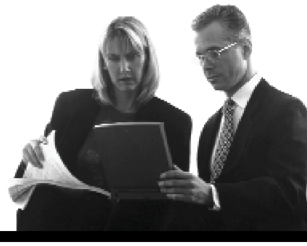
BKD

Advisor

Beyond Your Numbers

March
2006



Information to Help You Make Smart Business & Financial Decisions

New tax act provides additional hurricane relief

The *Gulf Opportunity Zone Act of 2005* (the Act), signed into law December 21, 2005, provides additional relief to the Gulf States ravaged by hurricanes last year.

Though the Act provides other benefits, highlights for business taxpayers include:

- A 50% bonus depreciation for businesses rebuilt in the Gulf Opportunity Zone and for qualifying property acquired after August 27, 2005, and before January 1, 2008 (January 1, 2009, for real property). This will allow additional upfront deductions for fixed-asset investment
- A deduction for half of the generally nondeductible site cleanup and demolition costs
- A five-year net operating loss carryback of qualifying expenses; this will enable affected businesses to apply for refunds of prior years' taxes
- Double the usual upfront asset expensing (Sec. 179) limit, which will allow additional upfront deductions for equipment investments
- A broadened tax credit for retaining affected employees
- The extension of certain provisions of the *Katrina Emergency Tax Relief Act of 2005* to victims of Hurricanes Rita and Wilma

For more information, visit **www.irs.gov** or **www.bkd.com**.

Guarding your home computer system: an IT consultant's cautionary tale

by Don Smith, BKD Risk Management & Technology, dsmith@bkd.com

Editor's note: Don Smith, a BKD information technology consultant who works with financial institutions, was shocked when his home-based computer system crashed after a cyberspace attack.

To help readers protect their own home-based systems, Smith agreed to write about his personal brush with the Internet's dark side and what the experience taught him.

It was a beautiful Saturday morning, and I was ready to roll with plans to create a CD for family and friends to announce my grandson's first birthday. I fired up my home computer to select photos of his first year, photos I would put to music on the CD. I couldn't wait to begin.

I sat at my two-year-old computer for what seemed an eternity as it moaned and groaned like the dead battery of an automobile. I hit a quick Ctrl-Alt-Delete on the keyboard, hoping a reboot would fix the problem, but nothing happened.

My system wasn't going anywhere because it was already gone. It had been hijacked,

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Deduct yacht & motor home financing

Your second home doesn't have to sit on a fixed foundation to qualify for tax advantages. According to the Internal Revenue Service (IRS), a facility qualifies as a residence if it has sleeping, cooking and bathroom accommodations.

Therefore, your yacht or smaller boat can be a second home. So can a motor home of any size or value. Provided the boat or motor home secures the purchase loan, your mortgage interest is as deductible as it would be on a more conventional second home.

IRS increases scrutiny of tax-exempt organizations

The IRS has announced it will conduct 600 random audits of tax-exempt hospitals in 2006. IRS agents will check to see if hospitals are performing a sufficient amount of charity care to justify their tax-exempt status. Agents also will analyze executive-compensation practices.

In addition, the IRS plans to include more questions about compensation on Form 990 that focus on the outside business relationships of executives, conflict-of-interest policies and other similar issues. The data col-

What's inside:

lected may be used to select organizations for IRS examinations.

Get educated about student loan tax breaks

Are there college students in your family? If so, and a student loan is part of the educational experience, you may be able to reduce your taxable income by up to $2,500 by deducting the interest you paid this year. You won't even have to itemize on your tax return to do it.

To qualify for the deduction, the loan must have been taken out only to pay for qualified education expenses at an eligible institution. Qualified expenses include:

- Tuition and fees
- Room and board
- Books, supplies and equipment
- Other necessary expenses, such as transportation

Eligible institutions are accredited public and private postsecondary institutions, such as colleges, universities and vocational schools. Also included are institutions offering internship or residency programs that lead to a degree or certificate from a hospital, a health care facility that offers postgraduate training or an institution of higher education.

The qualifying student could be you, your spouse or your dependent and must be enrolled at least half time in a program leading to a degree, certificate or other recognized educational credential.

