by the corporation, it is very likely that the property will be presumed to be that of the corporation and be subject to the lawsuit.

At other times, corporations will face lawsuits from the public. Corporate records will be seized under a subpoena power of the court. If the corporate records do not exist or have not been kept up, it is too late to produce them. The person suing at that point has another foot forward in proving that your corporation is merely an alter ego of the owner. Under this, a court can pierce the corporate veil to attach the owner's personal assets to satisfy claims against it.

IT IS IMPORTANT TO KEEP RECORDS. Granted you will not be legally bulletproof

with them, but without them you are a sitting duck.

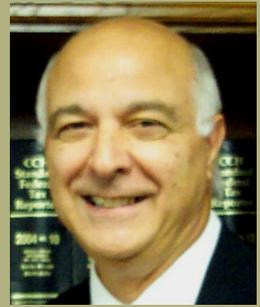
It is imperative to maintain your corporate records. If you have not kept records, there is hope for you yet.

Solution

There is no requirement or rule stating that records cannot be made for past events. Therefore records can be made of events that happened long ago, from memory.

However, records must be maintained in a particular format. Writing "had a meeting on 4/15/08 to discuss tax problem" is probably not sufficient. There is a near standard format used to show formality both of the record and of the meeting. The format should state the date, time, location, and actions taken at each meeting.

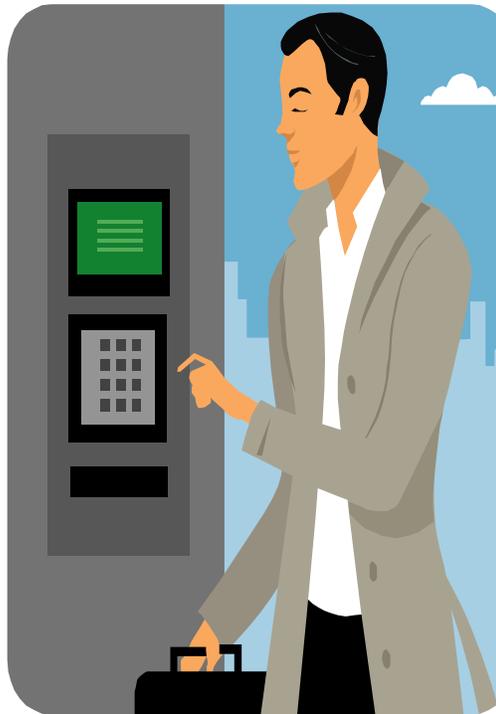
The Center handles records for numerous clients. If you would like The Center to help you with your records or maintain them, please give us a call. Remember, the law states that you should have corporate records and keep them current!



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 illustrates the importance of claiming legitimate business expenses and keeping adequate records in order to support such claimed expenses. It is always beneficial to have clear and orderly records available to provide to the IRS or the Tax Court when a dispute arises so as to not only avoid unfair tax liability, but also to avoid any penalties, which can prove very costly.



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Points of Interest

- **One of the requirements to avoid losing the protection of limited liability, also known as piercing the corporate veil, is to hold meetings and keep accurate records.**
- **Records must also be kept of resolutions creating all classes of stock, all written communications to the shareholders, the most recent annual report, and names of shareholders.**
- **IT IS IMPORTANT TO KEEP RECORDS. Granted you will not be legally bulletproof with them, but without them you are a sitting duck.**



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Making an Offer to Acquire a Business

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

Often when a serious buyer gets ready to make an offer to acquire a business, he/she begins to question just how low of an offer can they make and still succeed.

Certainly, every buyer is entitled to negotiate the best possible deal for themselves. And it is certainly true that many businesses sell below their initial Asking Price.

However, if you've determined that the Seller's Asking Price is in the range of fair market value based on an analysis of market comparables & sold comparables, and therefore is not unreasonably overpriced, let me suggest another way a serious buyer should look at this question.

In most cases you'll need the Seller's continuing cooperation after closing to teach you the business, or to retain his key customers, suppliers, and employees, or to use his license(s) to qualify the business until you can secure your own license(s);

In most cases -- and particularly in today's tight credit market -- you may not be able to make an all cash offer, and may instead require, or would at least appreciate, some Seller financing, and/or some earn-out component, and/or some mid-term employment/ consulting agreement with the Seller;

In most cases, you've probably thoroughly researched the market and concluded that this particular business is uniquely well suited to your needs & your future business plans, and no other competing business would fit quite as well;

Finally, once you've reached the point of making an offer, time is frequently of the essence in getting this deal closed and moving forward under your ownership;

IF ANY of the above conditions are met, then I'd recommend that you seriously consider making an offer at -- or very close to -- the Seller's Asking Price, and do your bargaining over more favorable terms.

I advise my clients that the PROCESS of acquiring a business bears many similarities to buying a home, with inspections and appraisals, and mortgage notes and closing documents; but the ACT of acquiring a business is much more like getting married, in that in most cases you need the whole-hearted support of the Seller to make this venture successful, and no expectant groom ever achieved that kind of success by bragging about how little he paid for the ring.

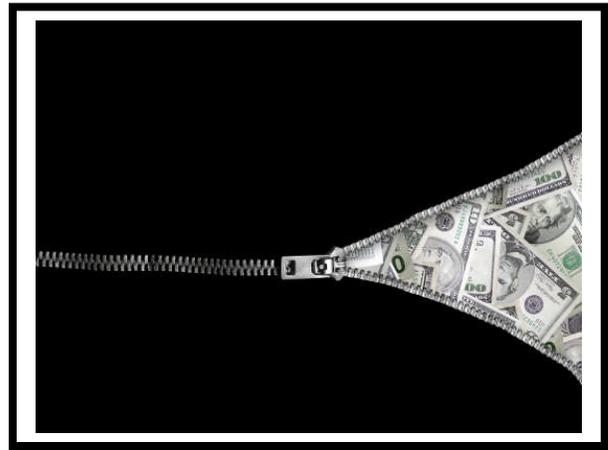
If you know of a business owner who's thinking of selling or buying a business and who might benefit from a free consultation with us, have them contact me, or any of the M&A professionals at www.bradwaygroup.com

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Frequently Asked Questions...



Q: I am operating a business. As of last year, the company had a loss or no income at all. Do I have to file a tax return this year?

A: It is absolutely best to file a tax return each and every year that a business is operating or existing. If a tax return is not filed, not only are red flags raised for audit, but also net operating losses can be lost if the tax returns are not timely filed. It is always in your interest to file a return no matter what the income or activity of a business is.

Q: I missed setting up estate planning last year. Can I still take advantage of 2008's gift tax exemption of \$12,000 this year?

A: No. Unfortunately, once a year lapses the gift tax exemption opportunity lapses along with it. Fortunately, the gift tax exemption increases to \$13,000 in 2009 and the estate tax exemption increases from \$2,000,000 to \$3,500,000.

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