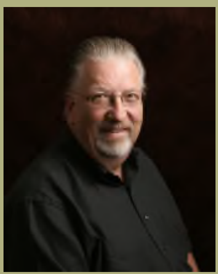
Legacy M&A ADVISORS LLC

M&A UPDATE®

October 2015 Volume 10, Issue 10



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.

Reducing the Value of Your Business with a Valuation Discount

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

Introduction:

When businesses are valued, the owner desires the highest value possible for the business. After all, it is human nature to desire the most wealth possible. Many times, valuations are prepared to determine what price potential exists if the business is sold. Even when a divorcee is trying to obtain an amount for a spouse's business during a divorce proceeding, a valuation will be completed with a goal toward the highest value possible. Other situations exist where the client aims for a low value; such situations include estate planning, divorce when the client will be paying out a sum, and when a potential buyer desires to purchase a business.

Legitimate devices exist to reduce the value of a business when appropriate. Discounts determined for lack of control and lack of marketability are legitimate and even common in valuations. In addition, discounts taken for a built-in gains tax potential are becoming increasingly common as more case law develops.

The Three Key Discounts

1. People generally prefer to have controlling power as opposed to being controlled. The lack of control discount or minority ownership discount in closely held and small companies is given to reflect the detrimental effect of not having control of a business. While a minority interest in a publically traded company is not subject to a lack of control discount, in small companies, lack of control means the minority owner is subject to the whim of majority shareholders. Such detrimental decisions to minority shareholders can include: determination of management compensation, declaration of dividends and disbursements, setting the course of the business, and decisions to liquidate or sell business interests. Lack of control discounts can range from 35 to 50 percent, and even higher in some cases when compared to publically traded stocks. Readers should be aware that the state of Florida has recently passed a law making the minority discount illegal whenever a company that has ten or fewer owners is valued.

Continued on page 2

A CASE STUDY

Timely Delivery

The IRS published a proposed regulation to clarify Code Section 199, the Domestic Production Activities Deduction. Manufactured, produced, grown, or extracted (MPGE) includes that plus installing, developing, improving, and creating Qualified Production Property. It also includes making QPP out of scrap, salvage, or junk by processing manipulating, or refining or changing the form of an article or by combining, assembling two or more articles.

This activity includes cultivating soil, raising livestock, fishing, and mining materials.

The IRS also clarified regulations for construction. In order for this deduction to apply, they must be construction activities that are more than the mere approval and authorization of payments. Taxpayers with oil related activities (desiring this deduction) does not include transportation or distribution of oil.

Continued page 3

The Center for Financial, Legal & Tax Planning, Inc.

Cover Story

2. The lack of marketability discount applies to many small businesses as well. Owners prefer to have assets that are more liquid as opposed to less liquid. It is with this preference that those businesses that can be bought and sold quickly are worth more. Businesses that are hard to liquidate or are generally unmarketable are worth less than publicly traded companies. Because of this lack of marketability, certain businesses are given a discount to reflect the detriment of the ability to sell the company. Lack of marketability discounts can range in the area of 20 to 50 percent when compared to their publically traded counterparts.

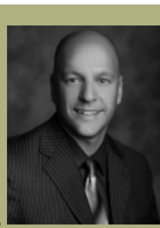
3. As of late, discounts for built-in gains tax are gaining more and more support. When C corporations are converted from taxable entities into flow through entities such as S corporations, LLC's and the like, the potential for a tax liability known as "built-in gains" appears. Because of this potential, the company must plan and maneuver carefully around built-in gains issues. Nonetheless, from time to time, decisions are made on business bases that demand that built-in gains be recognized and taxes become due to the government. Many businesses, including businesses with deceased owners, run the risk of paying built-in gains tax. As such, taxpayers have successfully argued that such potential liability can be deducted from the value of a business under the theory that an investor, similarly situated, could purchase similar securities in a business without the built-in gains tax potential. This is because investors can invest elsewhere in order to avoid tax losses, theoretically, that the company with the built-in gain tax event potential is worth less than a company that does not have potential for a huge tax loss.

Conclusion:

Some confusion results between the two types of discounts noted above when analysts arrive at discounts for control and marketability. Minority ownership interest discounts relate to the control the subject has in relation to the business. Marketability, on the other hand, deals with the potential to liquidate the company and how quickly and easily the company can be reduced to cash.
Discounts based on control and marketability have been around since the beginning of valuations. The built-in gains tax liability discount is new, and it has major estate tax implications as well as gift tax consequences then other discounts. Knowledge and use of the built-in gain discount is critical for valuations.

Points of Interest

- **...situations exist where the client aims for a low value; such situations include estate planning, divorce when the client will be paying out a sum, and when a potential buyer desires to purchase a business.**
- **Legitimate devices exist to reduce the value of a business when appropriate.**
- **As of late, discounts for built-in gains tax are gaining more and more support.**



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.