The interest deduction is phased out for single filers with adjusted gross income (AGI) between $50,000 and $65,000 and joint filers with AGI between $105,000 and $135,000. (These amounts are for 2005 and may be adjusted for inflation in future years.)

Married couples must file jointly to claim the deduction. Interest payments are deductible for the life of the loan.

Claiming a dependent? Know the rules

Everyone is happy to owe less income tax. One way to reduce your tax bill is by claiming exemptions for your dependents. Each exemption cuts your taxable income by as much as $3,200 for 2005 and $3,300 for 2006 but is phased out for higher income taxpayers.

The IRS has five basic tax-dependency criteria that must be met:

Member of household/relationship test **-** The person must live in your home as a member of your household all year or, if living elsewhere, be a qualified relative, including a child (by birth or adoption), stepchild, grandchild, great-grandchild, brother, sister, step- or half-sibling, parent, stepparent, grandparent, aunt, uncle, niece, nephew or immediate in-law.

Citizenship or resident test **-** The person must be a U.S. citizen, a U.S. national or a resident of the U.S., Canada or Mexico for at least part of the tax year. An adopted child who lives with you but is not a citizen may qualify.

Joint return test **-** You can't claim as a dependent anyone who files a joint return with a spouse, unless the joint return was filed solely to claim a refund of withheld tax.

Gross income test **-** The person's gross income generally must be less than the exemption amount. This doesn't apply to children younger than 19 at the end of the tax year or to children under age 24 who were full-time students (during some portion of at least five calendar months).

Support test **-** In general, you must have provided more than half the person's total support.

Early retirement plan payout means tax decisions

Retirement is just one of many events that can trigger a retirement plan distribution. Others include changing jobs, getting laid off or losing a job.

It's not unusual for employees years away from retirement to suddenly find themselves with a large lump-sum retirement plan payout. If you receive an early distribution of your retirement plan funds, consider an eligible rollover to avoid immediate and full taxation of your distribution.

Retirement plan lump-sum distributions are generally taxable in full when received. (Of course, Roth-type plan distributions are generally not taxable.) Further, if the distribution takes place before age 59½, it also may be subject to an additional 10% early withdrawal penalty. An eligible rollover avoids this result.

In an eligible rollover, funds are transferred to an individual retirement account (IRA) or another qualified retirement plan, either directly (a trustee-to-trustee transfer) or indirectly (by the employee within 60 days of receipt of the distribution).

If the rollover is implemented successfully, you won't owe any tax or penalty on the amount distributed until it's withdrawn from the rollover IRA or new qualified retirement plan.

Avoid indirect rollovers if possible. There are many horror stories of employees who received a distribution and failed to recontribute it to an IRA within 60 days due to misunderstandings. Thus, unexpected tax and penalties were triggered.

On top of this risk, plans are generally required to withhold 20% of a distribution for taxes. While the withholding may be refunded when you file your return, you could be left in a situation where you need to make up the withheld 20% from other funds to make a full rollover within the 60-day period.

For these reasons and simplicity's sake, a direct trustee-to-trustee rollover is preferable. This should typically be arranged with your old employer.

Above all, think through investment decisions carefully. You may not need the money for retirement for 10, 20 or more years. How you invest the money and the annual investment return you earn can have a dramatic effect on the sum eventually available at retirement time.

S corporation family shareholder election

One requisite for S corporation eligibility is the corporation cannot have more than 100 shareholders. This prevents corporations with diverse ownership to be granted S corporation status.

A law change enacted late in 2004 expanded the eligibility requirements for S corporation status by providing for an election to treat family members as one shareholder. This is known as the S corporation family shareholder election.

For this purpose, family members include:

- The common ancestor
- The lineal descendants of the common ancestor
- The spouses (or former spouses) of the lineal descendants or of the common ancestor

The common ancestor may not be more than six generations removed from the youngest generation of shareholders who would be members of the common ancestor's family.

The IRS has now issued long-awaited guidance on how to make the S corporation family shareholder election. The election may be made by any member of the family and is made by notifying the corporation to which the election applies.

In addition, the notification must identify by name:

- The family member making the election
- The family's common ancestor for whom the election applies
- The first taxable year of the corporation for which the election is effective

Problems with disproportionate S corporation distributions

S corporations sometimes make income tax payments directly to the IRS or states on behalf of shareholders. Problems can arise because the amount of tax payments may not be in direct proportion to the shareholders' ownership percentages.

