Legacy Advisors Group

M&A UPDATE®

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Business People, Start the New Year Off Right!!

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Introduction

The beginning of the year is the best time to develop a strategy for your business. Too often, business people wait until the last week of the year to do their planning. While there are some actions that can be taken late in the year, those who work proactively throughout the year implementing business and tax strategies fare far better than those who put planning off to the last minute. There are plenty of areas and items of tax planning that should be attended to throughout the year.

Business Operations

Given that the economy is currently in a recession, businesses should trim unnecessary expenses and work hard to increase revenue. Most expenses that business people trim tend to involve payroll and inventory. Now might be the right time to cut back on the hours an employee works rather than to layoff employees. It is more efficient to have employees work fewer hours than to cut back on employees and lose the value of a good employee. In addition, rather than stop purchasing inventory, it may be best to purchase smaller amounts more often. This will decrease the cash outlay as well as the space and people needed to handle the inventory. The benefits to this concept of inventory control will be seen not just in dollars saved, but in efficiency increases as well. When business picks up, as it inevitably will, then will be the right time to increase hours worked by employees and increase inventories as necessary to deal with the increased business.

Investments

Instinctively, businesses tend to cut investments as well when business is slow. Ordinarily, this response to the business stimuli would be appropriate. However, given increased Internal Revenue Code section 179 expense deductions and manufacturer's incentives to purchase more investments like trucks, equipment, and even buildings, economic down turns tend to be excellent times to increase investments in business property, especially if the investments will create more efficiency in operations. The superior financing and tax incentives during

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A CASE STUDY

The Tax Court has held that business startup expenses were deductible under the Internal Revenue Code, even though such expenses were incurred before the operation became an active trade or business. In this case, the taxpayer began operating a horse boarding and training facility before the business was incorporated. As income increased, she established a limited liability company to operate the facility. However, this occurred six years later. The IRS argued that the taxpayer's initial expenses were startup expenses that should be capitalized, not deducted immediately. However, the Court found that even though the expenses paid were incurred in the pre-operating phase of the horse farm becoming an active trade or business, the expenses were still deductible under the Internal Revenue Code.

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C o v e r S t o r y

an economic down swing can and usually do outweigh any benefit through saving money by cutting back on needed investments. Further, think of it this way, if you do not reinvest now, you may have to reinvest later, when the tax and manufacturer's incentives are not as good as they are today.

Financing

The economic down turn has also brought with it lower financing rates. The financing on buildings and equipment may be eligible for lower refinancing rates. Check with your bank to see if your loans can be refinanced. The key is to work with your current financial institution, as changing financial institutions could result in high fees. Please check the fees and costs before committing to any refinancing.

Estate Planning

Many business people have complex estates. Along with the complexity, the average net worth of a business person is substantially higher than an employee. In 2011, barring action from Congress, the estate tax exemption falls from "unlimited" back to $1,000,000. One million dollars used to be a sizable estate; however, now with the changes in housing values, the potential increase in business value and other sources of worth, an average business person's estate may very easily be over the maximum amount of the current or future tax exclusion amount. It is best to begin estate planning early in a year so issues can be ironed out throughout the year and the estate plan can have time to operate during the year. Please review your total estate value and start the process of a complete estate planning process now.

Succession Planning

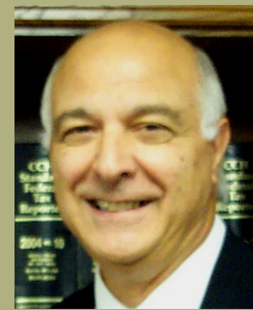
Along with estate planning, comes business succession planning for those who own businesses. Business succession planning is not as simple as drafting a will. Business succession planning, when done properly, provides a smooth transition for the succeeding generation. The process includes the valuation of the business and the creation of legal documents, such as a buy/sell agreement (the most important legal document a business owner can have.) When succession planning is not done or is done improperly, it usually means the loss of the business and therefore the loss of your lifetime of hard work. Don't procrastinate, start the process now!

Conclusion

Beyond the above subjects, there is plenty that can be done to improve your financial and tax situation throughout the year. Too often people approach financial, tax, and business planning as an after thought of running the operations of their business. Operating a business in this manner does not afford the business person an opportunity to see the bigger picture. Running a business without a plan to exit and retire is similar to driving a vehicle, yet having no destination. Proper planning and implementation of an exit, succession and tax strategy allows you to keep more of your hard earned cash and allows you to have a better retirement when the time comes. If you are not sure where to start or how to start, please contact the experts at the Center to assist you in your exit, succession and tax planning strategies.

A CASE STUDY CONTINUED:

Editor's Comment: This is a very taxpayer-friendly holding. Under the tax laws, an individual can deduct all ordinary and necessary expenses paid or incurred in the production or collection of income. In this case, the Tax Court reasoned that just because this income-producing activity eventually qualified as a trade or business because of the incorporation, that fact only did not mean that the expenses were not deductible. The expenses were incurred and the operations were in effect part of the incorporation.



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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Points of Interest

- **The beginning of the year is the best time to develop a strategy for your business.**
- **Given that the economy is currently in a recession, businesses should trim unnecessary expenses and work hard to increase revenue. Most expenses that business people trim tend to involve payroll and inventory.**
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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 consultation with us, have them contact me in <u>strictest</u> <u>confidence</u> at mikeertel@legacyadvisorsgroup.com

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Frequently Asked Questions…

Q: I am considering making a major capital investment this year. The liberal amounts allowed under Section 179 and Bonus Depreciation have expired as of December 31, 2008. What are or will be the new Bonus Depreciation and Section 179 expensing amounts for 2009?

A: According to many outlets, Congress and the Office of the President are working on the first of multiple stimulus packages. This should include new amounts for Section 179 expensing and Bonus Depreciation. As of yet, Section 179 expense is limited to $133,000 for 2009. For 2010, the deduction will be inflation adjusted; however, in 2011, the deduction drops back to Pre-Bush Tax Policy - $25,000. Barring any further action from Congress and the President, the amount will stay at that level, as it is not inflation adjusted.

Q: I am in business and have been for 10 years. Recently I have noticed that payments from clients to my company have slowed considerably and I am experiencing defaults. Currently I am on the accrual method of accounting and I am recording revenue that I am not receiving and paying taxes accordingly. Is there some other method of accounting which I could use that would not show revenue that is not received?

A: In hard times, often clients and customers will slow down payments or default all together. The result is a tax liability on revenue that is not received. One way to combat the problem is to switch to cash accounting. Under this method, revenue is booked when received, not when all events have been satisfied to receive the revenue, resulting in a more appropriate tax liability.