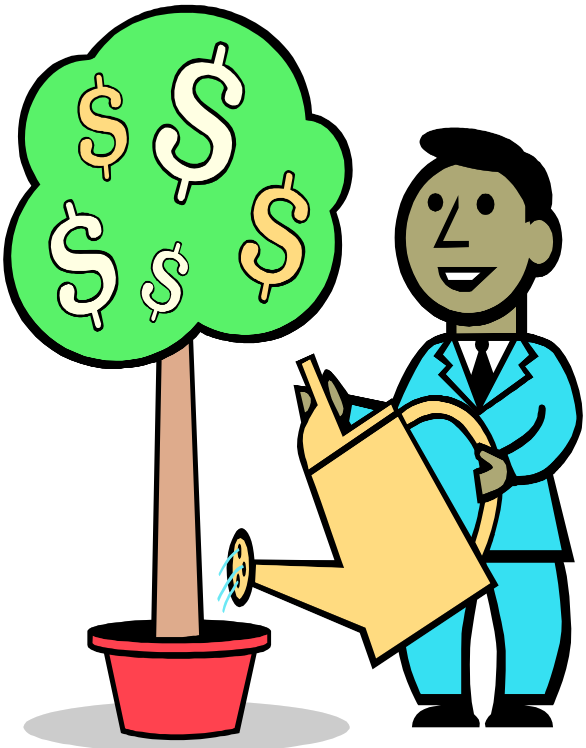
Legacy M&A Advisors, LLC
970 Lake Carillon Drive, Suite 300
Saint Petersburg, FL 33716

The Center for Financial, Legal & Tax Planning, Inc.
4501 W. DeYoung St., Suite 200
Marion, Illinois 62959

A CASE STUDY CONTINUED:

Editorial Comments:

Whenever guidance comes up regarding Code Section 199, I always take notice of the guidance. The Domestic Production Activities Deduction is still relatively new, just being enhanced within the last 15 years. Practitioners are still afraid of this one though, because there is not a lot of guidance. Most of the Internal Revenue Code has cavernous sums of regulations, cases, memos, and interpretive guidance. With the DPAD, essentially none.



The Center for Financial, Legal & Tax Planning, Inc.
4501 W. DeYoung St., Suite 200
Marion, Illinois 62959

Legacy M&A Advisors, LLC
970 Lake Carillon Drive, Suite 300
Saint Petersburg, FL 33716

Win-Win-Win, Or No Deal

Sometimes in the process of buying or selling a business, buyers – and sellers – get caught up in negotiating the best possible deal for themselves and lose sight of their ultimate objective, which is presumably to buy – or sell – a successful, ongoing business and maintain – or even improve – its prospects for a highly successful future.

In a lot of ways the sale of a business resembles the sale of real estate, but it differs in one important respect: In most real estate sales, the buyer and seller have little or no common interest following the sale. In many cases, the buyer and seller of real estate may never even meet face-to-face.

Contrast that with a business acquisition, where in almost every case the Buyer and Seller become somewhat co-dependent to successfully transfer and transition the business and its employees, its customers and its vendors. Most business sales will not be fully successful without the continuing goodwill of the Seller following the closing.

Thus, it only makes sense that both parties would want the other to leave the closing table feeling like they got a very good deal. Anything less is simply leaving the door open for future difficulties.

From experience, I have long believed the only realistic negotiating style in acquiring an ongoing business is: Win-Win, Or No Deal. In other words: If it isn't a good deal for the Buyer, and/or it isn't a good deal for the Seller, it isn't a good deal. Period.

Of late I've recognized that this successful and time-honored negotiating style needs to be updated to Win-Win-Win, Or No Deal. In other words: If it isn't a good deal for the Buyer, and/or it isn't a good deal for the Seller, and/or it isn't a good deal for the Bank or the Investors, than it isn't a good deal. Period.

Furthermore, in today's highly sophisticated and highly competitive marketplace, essentially all of the players are well-informed and/or well-advised, and if there is anything wrong with this deal it will be uncovered in due diligence or before, and it will never close. So why waste everyone's time with a deal that doesn't pass the Win-Win-Win test from the outset?

If you , or someone you know, may be thinking about buying or selling a business, and who might benefit from a free, confidential, consultation with us, please contact me directly at 813.299.7862, or mertel@lmaallc.coM

Mike Ertel, CBI, M&AMI, CM&AA
Managing Director, Broker
Legacy M&A Advisors, LLC
813.299.7862 Direct

Legacy M&A Advisors, LLC
970 Lake Carillon Drive, Suite 300
Saint Petersburg, FL 33716
Phone: 888-864-6610
Fax: 866-353-0382

The Center for Financial, Legal & Tax Planning, Inc.
4501 W. DeYoung St., Suite 200
Marion, Illinois 62959
Phone: 618-997-3436
Fax: 618-997-8370
Satellite Office:
Longboat Key, FL 34228
Phone and Fax: 941-383-3338

We're on the Web!

www.taxplanning.com

www.legacymandaadvisorsgroup.com

Frequently Asked Questions…

Q: Is it possible to have Roth and traditional IRAs as part of a comprehensive plan?

A: Yes. Individuals can have an assortment of Roth IRAs, traditional, and even employer retirement plans as their overall retirement plans. However, when funding the IRAs, it is important to mention the combined limit for both IRA types remains the same at $5500 per year.

Q: Are Roth and traditional IRAs taxed differently in an estate?

A: Yes and no. In an estate setting all property is considered part of the estate. As such, all property contained within the estate is subject to estate tax. Once the estate is taxed, the distributed property is subject to tax on its own character of gain. A Roth IRA is not subject to income tax as its character holds from one generation to the next. The traditional IRA's character remains ordinary income in nature, and in so far as the traditional IRA is income, it is subject to income tax.

Q: I own a business that is moderately successful and would like to see it passed on to my wife and children. How and when is the best time to start the process or begin planning the transfer?

A: The best time to begin the business succession process is right now, if it is your desire to keep your business as a going concern after your leaving, or even if you do not plan for the business to stay as a going concern. If you do not plan for the succession (or even non-succession of your business), your estate or heirs can and will be subject with the burden of making decisions that may not be the best for the business or your interests.