

MBBA

MICHIGAN
BUSINESS
BROKERS
ASSOCIATION

Year 2022 – Key Topics and Trends

Michigan Business Brokers Association
2022 Annual Conference
Friday October 21, 2022 10:15 AM – 11:30 AM

Presented By:
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Walker Business Advisory Services

YEAH, I'M INTO FITNESS.



**FITNESS WHOLE PIZZA IN MY
MOUTH.**



The History of Bonus Depreciation Extensions

Act	Depreciation Percentage	Effective Dates
Job Creation and Worker Assistance Act of 2002	30%	Sept. 12, 2001 – Dec. 31, 2004
Jobs and Growth Tax Relief Reconciliation Act	50%	May 5, 2003 – Jan. 1, 2006
Economic Stimulus Act of 2008	50%	2008
American Recovery and Reinvestment Act of 2009	50%	2009
Small Business Jobs Act of 2010	50%	2010
Tax Relief, Unemployment Compensation Reauthorization, and Job Creation Act of 2010	100%	Sept. 9, 2010 – Dec. 31, 2011
Tax Relief, Unemployment Compensation Reauthorization, and Job Creation Act of 2010	50%	2012
American Taxpayer Relief Act of 2012	50%	2013

The History of Bonus Depreciation Extensions

Act	Depreciation Percentage*	Effective Dates
Tax Increase Prevention Act of 2014	50%	2014
Protecting Americans from Tax Hikes Act of 2015	50%	2015 - 2017
Protecting Americans from Tax Hikes Act of 2015	40%	2018
Protecting Americans from Tax Hikes Act of 2015	30%	2019
Tax Cuts and Jobs Act	100%	Sept. 27, 2017 - Dec. 31, 2022
Tax Cuts and Jobs Act	80%	2023
Tax Cuts and Jobs Act	60%	2024
Tax Cuts and Jobs Act	40%	2025
Tax Cuts and Jobs Act	20%	2026

Biden's Fiscal Year 2023 Budget Proposal

The major tax proposals include:

- ▶ Higher top rates for individual income, corporate income, and capital gains income;
- ▶ Ending step-up in basis by making death a taxable event;
- ▶ Expanding the base of the Net Investment Income Tax (NIIT) to apply to active pass-through income and making the active pass-through business loss limitation permanent;
- ▶ Major changes to international taxation; and,
- ▶ A laundry list of new minimum taxes for individuals, businesses, and international corporations.

Biden's Fiscal Year 2023 Budget Proposal

Individual Ordinary Tax Rate:

- ▶ Raise the top marginal tax rate on individual income from 37% to 39.6 percent; and
- ▶ Apply an 8 percent surtax on Modified Adjusted Gross Income above \$25 million

Biden's Fiscal Year 2023 Budget Proposal

Individual Capital Gain Rate:

- ▶ Increase the top capital-gains tax rate from 20% to top ordinary tax rate

Biden's Fiscal Year 2023 Budget Proposal

Net Investment Income Tax (“NIIT”):

- ▶ Expand the base of the NIIT to apply to active pass-through income
- ▶ **Result →** 3.8% will be imposed on all business income earned by S corporations, partnerships, and LLCs

Biden's Fiscal Year 2023 Budget Proposal

Estate Tax:

- ▶ End step-up in basis
- ▶ The step-up in basis provision adjusts the value, or “cost basis,” of an inherited asset (stocks, bonds, real estate, etc.) to the current fair market value on either (1) the date a person passes away or (2) 6 months after the person passes away.

Biden's Fiscal Year 2023 Budget Proposal

Corporate Tax Rate:

- ▶ Raise the corporate tax rate from 21% to 28%

Cash-Free Debt-Free

“CFDF”

Cash-Free Debt Free – Common but Unclear

- ▶ On the surface, it is a fairly simple concept.
- ▶ The buyer purchases the business to include:
 - all operating and certain negotiated non-operating assets; and
 - the seller is left with the cash and debt.

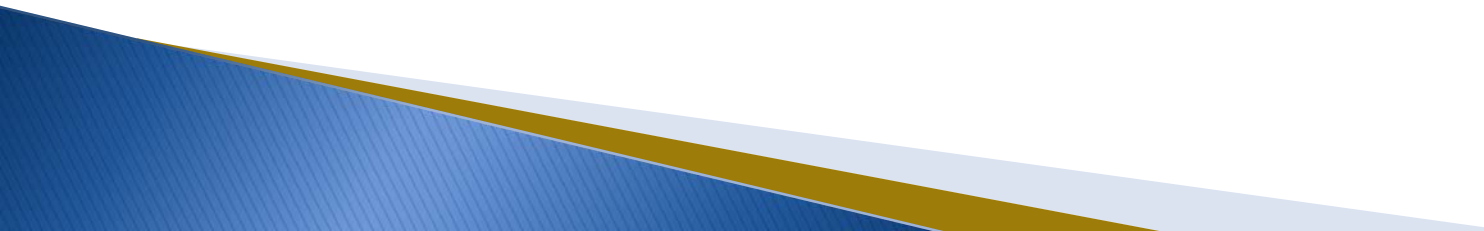


Cash Component

- ▶ Bills
- ▶ Coins
- ▶ Bank Balances
- ▶ Money Orders
- ▶ Checks
- ▶ Credit Card Payments



Cash Equivalents

- ▶ Undeposited Negotiable Instruments
 - ▶ Bank drafts
 - ▶ Money orders
 - ▶ Money market holdings
 - ▶ Certificates of deposit
- 