The solution is to make additional cash distributions to correct the disproportion. Not doing so may result in termination of the S election—a potential tax nightmare.

An S corporation cannot have more than one class of stock. A corporation generally is treated as having only one class of stock if all of its outstanding shares confer identical rights to distribution and liquidation proceeds.

Although a corporation is not treated as having more than one class of stock as long as its governing provisions provide for identical distribution and liquidation rights, any distributions, *e.g.*, actual, constructive or deemed distributions, that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

S corporations should be aware of this issue and have procedures in place to correct disproportionate distributions.

Charitable donations: more than just writing checks

If your contributions to charity begin and end with check writing, you may be missing out on some satisfying volunteer opportunities—not to mention a few tax deductions.

The tax law provides a number of tax breaks for making contributions other than cash to qualified organizations:

Deduct transportation costs - You can generally deduct vehicle expenses incurred in helping a qualified charity, such as picking up or delivering items for it.

To compute your deduction for charitable driving, use the standard mileage rate of 14 cents per mile. Parking fees and tolls are deductible in addition to the mileage rate.

Recoup your expenses - Unreimbursed out-of-pocket expenses you pay in giving services to a qualified organization may count as a charitable donation. You cannot deduct most personal expenses, such as the cost of meals, even if they are necessary for you to volunteer; however, you may deduct travel and meals if you must be away from home overnight on charity business.

No time to volunteer - Many charities accept noncash donations. Giving investments that have increased in value can be a smart tax move. Instead of selling the investment and paying capital gains tax, give it to a qualified organization.

If you held the investment for more than one year, you generally can deduct its fair market value at the time of the donation. Remember, you'll need a receipt from the organization to claim a tax deduction for any gift worth $250 or more. Other records also may be required.

Things you cannot deduct:

- Contributions to a specific individual
- The value of your time or services
- Appraisal fees to determine the value of donated property

Restrictions may apply - Contributions must be made only to qualified organizations that meet IRS guidelines; IRS **Publication 78** has a current list of qualified organizations.

Avoid relocation reimbursement trap

If your business helps relocating employees sell their homes and reimburses them for any resulting loss, be aware a tax trap exists if the title to the home passes to your business.

The title transfer to the business is treated as a sale, and any loss on the subsequent sale of the home by the business gets unfavorable capital loss treatment.

The IRS also ruled the unfavorable treatment applies even if the title passes to a third-party relocation firm hired by your business or other agent of your business. However, if the employee retains title, any loss reimbursement your business pays is eligible for a more favorable ordinary tax deduction.

Don't overlook disabled access credit

You may be eligible for a tax credit if you own a small business and plan to make or have made improvements to your facilities that provide access for your disabled customers.

Expenditures incurred in the construction of a new facility do not qualify, but many improvement costs may. Eligible small businesses can take a tax credit to help offset certain necessary expenditures to provide disabled people access to their businesses.

The credit equals half the eligible access expenditures up to $10,250. Eligible small businesses are those with gross receipts under $1 million *or* 30 or fewer full-time employees during the previous taxable year.

Eligible access expenditures are those enabling businesses to comply with the *Americans with Disabilities Act of 1990* and include:

- Removal of architectural, communication, physical or transportation barriers that prevent access to or use by individuals with disabilities
- Providing qualified interpreters or other effective methods of making aurally delivered materials available to hearing-impaired individuals
- Providing qualified readers, taped texts and other effective methods of making visually delivered materials available to visually impaired individuals
- Acquiring or modifying equipment or devices for disabled individuals
- Providing other similar services, modifications, materials or equipment

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Guarding your home computer system. . .

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attacked—it was toast! How could this be? After all, I had installed what I thought was the best protection available—a firewall, antivirus software, all the bells and whistles. Despite my efforts, there it sat, mute and lifeless.

Help is on the way

I tried to imagine how distressing my plight might be to the average home computer user who might know little about online risks or the need to safeguard data and even less about protecting a computer from attack.

How do you fix computer problems you're ill-equipped to prevent or solve? For example, data backups are a true life saver, but have you ever had to reinstall *all* your original software? It once took me three days to do just that.

