M & A UPDATE®

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The Hiring Incentives to Restore Employment (HIRE) Act

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Introduction

As of May 7, 2010, our nation's unemployment rate remained at 9.9%. Economists have predicted that it will remain high for months and possibly the next couple of years to come. With 8.5 million jobs having been eliminated in the past few years, returning to a normal state of unemployment will be quite challenging for businesses, people and the government to achieve. Recently, we did receive some good news in that the last quarter resulted in a drop in unemployment claims and 240,000 new jobs. In addition, the federal government is hard at work to try to change the tide in unemployment. Along with healthcare reforms passed, Congress has enacted The Hiring Incentives to Restore Employment (HIRE) Act in an attempt to alleviate unemployment. While it is much lesser known than the Patient Protection and Affordable Health Care Reconciliation Act that was hotly contested and publicized, this Act is also extremely important and has great benefits for employers.

Exemption

HIRE was enacted on March 18, 2010 and contains two major provisions: 1) an exemption from the Old Age Survivor's and Disability Tax, and 2) a credit under the General Business Tax Credit for employees retained for 52 weeks and longer.

As mentioned, the first major provision of the Act pertains to hiring unemployed workers. According to the IRS website, employers, who hire qualifying employees, will be excused from paying that employer's share of Old Age Survivor's and Disability Insurance (OASDI) taxes on employees hired February 3, 2010 to December 31, 2010. However, the actual exemption period applies to the wages paid to the qualified employee after March 18, 2010 until December 31, 2010. Medicare amounts and other withholding taxes (including state and federal income taxes and the employee's share of OASDI) must still be withheld and paid. Future Social Security benefits will not be affected by this exemption for the employee. Under the second part of the Act, focusing on employee retention, if the qualified employee

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A CASE STUDY

In a Letter Ruling, the IRS held that a second marriage and blended family qualify as an unforeseen circumstance for partial home sale exclusion. In the request, the two families had five children between them and the necessity arose that the family obtain a bigger dwelling to accommodate all of the children. One of the spouses owned the home for less than the required two years. The IRS determined that the larger family was an unforeseen circumstance necessitating a partial exclusion.

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is employed by the employer for a time span of 52 weeks or longer, there is an additional credit of $1,000 that applies for the employer under the General Business Tax Credit.

Qualified Employee

To be a qualified employee, the person must not have worked more than 40 hours total in the past consecutive 60 days prior to being hired. If the employee has worked so much as 40 hours and one minute in the past consecutive 60 days before being hired, that employee is ineligible.

Application

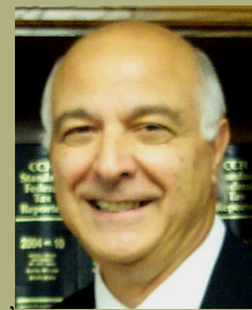
Additionally, a qualified employee must either sign an affidavit form W-11 or an affidavit containing the same information. The employee signs this form under penalty of perjury. Quite simply, it is an affidavit stating, "I certify that I have been unemployed or have not worked for anyone for more than 40 hours during the 60 day period ending on the date I began employment with this employer." It is not filled with the IRS, but must be retained as a record in case the IRS wishes to review the employer's compliance. If the record form is not present, the employer can face the loss of the exemption plus interest plus penalties. It is strongly recommended that all employees hired after February of this year be required to complete the form.

Section 179 Expensing

Contained within the HIRE Act, section 179 expensing has been extended one additional year through 2010. As such, for the tax year beginning in 2010, the dollar limitation is, once again, $250,000 on qualifying investments which includes most depreciable business property, including equipment, machines, etc. The investment limitation is still $800,000 and the deduction is reduced dollar-for-dollar for every dollar over $800,000 until the $1,050,000 is reached, where the deduction is completely phased out.

Conclusion

The government is doing exactly what it should be doing in order to fix the job market and drive employment back down to a more normal rate of between 5% and 5.5%. Cutting taxes and focusing on stimulus spending will achieve that result. Because of the actions taken, it is an exciting time to be in business. Taxes are low, finance rates are low, the estate tax laws are due to be changed and with the section 179 and employment credits, businesses should begin to hire back employees. As such, business succession and its planning should be actively engaged in today if you are in business and have not already done so.