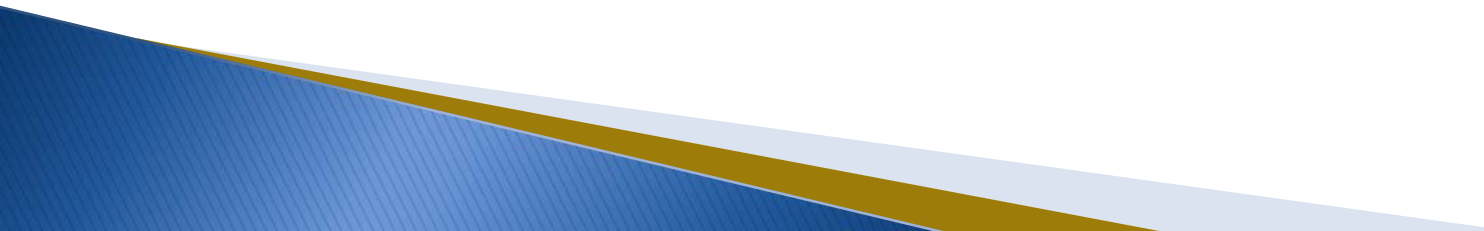
Cash Equivalents Can Also Include

- ▶ Government bonds
- ▶ Corporate bonds
- ▶ Commercial paper
- ▶ Treasury bills (T-Bill)
- ▶ Treasury notes (T-Note)

NOTE ==> These types of instruments are generally only included in cash if they mature within three months from when the financial statements are prepared and there is a minimal risk of these investments losing their value.

Cash Equivalents Can Also Include

Examples:


- ▶ Although publicly traded stock can be easily sold and converted into cash, it is typically not considered a cash equivalent because there is a risk that its value can decrease.
 - ▶ If a corporate bond matures within three months, but the company that issued it may not be able to settle the debt, this would not be able to be included as a cash equivalent.
- 

Debt

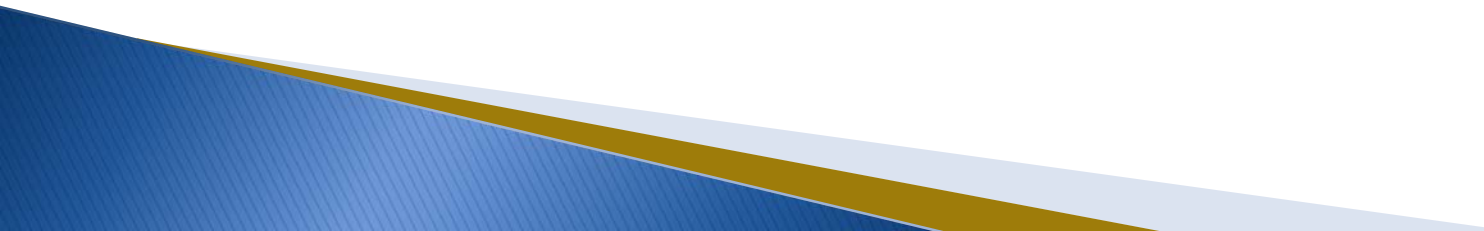
- ▶ Letter of credit
- ▶ Notes payable
- ▶ Capital lease
- ▶ Operating Lease
- ▶ Intercompany debts
- ▶ Unpaid dividends
- ▶ Overdraft Facilities
- ▶ Undelivered or unreleased checks



Debit-Like Items

- ▶ Accounts payable (overdue)
 - ▶ Customer deposits
 - ▶ Employee bonuses
 - ▶ Paid time off (“PTO”)
 - ▶ Deferred revenue
 - ▶ Deferred rent
- 

Debit-Like Items

- ▶ Gift cards
 - ▶ Legal settlement
 - ▶ Earn-out
 - ▶ Unfunded pension obligations
 - ▶ CapEx Underspend
 - ▶ Off balance sheet liabilities
- 

Structured Installment Sale

Structured Installment Sale

A solid tax deferral solution provided by:

Independent Life

A LOOK AT INDEPENDENT LIFE'S FINANCIAL STRENGTH

COMPANY	CAPITAL & SURPLUS/ GENERAL ACCOUNT ASSETS
Berkshire Hathaway Life Insurance Company of Nebraska	39.14%
Independent Life Insurance Company	17.30%
New York Life Insurance Company	12.33%
Prudential Insurance Company of America	11.73%
Pacific Life Insurance Company	10.55%
USAA Life Insurance Company	9.86%
United of Omaha Life Insurance Company	7.38%
American General Life Insurance Company	5.81%
Metropolitan Tower Life Insurance Company	5.79%

**2021 Statutory Statement Filings*

The ratio of capital and surplus to general account assets essentially represents the extra funds available after an insurance company meets its liabilities. Independent Life has more than 17 cents of every \$1 in assets available to address the risks and uncertainties related to its business.

What is iStructure?

The first **uncapped Index-Linked** Structured Settlement Annuity

A **structured settlement annuity** provides future periodic payments that are customizable in timing, amount, and duration.