And maybe, like me, you've purchased software online. Before you can reinstall it, you must submit your authorization code numbers. Do you remember where you stashed *your* code numbers? Just finding them can turn into a real nightmare.

The day my system crashed, I didn't have time to reformat and reinstall my operating system or other applications.

A nearby computer store assured me an employee could quickly reformat my hard drive and reinstall Windows XP for $99. Cyberattacks can cost a bundle in terms of money, time and lost data.

Protect yourself

My job as a BKD information technology (IT) consultant involves helping financial institutions protect their highly complex computer systems. Though they function differently from home-based systems, both are vulnerable to cyberattack.

Following are resources and precautions to help you protect your computer, safeguard your data and maybe even eliminate those annoying pop-up windows.

Install updates **- Be sure you have the latest patches installed.** If Windows XP Home or Professional Edition is your operating system, you can even set your system to automatically alert you when new patches become available. Here's how:

⇨First, go to "Start," then proceed to ⇨Settings ⇨Control Panel ⇨Automatic Updates ⇨Select "Notify me but don't automatically …" ⇨Select "Apply," then "OK"

Turn on your firewall - It's not that difficult and it's free. If you use Windows XP, go to:

⇨Start ⇨Settings ⇨Control Panel ⇨Network Connection ⇨Select the connection you want and change the settings ⇨Advanced Settings ⇨Select "On" ("Protect my computer…"), then OK

If you don't have Windows XP, free personal firewall products are available.

Use antivirus software - For the money, antivirus software is a sound investment. Most vendors will allow you to download and use the software for a given period free of charge.

Protect your system from spyware - Spyware programs automatically install themselves onto your computer system. Originally designed to collect user demographics for marketing companies, spyware can, in some cases, transmit files from an Internet-connected computer to various unknown locations using altered Windows registry files.

If your system is infected, it may run more slowly, some operations may be more difficult to perform or control, and you may be exposed to security risks.

Many of the free spyware programs advertised online are actually spyware. It's safest to go with spyware solutions from well-known companies like Microsoft.

Eliminate pop-up windows - Many of the free pop-up blocking programs available online are also spyware. Again, it's safest to go with solutions from well-known companies like Yahoo or Google or simply turn on the built-in pop-up blocking capabilities of Microsoft Internet Explorer. Go to:

⇨Tools, then proceed to ⇨Internet Options ⇨Privacy and check the box labeled "Block pop-ups."

* * *

Just like the real world, the virtual world is full of danger. The potential exists to be robbed (of confidential information), mugged (with a system attack or hijacking) and offended (by pornographic words and imagery). In fact, it's possible to lose everything (identity theft). ❖❖❖

BKD Technologies

Build your company's value before you sell

by Matthew Keeth, BKD Corporate Finance, LLC, mkeeth@bkd.com

Business owners generally decide to sell their company in reaction to an event—retirement, illness, burnout, attractive valuations, buyer solicitation—but the actual sale process must be built on a solid understanding of every component that contributes to the transaction's overall value. A successful exit from a closely held company can take three to seven years to plan and execute.

The components that build a company's value can be split into three general categories:

- Business fundamentals (managed by the seller)
- Uncontrollable industry and market fundamentals
- Transaction components (managed by the advisor)

To obtain the full market value for your company, proper timing, planning and execution of these components must be built into the sale process.

Business fundamentals

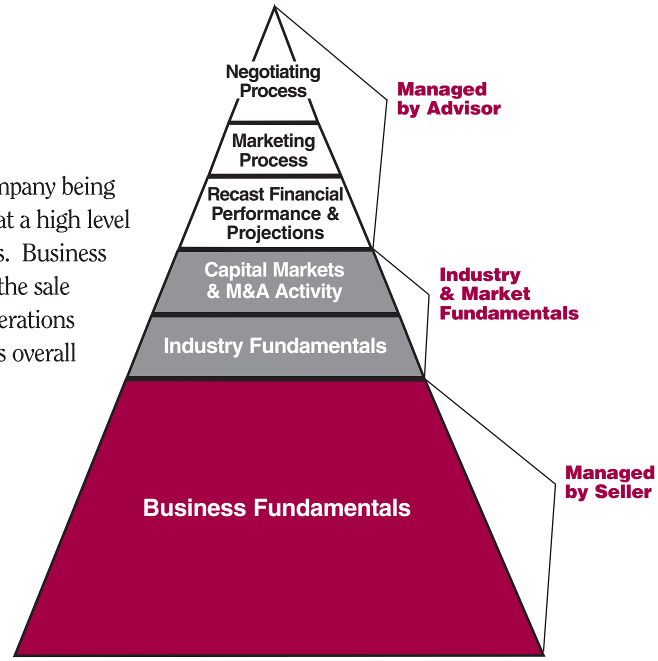
Business fundamentals, *e.g.*, revenue growth, sustainable cash flows and a solid balance sheet, set the foundation of your company's value and lay the groundwork for a successful transaction.