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A CASE STUDY CONTINUED:

Editor's Comment: Each year, the IRS has seemed to substantially soften its stance on what is foreseen and what is not foreseen. Traditionally, the IRS would not accept a situation where two adults who were making plans to do something as unforeseen. However, with this softening, it may be indicative of where the IRS is willing to draw the new line on what is acceptable. When taxpayers plan to sell a home, they are best advised to wait until the two year requirement is complete and obtain a complete exclusion. If the two year requirement is met, no explanation of circumstances is necessary and the taxpayer simply takes the exclusion by writing "Code Section 121, Homesale Exclusion" on their schedule D.

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Points of Interest

- **With 8.5 million jobs having been eliminated in the past few years, returning to a normal state of unemployment will be quite challenging.**
- **According to the IRS website, employers who hire qualifying employees will be excused from paying that employer's share of Old Age Survivor's and Disability Insurance (OASDI) taxes on employees hired February 3, 2010 to December 31, 2010.**
- **Contained within the HIRE Act, section 179 expensing has been extended one additional year through 2010.**

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HOW IS GOODWILL DETERMINED IN VALUING A BUSINESS?

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

In the real world of buying and selling businesses, some businesses have a very large component of goodwill, while others have little or none. The concept of goodwill is confusing to most business owners, and many hold serious misconceptions about how goodwill comes into play in valuing their business. If fact, many business owners believe that goodwill is somehow calculated from the years they've been in business, the cumulative effect of all their advertising, their long-term customer relationships, etc., which is then added to the value of all their tangible assets to arrive at the total value of their business.

Let's begin by reviewing two fundamental principles of business valuation. The first principle is that the fair market value of any ongoing business is fundamentally driven by the expected value of its future cash flows. This is what the buyer is willing to pay money for, i.e., the right to own the business' cash flow into the future. This may seem odd – or even counterintuitive – since so much time and attention is invested in gathering and analyzing historic cash flows. It may appear to the business owner that the value of his/her business is being determined by its past cash flows, but in reality, analyzing the recent past is perhaps the best ways to truly understand the proven, cash flow generating capacity of the business, and its predictability, volatility, and cyclicality, as well as the likelihood that it will continue into the foreseeable future.

The second fundamental principle of business valuation is that the minimum value of any ongoing business – even one that is currently losing money -- is at the fair market value of its tangible assets. Even if the owner decides to close the business, he/she should be able to collect the current accounts receivable and sell the inventory, equipment and other tangible assets at their current market value, depending upon how quickly it must be liquidated.

Goodwill is the accounting term given to the excess value of a business' future cash flow over the value of its tangible assets. Consequently, businesses which are losing money, or only marginally profitable, may only be worth the market value of their tangible assets, and have zero goodwill. In contrast, businesses that are profitable and earning a good to excellent return on their invested assets, will likely be worth much more than the fair market value of their tangible assets, and thus have very substantial goodwill.

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: I am planning on financing my child's education for college. Are there any good strategies to follow when saving for college expenses?

A: There are a number of good avenues to follow when planning your child's education financing. First, most states have some form of a 529 College Saving Plan. The main feature of these is that contributions made to the 529 Plan grow tax free until the child goes to college. At that time, the money is discharged tax free to pay tuition and other necessary expenses. Another unconventional approach to financing college is the Roth IRA. As you know, Roth contributions are not deductible when contributed, but are tax free when taken out, somewhat synonymous with the 529 plans. However, the main advantage to the Roth, as opposed to using a 529 plan for education is that the holder of a Roth has more liberty as what to do with the funds. The holder could use the funds contributed for education or retirement, depending on the circumstances.

Q: My portfolio has diminished in value in the month of May. If I decide to take a loss, is there any limit as to how much I can deduct against my taxable income?

A: First, losses taken from selling depreciated stock is what is known as "a capital loss." Second capital losses are directly deductible against any capital gains you might have had, such as any sale of stock taken at any time during the year. Last, any excess capital losses can be deducted against ordinary income at a rate of $3000 a year until the loss is used in its entirety.

Q: Recently, one of my clients applied for credit. Upon receiving his credit report, it was noted that the client had filed for Chapter 11 bankruptcy protection. Given the client has previously filed bankruptcy, is it now safe to extend this client credit?

A: No. A Chapter 11 bankruptcy is a reorganization of debt. And while the client is standing on better financial ground than what they were, there is no guarantee that the subsequently created debts will be paid. Further, if things get bad enough for the client, they can elect a Chapter 7 bankruptcy and possibly discharge all of their debts, including yours.