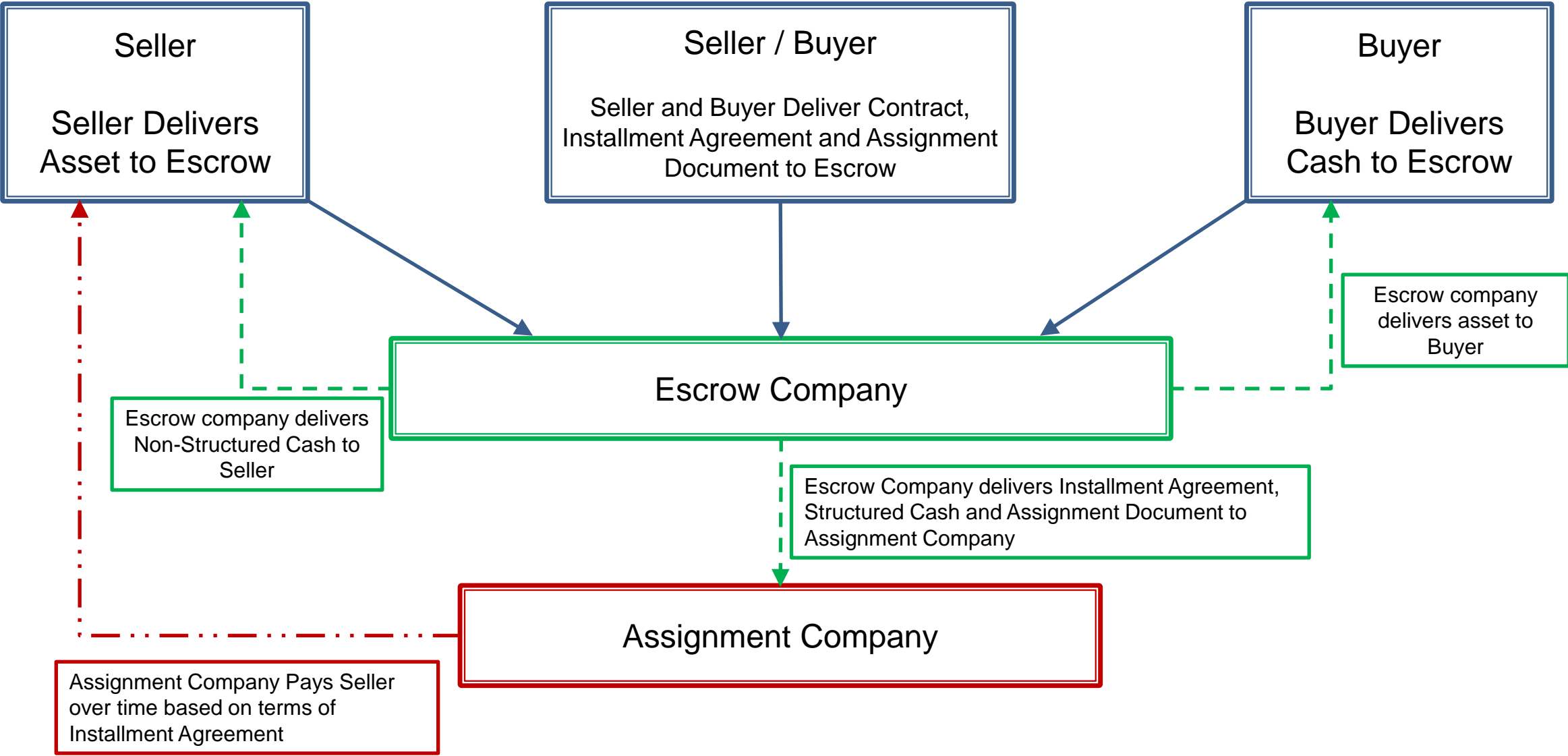
How is iStructure different?

- *Majority of structured settlement products are tied to a fixed rate where iStructure is tied to the proprietary Franklin BofA World Index*
- **Enhanced Growth Opportunity**
- **Customizable payouts: deferral, lump sums, increasing/decreasing**

How is it used?

- **Structured Installment Sales**
- Structured Attorney Fees
- Structured settlements on personal injury cases

Structured Sale Process Flow



Deal Structuring

How should tax matters be managed in the transition of a business?

- ▶ Should the issue of tax be addressed far enough in advance of the business's transition so it can be properly planned or when a negotiation is underway with a potential Buyer?
- ▶ In other words, should the matter of tax be addressed proactively or reactively?

Adverse Tax Interests

- ▶ Adverse tax interests deter allocations which lack economic reality.
- ▶ Where the tax interests of the buyer and seller conflict, the courts have been inclined to accept a specific allocation set forth in a contract arrived at in an arm's length transaction.
- ▶ The IRS and the courts closely scrutinize an allocation that doesn't have adverse tax consequences for the parties.

Winning vs. Succeeding

- ▶ Too often the Seller, Buyer and their respective advisors strive to WIN the tax game by trying to completely maximize all the tax benefits on one side of transaction.
- ▶ When negotiating a transaction the Seller and Buyer should not attempt to WIN the tax game but instead should work toward achieving some level of tax parity.
- ▶ Structuring design is what will help the Seller and Buyer achieve tax parity.

Party Desires

- ▶ Seller – Sell Stock
- ▶ Buyer – Buy Assets

Financial Objectives

- ▶ **Seller** – Maximize net AFTER TAX sale proceeds
- ▶ **Buyer** – Maximize Operational Cash Flow

Structuring Variables

“Non-Exhaustive List”

When negotiating a transaction the Seller and Buyer should not attempt to **WIN** but instead should work toward achieving some level of **PARITY**.



Structuring Variables

- ▶ Entity Type
 - C corporation
 - S corporation
 - Partnership (General or Limited)
 - Sole Proprietorship
 - Limited Liability Company
 - Taxed as a C corporation
 - Taxed as a S corporation
 - Taxed as a Partnership
 - Taxed as a Sole Proprietorship

Structuring Variables

- ▶ Date Entity Formed
- ▶ Date Operations Began
- ▶ Current Enterprise Level Value
- ▶ Projected Enterprise Level Value Growth
- ▶ Current Equity Level Value
- ▶ Projected Equity Level Value Growth
- ▶ Number of Entities in Operating Structure
- ▶ Are owners of various the entities the same with the same level of ownership?

Structuring Variables

- ▶ Types of Owners
 - Natural Persons (Human Beings)
 - Entities
 - Foreigners (Non-US Citizens)
 - Retirement Accounts
- ▶ Passive vs Non-Passive Owners
- ▶ Are owners related or independent?
- ▶ How did owners achieve ownership?
 - Purchase
 - Gift
 - Bequest

Structuring Variables

- ▶ Transaction Type
 - Asset
 - Stock
 - Bifurcated (meaning both)
- ▶ Transaction Purpose
 - 3rd Party
 - Management Buyout
 - Partner Buyout
 - Family Transfer
 - Merge

Structuring Variables

- ▶ Funding
 - Cash
 - Seller Note
 - Lender Financing
 - Rollover Equity
- ▶ Working Capital
 - Cash
 - Accounts Receivable
 - Inventory
 - Prepaids
 - Accounts Payable
 - Customer Deposits

Structuring Variables

- ▶ Transaction Value (i.e. Price)
- ▶ Seller Compensation
 - Consulting
 - Salary
 - Benefits

Structuring Variables

- ▶ Accounting Method
 - Cash
 - Accrual
- ▶ Recapture
 - Depreciation (FFE and Real Estate)
 - Amortization (Intangibles)
 - External Debt At Risk Deductions
- ▶ Deferral
 - Installment Note
 - Contingent Note
 - Earn Out