Other important business fundamentals include:

- Reliable financial information
- Product quality and service
- Reputation
- Geographic market served
- Condition and ownership of facilities
- Customer concentration
- Management experience and expertise
- Employee quality

Another significant factor can be your company's ability to effectively project its performance using a defensible forecasting model.

It's essential for the company being sold to continue operating at a high level throughout the sale process. Business owners that try to manage the sale can put their company's operations at risk, which can reduce its overall value.



Components of Company Value

Industry & market fundamentals

A company's value also depends on components beyond the owner's control. Many business owners underestimate the impact industry and market conditions have on a private company's value.

Uncontrollable, market-driven components include:

Industry fundamentals - Like the market as a whole, each industry experiences its own market cycle.

Be aware of industry cycles by watching fundamentals, such as industry growth, customer demographics, substitute products and obsolescence, all of which can affect company value.

Capital markets and M&A activity - The number of M&A transactions and values being paid are good indicators of how receptive the strategic and financial-buyer communities are to a prospective acquisition.

The improving economy, large amounts of private equity, low interest rates and rising corporate earnings drove M&A volume in 2005 to its second-highest total in history.

As middle-market M&A activity continues to be very strong, transaction values have approached the high levels of the late 1990s.

Uncontrollable factors can affect a company's value; correct timing is essential to increasing value.

Transaction components

An often-overlooked component that affects deal value is the way a transaction is managed.

An experienced advisor can add value by helping to provide professional recasting, negotiation and marketing skills and a successful strategy for closing a transaction. All are important factors in unlocking the total market value of a business:

Recasting financial performance - An experienced advisor can help with identifying and adding back discretionary and nonrecurring expenses. This can add significantly to a company's value.

Successful marketing - An advisor can help identify multiple, viable buyer prospects, many the seller may be unaware of.

The buyer group includes strategic buyers, as well as thousands of private-equity groups located throughout the U.S. that are fueled by historic amounts of available capital.

Advisors also understand the importance of confidentiality and positioning the company in its best light.

The competitive environment this combination creates translates into higher valuations and better options for sellers.

Successful negotiations - Experienced advisors also are skilled negotiators that are able to highlight the benefits and value of each component that increases a company's value.

Negotiating with multiple buyers further increases the seller's leverage. Increasing the

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Contact BKD Wealth Advisors for investment,

Unique retirement issues await aging baby

by Wayne Starr, BKD Wealth Advisors, LLC, wstarr@bkd.com

President Bush and former President Clinton will have at least one thing in common this year: Both will turn 60 along with an estimated 2.9 million other baby boomers. When the tail end of this generation surges toward that milestone, it will be 2023.

It's difficult to ignore the media coverage, commercials and ads that trumpet the wide-ranging products and services specially designed for this aging human wave as it rolls closer to retirement.

Yet, it's important for boomers to focus their attention on two major issues many could face as they age:

- Carrying significant debt into their retirement years
- The possibility of outliving their assets

Lighten debt before retirement

The largest debt most of us carry is a home mortgage. You can carry your mortgage into retirement and pay it off under its terms or pay it off early using other assets.

A third alternative is to accelerate the payoff by adding additional monthly or annual principal payments so the debt is retired by the planned retirement date.

If you're a baby boomer, each of these strategies is viable, but each requires careful analysis based on your particular situation. The following will affect your choice:

- How much you've saved for retirement, both in and outside a qualified plan
- How long you plan to live in your current home
- Your tax bracket before and after retirement
- Your expected rate of return based on your risk tolerance
- Your mortgage interest rate
- The time to your retirement date

Regardless of your situation, a feeling of security and comfort can come from knowing your retirement years can begin without a mortgage.

