Legacy M&A ADVISORS LLC

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Mike Ertel is a Certified M & A Advisor and a Principal Broker with Legacy M&A Advisors, LLC, 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 M&A Advisors, LLC, 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.

Who Wants My Business?

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

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 impossible for them to get the full financing to take on the challenges of an acquisition.

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A CASE STUDY

Valuations Include Everything

Recently the Tax Court ruled that vacation and sick pay are compensation items to be included as income tax when paid to a taxpayer.

In the facts, the taxpayer was a police officer on a city police force for 30 years. Unfortunately, he was badly injured and had to end his tenure with the department. Over the course of his career he accumulated 541 hours of unused vacation time and 800 hours of unused sick time. Initially after his injury he went on workers' compensation.

When filing the income tax return for the appropriate year, the taxpayer purposefully excluded the worker compensation, vacation, and sick pay from the return. The IRS contended that the sick and vacation time was improperly excluded. The taxpayer used verbatim law from the Workers' Compensation Act to justify his claim.

The Court ruled that the IRS was correct because the definition of income "as compensation for personal injury and sickness" did not include vacation and sick pay that is from the employer (covered under the Internal Revenue Code), The exclusion applies only to a narrow set of direct payments.

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C o v e r S t o r y

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.

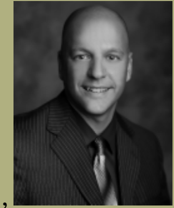
Investors
An investor, for many smaller businesses is hard to come. Many investors are happy to invest money, but typically they are seeking companies established and operating similarly to a publically held company. Many or most smaller companies operate for the benefit of the owners' and their families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

I would also like to point out that there is yet another option that Mike Ertel has written about over the course of the last six issues of this M&A Update. It is the Employee Stock Option Plan, better known as **the ESOP**. An ESOP is a relatively complicated arrangement for a company to make. However, the benefits can be substantial for the person wanting to exit a business and employees wanting to fully participate in the company's success.

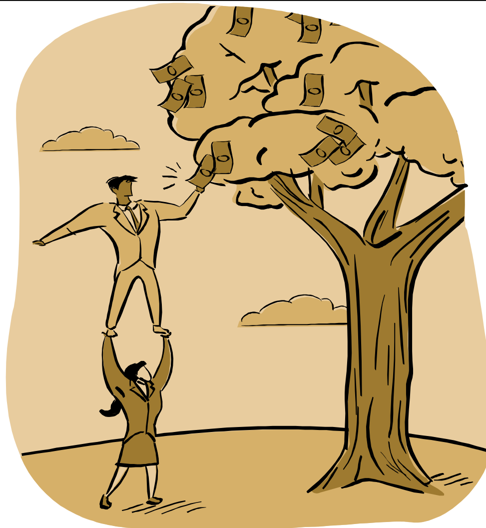


About the author:

Roman A. Basi, President of The Center, is an Attorney, Real Estate Broker, and Title Insurance Agent. Roman speaks and advises The Center's clientele on such matters as Business Law, Succession, Estate & Tax Planning and Real Estate.

Points of Interest

- **Family involvement is often the simplest form of business succession planning. Knowing your successor creates a level of trust.**
- **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.**
- **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:

Editorial Comments:

I've included because I find this to be daring on behalf of the taxpayer. The case even had merit! The Worker Compensation Act specifically "…provides that the exclusion includes amounts received under a statute in the nature of the Workers' Compensation Act".

One reason the taxpayer was denied this exclusion was because the state statute did not provide for this exclusion. Had it, the outcome would have been different. This is what I would like to take away from this case: State law does have an effect on the way you pay federal income taxes.

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Ten ESOP Fables – Debunked – Part VI

This is the sixth – and last - in a series of articles that will attempt to dispel ten common misconceptions, or fables, about ESOPs.

ESOP Fable #10: An ESOP will remedy all of my company's problems.

While the Employee Stock Ownership Plan is a powerful financing vehicle, it is not a panacea. If your company has fundamental financial, organizational, or operational problems, an ESOP may not be appropriate. ESOPs work best in healthy companies or in companies demonstrating potential for future success.

Likewise, installing an ESOP in a healthy company does not ensure improved performance. In order to realize the greatest performance improvement from an ESOP, the employees must be educated about the benefits offered; and this education process must be reinforced regularly. Otherwise, skeptical employees will consider the plan as just another management scheme.

The Employee Stock Ownership Plan has become one of the most powerful vehicles of corporate finance available to owners of privately held businesses. Accordingly, its success can be measured by the rapid growth in the number of plans established, from less than 200 in 1974, to more than 6,900 today. By dispelling some of the most commonly held ESOP misconceptions, and by studying the opportunities offered by such plans, business owners may find that creating an ESOP offers some significant advantages over selling a business to a third party.

If you would like to receive a copy of the complete white paper with all ten ESOP fables, please contact me directly.

*As ever, 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 directly.*

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Frequently Asked Questions…

Q. I purchased stock from my employer under a § 423 employee stock purchase plan and received a Form 1099-B for selling it. How do I report this?

A. Under a § 423 employee stock option plan, you have taxable income or a deductible loss when you sell the stock. Your income or loss is the difference between the amount you paid for the stock (the option price) and the amount you receive when you sell it. You generally treat this amount as capital gain or loss, but you may also have ordinary income to report.

Q: I would like to set up a Subchapter S Corporation. How do I do this?

A: You must first file articles of incorporation with your respective state. Once this is done, IRS Form 2553 must be filled out to make the Subchapter S election.

Q: Where is the best place to store estate plan documents?

A: The best place to store estate plan documents is in a secure location that others know of and that is easily accessible. Storing the documents in a safe deposit box that a friend knows of can be a good place as long as that friend knows where to get the keys. Hiding documents in a book or in a safe that no one has the combination for renders the documents useless to both you and those that are trying to help you.

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