Structuring Variables

- ▶ Tax Basis - Internal
 - Accounts Receivable
 - Inventory
 - FFE
 - Real Estate
 - Intangibles (Goodwill, Non-Competition Agreement, etc.)
- ▶ Tax Basis - External
 - Gift
 - Bequest
 - At Risk

Structuring Variables

- ▶ Tax (Federal and State)
 - Income Tax (Entity and Individually)
 - Net Investment Income Tax
 - Self-Employment Tax
 - Gift Tax
 - Estate Tax
- ▶ **Owners Objectives ==> Most Important**

Structuring Cases

Transaction Case # 1

- ▶ Business = Manufacturing Business
- ▶ Entity Type = S Corporation
- ▶ Time in business = 25 years
- ▶ Transaction Price = \$2,500,000
- ▶ Ownership is comprised of the founder with 75% and 5 key employees with 5% each
- ▶ Occupied Real Estate is held in an LLC with same ownership structure

Discuss Structuring Options and Loan Options

Case # 1 - Answer

- ▶ **Problem:** If SBA Funding is used, the transaction is likely dead.
- ▶ **Reason:** The Key Employees will only be able to remain contracted for 1 Year.
- ▶ **Solution:** Have main owner buyout key employees on a promissory note. This must be done as early in the listing process as possible. This can be retracted later if the business never sales.

Transaction Case # 2

- ▶ Business: High End Technology Business
- ▶ Entity Type: S corporation
- ▶ Time in Business: 15 years
- ▶ Transaction Price: \$1,600,000
- ▶ Accounts Receivable: \$ 16,565
- ▶ Inventory: \$ 20,000
- ▶ Est. Equipment Value: \$1,400,000 ---- (Tax Basis is \$227,080)
- ▶ Retained Earnings: \$ 147,203
- ▶ Liabilities - Long Term: \$ 544,547
- ▶ Due to required lien release, the long term debt must be paid in full at or prior to closing
- ▶ The business has 2 owners Mr. and Mrs. Entrepreneur.
- ▶ Mrs. Entrepreneur is well known by the customers and plays an integral in the daily operations
- ▶ The business has a strong service and support team.

Discuss Structuring Options and Loan Options

Case # 2 – Answer Recap

Buy Side Benefit:

The \$16,565 of Accounts Receivable to be left in the corporation is a non-taxable collection to be used as collected because it already has existing tax basis.

The \$20,000 of inventory in the corporation can be expensed as fast as it is used because it already has existing tax basis.

The FFE, Equipment & Machinery and Rolling Stock have estimated remaining tax basis of \$227,080 and can be expensed via depreciation over their remaining lives.

The \$350,000 allocated to Personal Shareholder Covenant Not-To-Compete can be amortized over 15 years.

Case # 2 – Answer Recap

Buy Side Benefit:

The \$480,000 partitioned to Personal Goodwill can be amortized over 15 years.

The \$770,000 paid for the stock can be expensed at a future disposal point.

Total short-term write offs and tax benefits for the Buyer equals \$1,093,645 and total long-term write offs equals \$770,000 resulting in total aggregate write offs and tax benefits of \$1,863,645 based on a purchase price of \$1,600,000.

Transaction Case # 3

- ▶ Business Entity is an S corporation
- ▶ Business is Trucking Business
- ▶ The business is classified as a Woman Owned Business Enterprise
- ▶ The Selling Price is \$2,000,000
- ▶ FFE value is \$1,000,000 and tax basis is \$500,000

Discuss Structuring Options

Case # 3 - Answer

- ▶ **Problem:** Woman Owned Business Enterprise status.
- ▶ **Reason:** Revenue likely highly depend and tied to this status.
- ▶ **Solution:** Sell at least majority ownership to a woman. This needs to be a stock transaction but handled as a Deemed Asset Transaction for tax purposes. Thus, for legal it will be a stock transaction and for tax it will be treated as an asset transaction.

Transaction Case # 4

- ▶ Business entity is an LLC taxed as a S corporation
- ▶ Seller's asking price is \$1,500,000
- ▶ The business has experienced a 35% revenue increase during the past 12 months due to a new service offering
- ▶ Buyer has offered to purchase the assets with about \$150,000 being FFE.
- ▶ The Buyer is willing to meet the asking price with a (1) \$1,000,000 fixed obligation and (2) \$500,000 Earn Out
- ▶ The Seller is currently critical to operations.
- ▶ The Buyer has offered the Seller a 3-year employment agreement with a provision that the Buyer's obligations under the Earn Out will cease if the Buyer's resigns before the completion of the employment agreement.

Discuss Structuring Options and Loan Options

Case # 4 - Answer

- ▶ **Problem:** Structure of Earn Out
- ▶ **Reason:** Earn Out is tied to an employment requirement which causes payments under the Earn Out to be ordinary income from compensation instead of capital gain from purchase consideration.
- ▶ **Solution:** Ensure that the Earn Out agreement has no association with or tie to an employment or service requirement.

Transaction Case # 5

- ▶ Business Entity is an S corporation
- ▶ The corporation has authorizations and contracts in place that are critical to the business.
- ▶ Two Buyers, one an LLC and the other an individual, are extremely interested in the business.
- ▶ The interested Buyers want to be able to expense the purchase price and maintaining pass-through status is a requirement.

Discuss Structuring Options

Transaction Case # 6

▶ Entity Type:	C corporation
▶ Business Type:	Wholesaler
▶ Transaction Type:	Asset
▶ Transaction Price:	\$2,500,000
▶ Tax Basis of Assets Included in Transaction:	\$600,000
▶ Intermediary Success Fee:	\$210,000
▶ Federal Corporate Tax Rate:	21%
▶ Shareholder Capital Gain / Dividend Tax Rate:	20%
▶ Date Stock Issued to Shareholder:	October 1, 2011
▶ Date Stock Sold:	July 24, 2022
▶ Amount Shareholder paid for Stock:	\$1,000

