

# Tax & Business Alert

APRIL 2017

## REVIEWING YOUR COMPANY'S BUY-SELL AGREEMENT\_\_\_\_\_

If you own a business and follow professional advice, you've likely established a buy-sell agreement in case you or a co-owner voluntarily or involuntarily leaves the company. Assuming this is true, remember that it's not enough to draft an agreement and put it in a safe place. You need to review and perhaps revise the document periodically.

### PROBLEMS SOLVED

The primary purpose of every buy-sell agreement is to legally confer on the owners of a business or the business itself the right or obligation to buy a departing owner's interest. But a well-crafted agreement can also help ensure that control of your business is restricted to specified individuals, such as current owners, select family members or upper-level managers.



Another purpose of a buy-sell agreement is to establish a price for the ownership interests. You should engage a qualified appraiser to estimate the value of those interests when first making a buy-sell agreement, and periodically thereafter to ensure the price keeps up with the growing (or shrinking) value of your company.

Estate planning is also a priority for many buy-sell agreements. If your agreement was drafted more than a few years ago, you may need to update it based on recent gift and estate tax changes. For 2017, the top rate for the gift, estate and generation-skipping transfer (GST) taxes is 40% and the exemption limit is \$5.49 million. However, also keep in mind that the President

and Republicans in Congress have indicated a desire to repeal the estate tax, which might happen later this year.

### STANDARD AND UNUSUAL TRIGGERS

Most buy-sell agreements lie dormant for years. What can quickly bring one to life is a "triggering event," such as when an owner:

- Dies,
- Becomes disabled, or
- Retires or voluntarily leaves the company.

But you may want to make sure your agreement also covers triggers such as changes in an owner's marital status. And to prevent fraud or inappropriate behavior, many agreements include "conviction for committing a crime, losing a professional license or certification, or becoming involved in a scandal" as a triggering event.

### 3 OPTIONS

Buy-sell agreements typically are structured as one of the following agreements:

1. *Redemption*, which permits or requires the business as a whole to repurchase an owner's interest,
2. *Cross-purchase*, which permits or requires the remaining owners of the company to buy the interest, typically on a pro rata basis, or
3. *Hybrid*, which combines the two preceding structures. A hybrid agreement, for example, might require a departing owner to first make a sale offer to the company and, if it declines, sell to the remaining individual owners.

In choosing your buy-sell agreement's initial structure, consider the tax implications. They'll differ based on whether your company is a flow-through entity or a C corporation.

### SOURCES OF FUNDS

Buy-sell agreements require a funding source so that remaining owners can buy their former co-owner's shares. Life insurance is probably the most common, but there are alternatives.

If your company is cash-rich and confident in its ability to remain so, you could rely on your reserves. However, this would leave many businesses vulnerable

to an unplanned cash shortfall. Another option is to create a "sinking fund" by setting aside money for paying out the agreement over time. Again, if your cash flow *ebbs* more than *flows*, you may not have enough funds when they become necessary.

### WORTH THE EFFORT

Keeping your buy-sell agreement updated requires some effort. But the effort will more than pay off in saved time and prevented conflicts should a triggering event occur. And if you haven't yet established an agreement, now's the time to do so. ■

## ABLE ACCOUNTS CAN HELP SUPPORT THE DISABLED

The Achieving a Better Life Experience (ABLE) Act of 2014 created a tax-advantaged savings account for people who have a qualifying disability (or are blind) before age 26. Modeled after the well-known Section 529 college savings plan, ABLE accounts offer many benefits. But it's important to understand their limitations.

### TAX AND FUNDING BENEFITS

Like Sec. 529 plans, state-sponsored ABLE accounts allow parents and other family and friends to make substantial cash contributions. Contributions aren't tax deductible, but accounts can grow tax-free, and earnings may be withdrawn free of federal income tax if they're used to pay qualified expenses. ABLE accounts can be established under any state ABLE program, regardless of where you or the disabled account beneficiary live.



In the case of a Sec. 529 plan, qualified expenses include college tuition, room and board, and certain other higher education expenses. For ABLE accounts, "qualified disability expenses" include a broad range of costs, such as health care, education, housing, transportation, employment training, assistive technology, personal support services, financial management, legal expenses, and funeral and burial expenses.

An ABLE account generally won't jeopardize the beneficiary's eligibility for means-tested government benefits, such as Medicaid or Supplemental Security Income (SSI). To qualify for these benefits, a person's resources must be limited to no more than \$2,000 in "countable assets."

Assets in an ABLE account aren't counted, with two exceptions: 1) Distributions used for housing expenses count, and 2) if the account balance exceeds \$100,000,

the beneficiary's eligibility for SSI is suspended so long as the excess amount remains in the account.

### NOTABLE LIMITATIONS

ABLE accounts offer some attractive benefits, but they're far less generous than those offered by Sec. 529 plans. Maximum contributions to 529 plans vary from state to state, but they often reach as high as \$350,000 or more. The same maximum contribution limits generally apply to ABLE accounts, but practically speaking they're limited to \$100,000, given the impact on SSI benefits.

