
Year-end tax planning for your business owner clients

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Current tax rates are likely the lowest we will see in our lifetimes. At some point, burgeoning budget deficits, ballooning costs of social programs and war expenses must be paid. As year-end tax planning time for your business owner clients approaches, this article will discuss some planning initiatives you need to remind them to consider. They are not the usual IRA or compensation tips, but rather ones that can materially affect their net worth over time.

The first thing to convey to your business owner clients is that they should expect tax increases. For nearly all business owners contemplating a business exit, this prediction means that the tax bill due on the exchange of their ownership interest for cash may rise. The following is a list of actions that your clients can take today to help minimize the size of that future tax bill for their businesses.

1. Prepare to sell sooner rather than later. This doesn't mean rushing to the market today. It does mean that it is time to begin the planning necessary to help increase the money your client receives. Your clients' planning goals are to increase the value of the business and to reduce the tax bite on that value as the business is transferred. Part of this process may include the need for a certified valuation by a certified valuation analyst (CVA) to establish what the business is worth today. The CVA accreditation is offered by the National Association of Certified Valuation Analysts (NACVA), which also offers additional training, reference materials, and customized databases that can be helpful to your practice in determining business value. If your client accepts the argument that taxes are likely to rise, it just makes sense to be prepared to sell before the increases arrive.
2. Recognize the importance of careful tax planning. Your clients' tax planning goal is not just to minimize their taxes. Recognize that the tax consequences affecting your clients' eventual buyers may be more important. The greater the tax on the stream of income available to pay your clients their purchase price, the less money is available. If there is less cash available, buyers may offer a lower purchase price or extend the time it will take to pay your clients off. (Neither option is particularly attractive to your clients or to the buyer.) Proactive tax planning can help cushion your clients' businesses from future tax increases. Obviously, you need to reinforce with your clients the need to consult with an experienced tax advisor, such as yourself.
3. Don't ignore estate taxes. Estate taxes may increase along with income tax and social security taxes. At a minimum, don't expect to see a decrease or elimination of estate taxes. Delaying a decision to engage in estate and gift tax planning, pending resolution of estate tax uncertainties, may benefit the IRS rather than your clients' families.
4. Check your entity. If your clients' companies are currently organized as a regular or "C"

corporation (and many of them still are), convince your clients to talk to you about the possible benefits and disadvantages of converting to an "S" corporation in advance of a sale of the business. Convince your clients to resolve to begin a dialogue now with you regarding the advisability of creating multiple entities (for tax as well as asset protection reasons).

5. Evaluate capitalization. Warn your clients to beware of over-capitalizing their businesses. Delaying the decision to distribute cash from the company may cost them more in taxes in the future. Again, convince them of the need to consult with you about the practicality of taking cash out now.
6. Examine various tax-advantaged tools. Your clients and their companies may (with some planning) be able to take advantage of tax-advantaged transfer tools such as Employee Stock Ownership Plans (ESOPs), Charitable Remainder Trusts (CRTs), or tax-free exchanges. Investigate with your clients the benefits and the detriments of each tool. Remember that when the IRS "giveth" (a tax benefit) it usually "taketh away" something else.
7. Consider a partial transfer of ownership. If your clients are thinking about passing part of their businesses to children or employees who have little money and who must look to the business as a source of cash flow (and pay tax on that cash flow as they receive it), they need to consider beginning that transfer soon. Today's tax rates are lower than they are likely to be in the future so taxes may have less impact on cash flow today than they will tomorrow.

The bottom line is that when (if) tax rates increase, your clients may end up with less money. Keep in mind that if their goal is to leave their company with a bushel of cash, the IRS may take a larger amount of that bushel—based not only on the size of the bushel, but also on the size of the U.S. Government's need.

About the authors

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AccountingWEB.com Nov-5-2008