Discuss Structure Options

Transaction Case # 6

Answer

	Qualified Small Business Stock "Asset Transaction"	Regular Stock "Stock Transaction"
Transaction Price	\$ 2,500,000	\$ 2,500,000
Less: Tax Basis	(600,000)	(1,000)
Success Fee	<u>(210,000)</u>	<u>(210,000)</u>
Transaction Gain	1,690,000	2,289,000
Federal Tax Calculation		
Tax Due on Gain	21.00% <u>354,900</u>	
Total Federal Tax	354,900	
Shareholder Distribution		
Transaction Price	2,500,000	
Less: Corporate Federal Tax	(354,900)	
Success Fee	(210,000)	
Shareholder Distribution	1,935,100	
Less: 100% Exemption	(1,935,100)	
Taxable Shareholder Income	<u><u>0</u></u>	

Transaction Case # 6

Answer

Individual Tax Calculation

Capital Gain
 Tax Due Dividend
 Net Investment Tax

Total Individual Tax

Net to Individual Calculation

Individual Distribution
 Less: Tax
 Success Fee

Individual Net

Effective Tax Rate

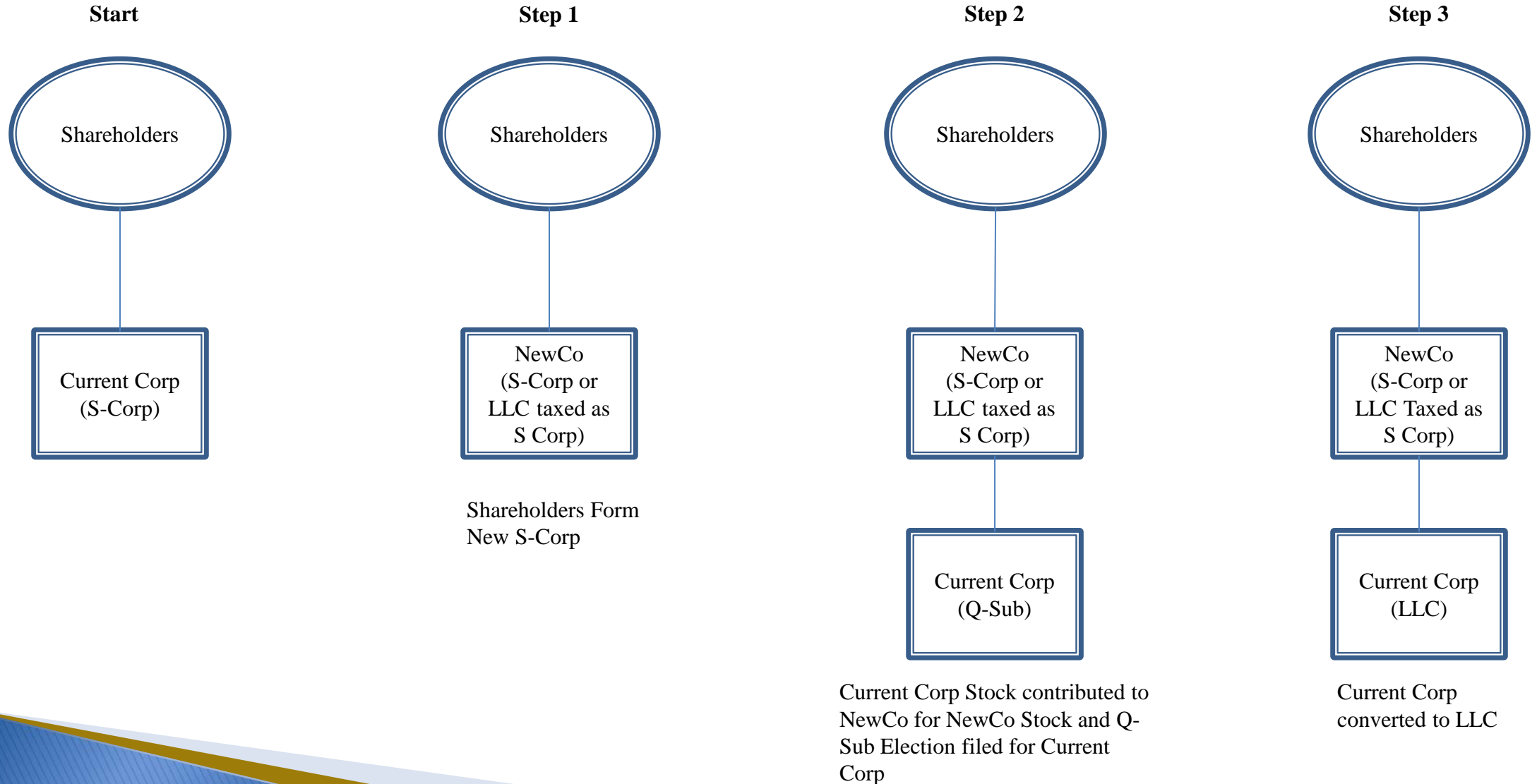
	Qualified Small Business Stock "Asset Transaction"	Regular Stock "Stock Transaction"
Capital Gain		20.00% 457,800
Tax Due Dividend	20.00% 0	
Net Investment Tax		3.80% 86,982
Total Individual Tax	<u>0</u>	<u>544,782</u>
Individual Distribution	1,935,100	2,500,000
Less: Tax	0	(544,782)
Success Fee		(210,000)
Individual Net	<u>\$ 1,935,100</u>	<u>\$ 1,745,218</u>
Effective Tax Rate	21.00%	23.80%

S Corporation Inversion

F Reorganization

- ▶ Plan of reorganization within the meaning of Section 368(a)(1)(F) as amended, pursuant to Revenue Ruling 2008-18

F Reorganization (i.e. S Corporation Inversion)