Like a 529 plan, an ABLE account allows investment changes only twice a year. But ABLE accounts also impose an annual limit on contributions equal to the annual gift tax exclusion (currently \$14,000). There's no annual limit on contributions to Sec. 529 plans.

ABLE accounts have other limitations and disadvantages as well. Unlike a Sec. 529 plan, an ABLE account doesn't allow the person who sets up the account to be the owner. Rather, the account's beneficiary is the owner.

However, a person with signature authority — such as a parent, legal guardian or power of attorney holder — can manage the account if the beneficiary is a minor or otherwise unable to manage the account. Nevertheless, contributions are irrevocable and the account's funders may not make withdrawals. The beneficiary can be changed to another disabled individual who's a family member of the designated beneficiary.

Finally, be aware that, when an ABLE account beneficiary dies, the state may claim reimbursement of its net Medicaid expenditures from any remaining balance.

### WORTH EXPLORING

If you have a child or relative with a disability in existence before age 26, it's worth exploring the feasibility of an ABLE account. Please contact our firm for more details. ■

## SO YOU JUST FILED YOUR TAXES — COULD AN AUDIT BE NEXT?

Like many people, you probably feel a great sense of relief wash over you after your tax return is completed and filed. Unfortunately, even professionally prepared and accurate returns may sometimes be subject to an IRS audit.

The good news? Chances are slim that it will actually happen. Only a small percentage of returns go through the full audit process. Still, you're better off informed than taken completely by surprise should your number come up.

### RED FLAGS

A variety of red flags can trigger an audit. Your return may be selected because the IRS received information from a third party — say, the W-2 submitted by your employer — that differs from the information reported on your return. This is often the employer's mistake or occurs following a merger or acquisition.

In addition, the IRS scores all returns through its Discriminant Inventory Function System (DIF). A higher DIF score may increase your audit chances. While the formula for determining a DIF score is a well-guarded IRS secret, it's generally understood that certain things may increase the likelihood of an audit, such as:

- Running a traditionally cash-oriented business,
- Having a relatively high adjusted gross income,
- Using valid but complex tax shelters, or
- Claiming certain tax breaks, such as the home office deduction.

Bear in mind, though, that no single item will cause an audit. And, as mentioned, a relatively low percentage of returns are examined. This is particularly true as the IRS grapples with its own budget issues.

Finally, some returns are randomly chosen as part of the IRS's National Research Program. Through this program, the agency studies returns to improve and update its audit selection techniques.



### CAREFUL READING

If you receive an audit notice, the first rule is: Don't panic! Most are *correspondence* audits completed via mail. The IRS may ask for documentation on, for instance, your income or your purchase or sale of a piece of real estate.

Read the notice through carefully. The pages should indicate the items to be examined, as well as a deadline for responding. A timely response is important because it conveys that you're organized and, thus, less likely to overlook important details. It also indicates that you didn't need to spend extra time pulling together a story.

### YOUR RESPONSE (AND OURS)

Should an IRS notice appear in your mail, please contact our office. We can fully explain what the agency is looking for and help you prepare your response. If the IRS requests an in-person interview regarding the audit, we can accompany you — or even appear in your place if you provide authorization. ■

## TAX CALENDAR

### April 18

- Besides being the last day to file (or extend) your 2016 personal return and pay any taxes due, 2017 first quarter estimated tax payments for individuals, trusts and calendar-year corporations are due today. So are 2016 returns for trusts and calendar-year estates and C corporations, plus any final contribution you plan to make to an IRA or Education Savings Account for 2016. Simplified Employee Pension and Keogh contributions are also due today if your return isn't being extended.

### June 15

- Second quarter estimated tax payments for individuals, trusts, and calendar-year corporations are due today.



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## 5 GROWTH STRATEGIES FOR TODAY'S BUSINESSES

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It's probably safe to say that nearly every business owner wants his or her company to grow. The question is: How? As you ponder your company's ideal strategic direction, here are five common business growth strategies to consider:



### **1. Creating and delivering new products and services.**

This is probably the most obvious growth strategy, but that doesn't mean it's easy. Conduct market research to determine not only which

new products and services will appeal to your customers, but also which ones will be profitable.

### **2. Tapping into new markets and territories.**

The idea here is to market and sell your existing products and services to different customer niches or to customers in different geographic areas. Extensive market research is again one of the keys to success for this growth strategy.

**3. Penetrating your existing markets.** This strategy involves selling more of your existing products and services to your current customers. Start by performing a market segmentation analysis to determine which customers to target with marketing messages designed to increase specific product and service sales.

### **4. Developing new sales and delivery channels.**

The Internet is the best example of a new sales and delivery channel for products and services. Talk with your sales and marketing executives about ways you can use the Internet or another alternative channel to grow your sales and revenue.

**5. Mergers and acquisitions (M&A).** Growing through M&A is very different from the other, more organic growth strategies we've covered. This strategy can result in rapid growth literally overnight, as well as the realization of valuable synergies between the merged companies. But performing thorough due diligence on acquisition candidates is absolutely key to successful growth via M&A. ■