Allocate reasonable expenses

The second major concern involves the fearful prospect of outliving one's means. Determine how much money you'll *need* to live on in retirement and how much you'll *want*. "Need" covers the essentials—food, clothing, shelter and health care. "Want" includes the costs of nonessential items—hobbies, travel, a second home and gifting.

Think of *need* as the base target and *want* as the live-it-up target. And factor in life expectancy; retiring at age 60 and living to 90 translates into funding for one-third of your life!

Market commentary: fourth quarter

by Jeff Layman, BKD Wealth Advisors, LLC, jlayman@bkd.com

Economic environment

The most significant economic surprise of 2005 was positive: GDP growth registered a 4.1% real rate in the third quarter. This is the strongest pace of economic growth since the first quarter of 2004, remarkable given two major hurricanes prompted a huge rise in energy prices during the quarter's final month.

The economy proved resilient, despite the expectation that, with oil prices higher than $70 per barrel and gas higher than $3 per gallon, consumer spending would stall.

The Federal Reserve (Fed) continued to raise interest rates during the quarter, increasing the Fed funds rate to 4.25% at the December meeting, which represented the 13th consecutive boost.

Despite disruptions caused by the hurricanes, high energy prices and rising interest rates, the economy maintained a run of 10 straight quarters of 3% or more real growth, the longest string of above-average growth since 1986.

Growth in 2005 averaged just under 4%, which is impressive in the third year of an economic recovery. Our expectation is the economy is likely to slow toward 3% growth in 2006, as the lagged impact of higher interest rates and sustained high energy prices slow the pace of consumer spending.

Fixed income markets

Calendar year 2005 played out in a similar fashion to 2004 for the primary U.S. stock market indices. The S&P 500 index traded in a narrow range of roughly +/- 5% through the end of October.

During November and December, the market produced the majority of its modest return for the year, as the price of oil declined from its peak in September, and the Fed indicated the end of the current tightening cycle was near. The resulting "mini-rally" allowed the S&P 500 to close the year up about 5%.

Equity Index Returns	4Q 2005	2005
S&P 500	2.09%	4.91%
Russell 2000	1.13%	4.55%
S&P Mid-Cap 400	3.34%	12.56%
MSCI EAFE	4.08%	13.54%

For the first time since 1998, large-cap stocks (S&P 500) posted returns greater than small-cap stocks, as the Russell 2000 index of small companies gained just 4.55% in 2005. International stocks led the market higher again in 2005, with the MSCI EAFE index gaining 13.54%.

Foreign stocks benefited from strong, synchronized growth in the global economy and

boomers

Decide investments realistically

The next step in the planning process is to determine risk tolerance. Your investment decisions must be based on what is *probable*, not on what is *possible*. The S&P 500's average return of 28.5% from 1995-1999 is not probable.

Establish a distribution plan that provides the income you need and eases concerns about running out of money. How much can you safely spend each year as a percentage of your total assets? A reasonable percentage to plan on is between 4% and 5%.

Finally, take time to regularly review:

- Your income needs as they can change
- Your portfolio structure
- The need to rebalance your investments to help control risk

One-size planning does not fit all, and one product does not provide all the answers. Only through careful, thoughtful analysis can you answer your retirement questions and assess and plan for your needs *and* wants. ❖❖❖

closes year on positive note

valuation levels that remain relatively attractive, at least in the developed markets. The dollar gained against most of the major foreign currencies in 2005, meaning the currency effect was not the significant performance contributor it was in the preceding two years.

During the past two years, corporate performance and stock performance decoupled. Earnings for S&P 500 companies grew by more than 20% in 2004, and stocks rose 11%.

In 2005, earnings are on pace to have grown about 13%, while stock prices rose just 5%. The result is a compression in the market's price-to-earnings (P/E) ratio, now down to about 16 times expected 2006 earnings.

Fixed income markets

As expected, total returns posted by bonds in 2005 were modest. As the Fed continued to raise rates, market rates also rose for bonds, particularly those with maturities under five years.

For example, the benchmark two-year Treasury note yield increased from 3.07% at the beginning of 2005 to 4.39% at year end. When interest rates rise, a bond portfolio's market value declines, reducing its *total return* to a level below the rate of interest income produced.