Qualified Subchapter S Subsidiary Election

OMB No. 1545-0123

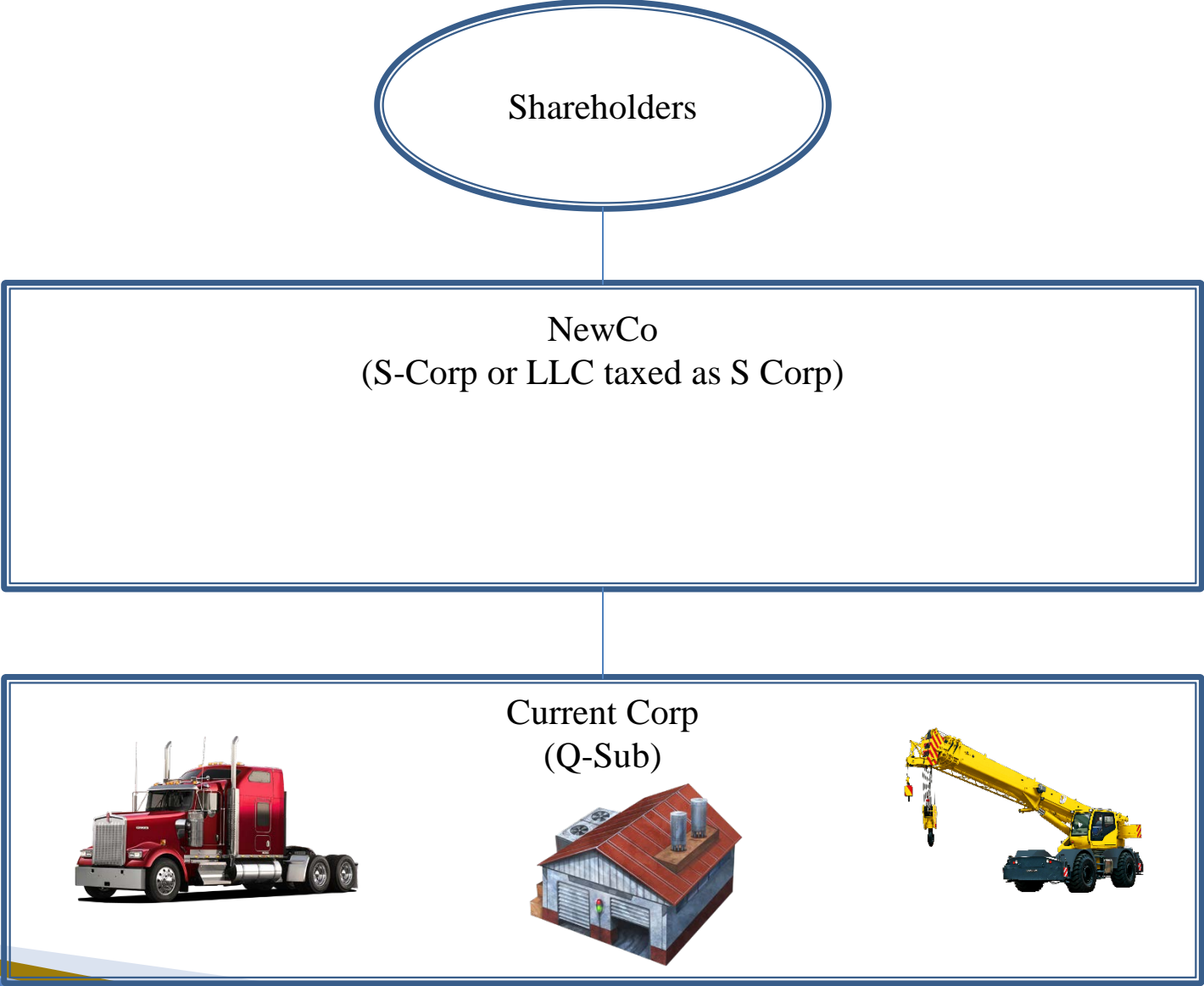
(Under section 1361(b)(3) of the Internal Revenue Code)

▶ Go to www.irs.gov/Form8869 for instructions and the latest information.

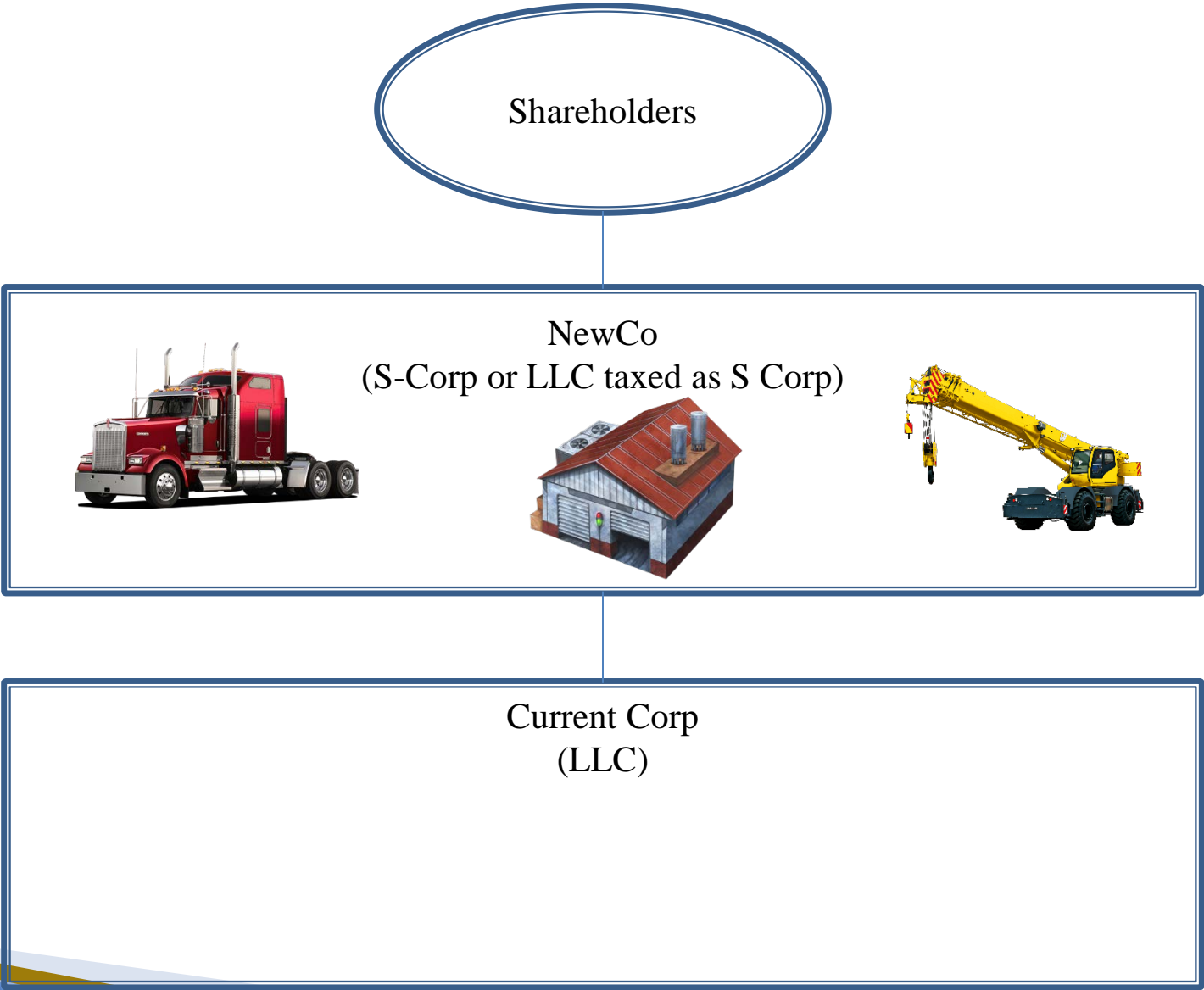
Part II Subsidiary Corporation for Which Election is Made (For additional subsidiaries, see instructions.)

