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TAX PLANNING FOR MATURE COMPANIES

By Bruce D. Bernard

Tax planning opportunities abound for companies that are fortunate enough to reach a mature state. A company is considered to have reached a mature stage when it no longer needs to retain significant earnings to sustain growth and expansion. Such a company has gone through the painstaking years of accumulating equity and struggling with financing growth, and its planning needs are far different from those of companies in the start-up or growth and expansion phases.

A company may continue in the growth and expansion mode for many years, but may manage its growth and become profitable. However, when the owners of such a sustained-growth company near retirement age, they must address many of the tax-planning issues they would normally consider if their company had already reached maturity.

Whether a company is in the start-up or growth and expansion phase, or is a mature company, business owners

are wise to “keep the company in a saleable position.” The succession plan for many business owners is to eventually sell the company to insiders or strategic buyers. Tax planning is one of many ways business owners can increase the value of the business to a prospective buyer.

One important factor that may affect an eventual sale is the type of business entity owners choose.

When a company reaches maturity, it is usually beneficial for it to be a flow-through tax entity such as an S-corporation, a limited liability company or a partnership. These business types generally will result in only one layer of tax when the business is sold. An S-corporation may be especially attractive to buyers since certain opportunities are available only when there is corporate stock.

A mature company that no longer needs to retain earnings for growth and expansion should normally be a flow-through entity, regardless of the potential for sale. The flow-through entity generally will result in the

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COURT'S DECISION BODES WELL FOR SMALL BUSINESS

The Daily Reporter March 23, 2004

When the U.S. Supreme Court handed down its decision in *Raymond B. Yates, M.D., P.C. Profit Sharing Plan, v. Hendon* earlier this month, in effect it gave working business owners some peace of mind in regard to retirement planning.

The court resolved on March 3 that owner-operators of companies may be considered to be “participants” in their company’s pension plans that are covered under the Employee Retirement Income Security Act of 1974. According to the ruling, an owner qualifies as long as there is one or more employees other than the owner and the owner’s spouse enrolled in the plan.

“Consequently, such individuals may be entitled to the same rights and protections that ERISA affords to their employee-participants,” which makes sponsoring retirement plans more attractive to small business owners, said Gregory L. Ash, an employee benefits lawyer at Spencer Fane Britt & Browne LLP, a firm based in Kansas City.

http://www.sourcenews.com/news/today/cdr_a.lasso

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lowest level of overall taxes. Further, the flow-through entity is better for estate planning.

There are, however, situations where a company should remain a C-corporation, even if a sale is anticipated. For example, a company should consider remaining a C-corporation if it has lower levels of retained earnings (say less than \$100,000) from year-to-year and there are other tax planning opportunities available to avoid tax problems upon a sale. It is sometimes possible to take advantage of the lower current rates without compromising on the tax planning available upon a sale.

It is often advantageous to vertically or horizontally segregate a business into separate business entities. Sometimes this is desirable for liability issues.

There can also be lower current income taxes and eventual lower taxes upon the sale of the company. Estate planning is often facilitated with separate entities.

Several other tax planning ideas that may be of value include the following:

Whether a company is in the start-up or growth and expansion phase, or is a mature company, business owners are wise to “keep the company in a saleable position.”

■ A deferred compensation or non-qualified stock option plan can create deductions at the company level to offset gains.

■ Document times when owners are undercompensated, even though they are providing employee services, so you can justify providing a bonus in the future if it's advantageous to do so for tax reasons.

■ Review any non-compete and employment agreement to make sure the company can maximize “shareholder intangibles” upon a sale.

Many tax-planning opportunities arise at the time of a sale. However,

other ideas need to be implemented well in advance of the sale. Maximizing after-tax proceeds is the key.

Tax planning for mature companies is not limited to a potential sale of the business. Business owners also should consider implementing or updating qualified retirement plans. The key is to establish a plan that benefits the people the owners want to benefit. A qualified plan can allow current reduction of taxes, tax-free accumulation of income and deferral of income to be taxed at lower rates upon retirement.

Other fringe benefits should be reviewed. A medical reimbursement plan, long-term care insurance and health insurance for key employee retirees (including the owners), should be considered.

Reimbursement plans should be reviewed. Is the maximum tax advantage being received for work-related expenses incurred by the owners?

“Key men” and “buyout” life insurance policies often have not been structured properly for the succession plan. The tax and non-tax considerations of such policies must be reviewed.

In general, the owners should be looking at their overall succession and estate plans. These issues come to the forefront with mature companies. It may be appropriate for owners of such a company to build a new line of key management, shift wealth, shift income and identify potential strategic buyers for the future, etc.

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IN THE HOPPER

Pending state legislation that could affect small business

Senate Bill 80, the latest attempt at CIVIL TORT REFORM sponsored by Steven Stivers (R-Columbus), would enact a legal consumers' bill of rights, limit attorney contingency fees in connection with certain tort actions, establish minimum medical requirements for filing certain asbestos claims, and make other changes related to civil actions. A related bill (House Bill 292) would establish limitations on successor asbestos-related liabilities relating to corporations.

The bill proposes to make changes related to the award of certain damages, collateral benefits evidence, and contributory fault in tort actions. If passed, the bill would establish a “statute of repose” for certain product liability claims and claims based on unsafe conditions of real property improvements and make other changes related to product liability claims.

The product liability provisions of the bill are intended: to replace common law product liability causes of action; to enact a “conflicts of law” provision for statutes of limitation in civil actions; and to modify the provisions on frivolous conduct in filing civil actions.

The OSBA has taken positions on several of the bill's provisions, but has asked the Ohio legislature to commission research to define the scope of the issues that need to be addressed before taking any further legislative action.

From the OSBA Office of Government Relations.

Web site resource for small businesses:

To learn about programs offered by the U.S. Dept. of Labor's Office of Small Business, go to:
<http://www.dol.gov/osbp>.