This dynamic resulted in a total return for the Lehman Municipal Index of 3.51% in 2005, while the Lehman Aggregate taxable bond index posted a total return of just 2.43%.

Outlook for 2006

Despite reaching four-and-a-half-year highs in the latter half of 2005, the S&P 500 index finished the year roughly 15% below the peak reached in early 2000. As of December 31, 2005, the *average annual five-year return* for the S&P 500 index is .54%, just slightly above even.

Over the same period, the Wilshire REIT Index (a proxy for real estate performance) gained more than 19% per year, and the Lehman Aggregate Bond Index is up 6% per year. Clearly, the bursting technology bubble, and the ensuing bear market resulted in a major repositioning of assets from U.S. stocks to other asset classes, *e.g.*, real estate and bonds.

Consequently, the prices of the latter two asset classes, particularly real estate, have been pushed to the high end of their normal valuation range. We believe this limits the potential for outsized future returns from these asset classes.

Meanwhile, cumulative earnings for S&P 500 companies have nearly doubled over the past five years. When combined with the fact stocks have posted no real gains in price over that period, the result is a much cheaper valuation.

The P/E of the market stands at 16 currently, vs. more than 30 at the start of 2000. This factor not only reduces risk in the market but, we feel, results in an attractive valuation for stocks, particularly in the current environment of moderate inflation.

Although bond returns are expected to be moderate again in 2006, this asset class still provides a tremendous benefit in terms of portfolio diversification and income production. Well-chosen alternative investments can provide a similar benefit.

As we enter 2006, be mindful that equities may return to a more normal level of volatility, which could mean significantly more fluctuation in price than we've seen over the past two years.

Therefore, appropriate allocation of investment assets continues to be crucial in managing both risk and return and increasing the chance of a prosperous 2006. ❖❖❖

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Loans from your company could look like dividends in disguise

If you're thinking about taking a personal loan from your closely held corporation, consider how the IRS would look at such a transaction. You'll want to take steps to make sure the IRS will not reclassify the loan as a taxable dividend.

Generally, a distribution to a shareholder is considered a bona fide loan if, at the time of the disbursement, both the corporation and the shareholder intend that the distribution will be repaid.

While you may be tempted to treat withdrawals of corporate funds by owners casually, the unfavorable results of many Tax Court cases show this may not be wise. Many corporate owners have been required to pay income taxes on loans that they could not properly substantiate.

Moreover, because these loans were considered dividends, the corporation could not deduct the payments as compensation. The result is a double tax on the payments.

Keep these rules in mind:

- Loans should bear interest and specify a maturity date (if not payable on demand). Merely classifying a disbursement as a loan on the corporate books and financial statements is insufficient documentation.
- All loans to shareholders should be documented by means of promissory notes.
- Making repayments of principal and interest according to a predetermined schedule will help bolster a shareholder's case that a distribution is indeed a loan.
- If a corporation doesn't charge adequate interest on loans of more than $10,000 to its shareholders, interest must be imputed (the IRS publishes acceptable interest rates monthly).

Deducting leasehold improvements

Many times, leased office space requires changes to accommodate the tenant's business. From a tax perspective, the tenant may be better off having the landlord make the improvements and reimbursing the cost through higher rent payments.

Why would this be preferable to simply paying for the renovations directly? Under federal tax law, the cost of most types of commercial real property improvements must be written off over 39 years, even if the tenant holds a much shorter lease. By contrast, rent payments generally are deductible in full in the year paid.

Businesses that do pay for leasehold improvements themselves should be sure to write off all remaining costs when their leases terminate. ❖❖❖

Build your company's value. . .

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competitive nature of the sale through a professionally managed process helps sellers achieve a higher value for their company.

Successful sale process

A company's ultimate value depends on the seller's ability to understand and effectively manage the complete array of value drivers:

Business fundamentals - The ability to stay focused on these factors is critical.

Industry and market fundamentals - Favorable industry and market conditions can add significant value.

Transaction components - An experienced advisor can also add value to the transaction by effectively managing these factors.

With greater numbers of aging boomer-owned businesses for sale, those sellers that prepare their companies in advance will achieve higher values. ❖❖❖

About *BKD Advisor*

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