7a Name of subsidiary		8 EIN (if any)
b Number, street, and room or suite no. If a P.O. box, see instructions.		9 Date incorporated
c City or town, state or province, country, and ZIP or foreign postal code		10 State of incorporation
11 Date election is to take effect (month, day, year) (see instructions) ▶		
12 Did the subsidiary previously file a federal income tax return? If "Yes," complete lines 13a , 13b , and 13c ▶ <input type="checkbox"/> Yes <input type="checkbox"/> No		
13a Service center where last return was filed	13b Tax year ending date of last return (month, day, year) ▶	13c Check type of return filed: <input type="checkbox"/> Form 1120 <input type="checkbox"/> Form 1120-S <input type="checkbox"/> Other ▶
14 Is this election being made in combination with a section 368(a)(1)(F) reorganization described in Rev. Rul. 2008-18, where the subsidiary was an S corporation immediately before the election and a newly formed holding company will be the subsidiary's parent? ▶ <input type="checkbox"/> Yes <input type="checkbox"/> No		

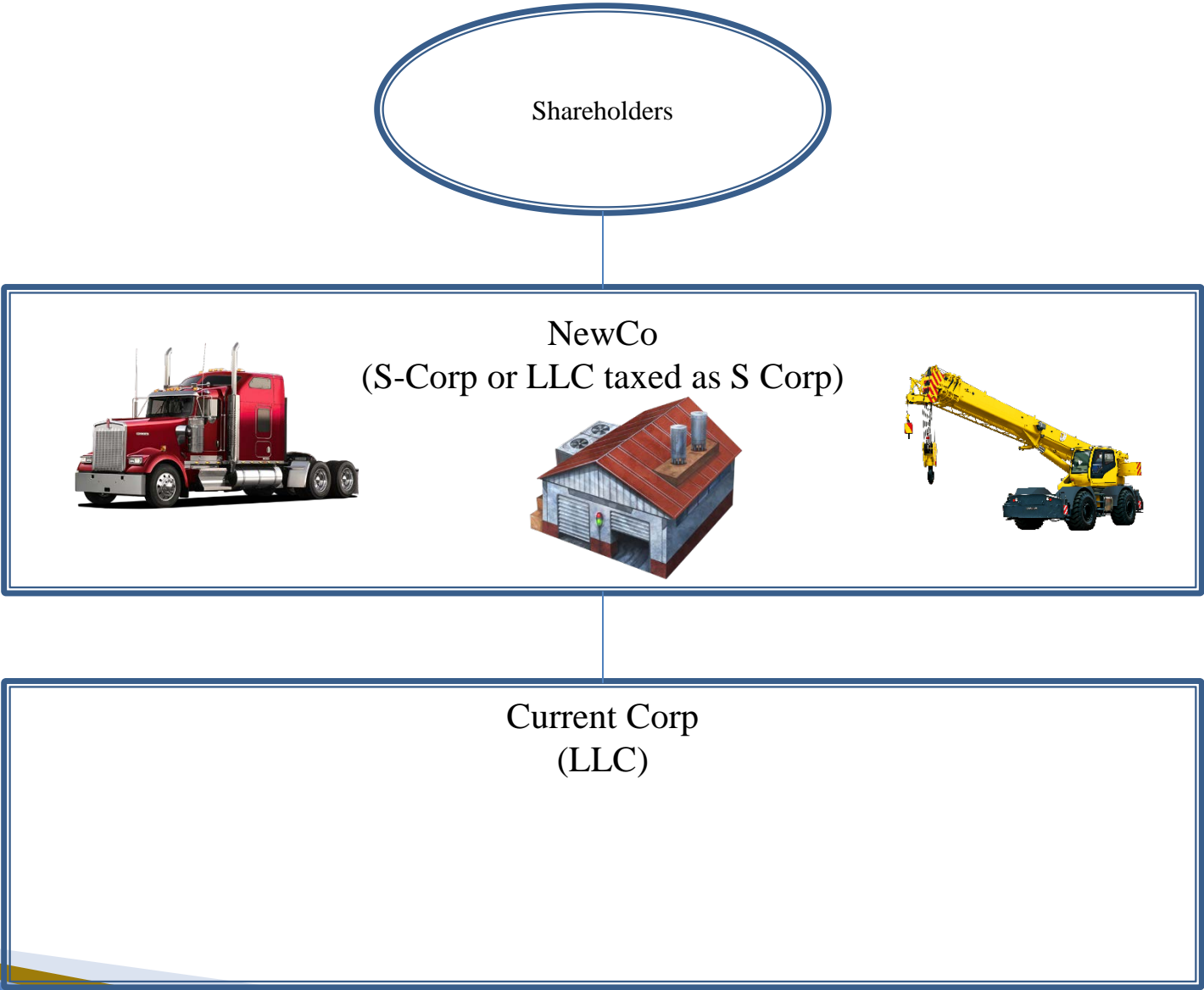
Step 2 – Assets are Deemed to Transfer to NewCo



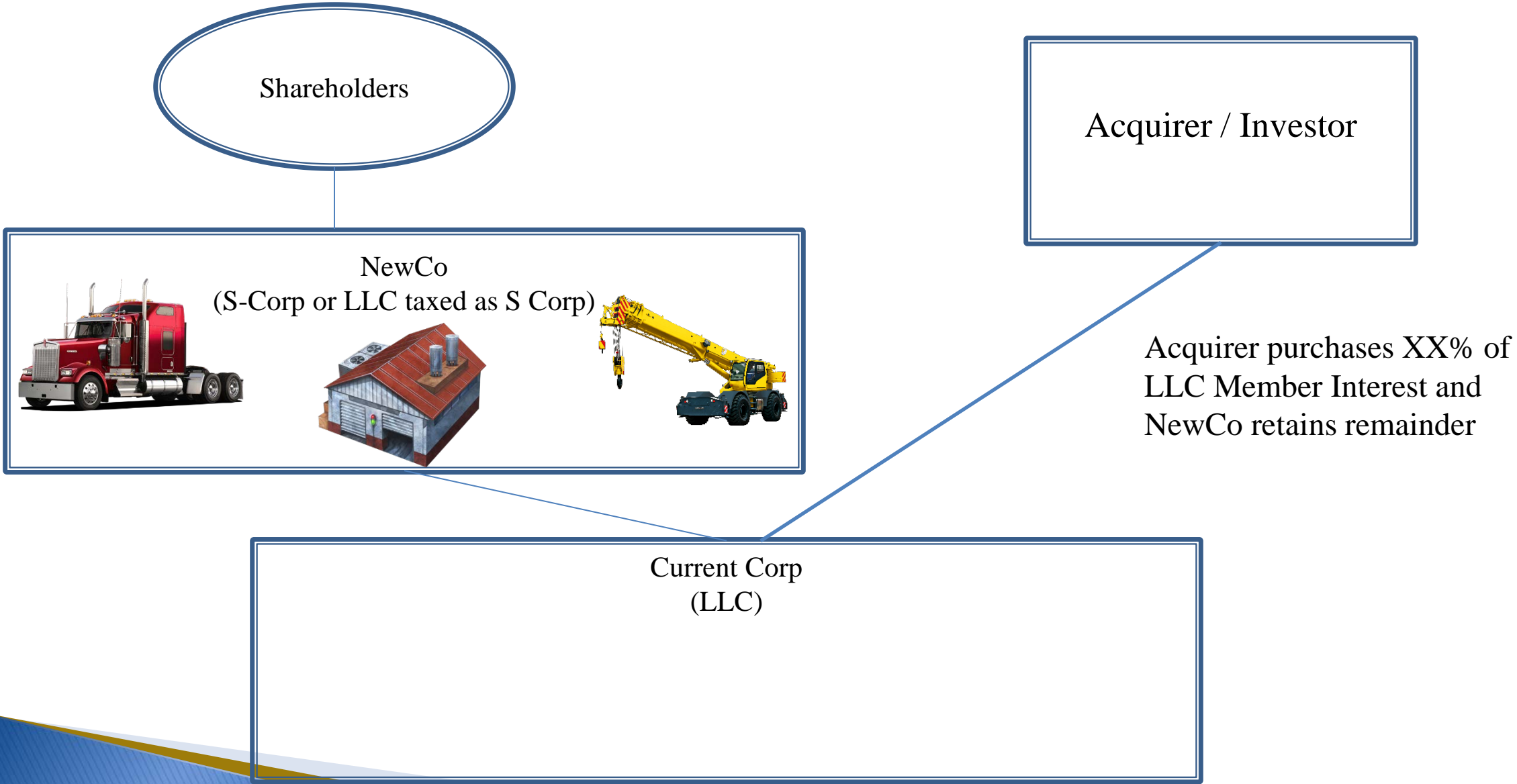
Step 3 – Corp with Q-Sub Filing Converted to LLC then LLC Equity Sold with both business operating assets and real estate



Step 3 – Corp with Q-Sub Filing Converted to LLC then Equity Sold with business operating assets only



Step 3 – Corp with Q-Sub Filing Converted to LLC then portion of Equity Sold with both business operating assets and real estate



END

About The Presenter



Monty W. Walker
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- Works with Business Sellers, Business Buyers and their various advisors, such as Business Intermediaries, Accountants and Attorneys, to manage the unique financial, tax, planning and procedural matters associated with Buying and Selling a business. **He does not serve as a Business Intermediary. He only provides Advisory Services.**
- Has a comprehensive business background in the private closely-held sector spanning over 30 years which includes experience in both startups and established entities
- Professionally manages and administers retirement plans including plans which enable entrepreneurs to use their accumulated retirement money as a business capitalization source while preserving tax deferrals and without incurring penalties. His advisory services in the qualified money arena include solutions using of Self-Directed IRAs and Small Business Investment 401(k) Plans.
- Developed and assists Entrepreneurs throughout the country with a unique proprietary comprehensive transaction planning review resulting in a deliverable entitled --- Transaction Structuring Report.
- Works with clients throughout the country rendering advisory support for Business Transactions, Business Exit Strategies, Business Tax Planning and Business Transition Planning.
- Subject Matter Expert for the International Business Brokers Association in the area of Business Transaction Taxation, Structuring and Planning. He is also an approved instructor for the International Business Brokers Association, the Texas Real Estate Commission and the Texas Department of Insurance.
- Authored various business transfer taxation and structuring courses and various other business transfer related workshop topics which he instructs for these organizations.
- Due to his background in the area of business planning and business transfers he is often referred to by his clients and colleagues as a --- “Business Transaction CPA”
- Is a member of the American Institute of Certified Public Accountants, the International Business Brokers Association, the M&A Source, the Texas Association of Certified Public Accountants, the Texas Association of Business Brokers and Alliance of Mergers & Acquisitions Advisors
- Certified Public Accountant, Chartered Global Management Accountant, Certified Business Intermediary