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A tax, business, and financial planning newsletter for our clients and friends

Tax Loopholes for Buying a Business

The manner in which you buy a business can have significant tax ramifications. Of the two ways to buy a business – by purchasing the stock or by purchasing its assets – an asset purchase can create better opportunities for bigger write-offs. Here's why.

Disadvantages of a stock purchase

When you buy a company's stock, the cost basis you must use for depreciation is the value of the assets as shown on the company's books at the time you purchase the stock. Any amount you pay over the book value of the assets cannot be depreciated.

Advantages of an asset purchase

When you buy a company's assets, you can allocate the purchase price among various assets of the business based on their fair market value at the time of the purchase. The amounts you allocate can then be used as the basis for the company's depreciation deductions and to establish a loss or gain when you dispose of the assets at a later date.

For example, assume that you pay \$100,000 for a business that has fixed assets with a fair market value of \$100,000 and a book value of \$50,000. If you buy the company's stock, you can only depreciate \$50,000 of fixed assets. But if you buy the assets of the business, you can take depreciation deductions on the full fair market value of the \$100,000 in fixed assets.

Allocate asset values for maximum tax savings

Since some assets are depreciable and some are not, the way you allocate the purchase price to the various assets of the business is the key to maximizing deductions. When you've determined those allocations, make sure that the



CONTINUED ON PAGE 4

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Tax Loopholes for
Buying a Business

Tax Points

Buying Insurance? The
Eight Worst Mistakes
You Can Make

Better Cash
Management

If Your Marriage Fails...

How to Lose a Customer

Better Ways to
Check Credit

taxPOINTS

American Opportunity Tax Credit is available for the first four years of undergraduate college education. The credit is worth up to \$2,500 and is equal to 100% of the first \$2,000 of qualified tuition and related expenses and 25% of the next qualifying expenses. Qualified expenses are tuition and related expenses. **Added bonus:** Up to 40% of the credit is refundable, meaning that your refund can be greater than the amount of taxes you paid. The credit does phaseout for higher income taxpayers.

Combine miscellaneous itemized deductions in the same year. Only miscellaneous itemized deductions that exceed 2% of your adjusted gross income (AGI) are deductible. Consequently, most people find that their miscellaneous itemized deductions are not deductible.

Loophole: By paying two years of expenses in the same year, you can often get over this 2% of AGI limit.

Contribute to your 401(k) plan. For 2015, you can contribute up to \$18,000. You pay no current taxes on the money contributed to the plan, and the income that is earned on the money contributed is also exempt from current taxes.



Buying Insurance? The Eight Worst Mistakes You Can Make

1. Not updating your insurance needs. Consult with your insurance agent once a year, preferably in January when you begin to assess your tax situation.

2. Setting your deductible too low. Insurance premiums drop dramatically when you raise the deductible. Check it out.

3. Not taking advantage of group plans. Business and professional organizations to which you might belong frequently offer group health or disability coverage at substantially lower premiums than anything that's available from an agent.

4. Not shopping for the best cost. You comparison-shop for a car, so why not do it for insurance? Just because you've always dealt with one insurance company doesn't mean your getting the best deal.

5. Failure to have disability insurance. It's three times more likely that

you'll be disabled before age 65 than it is that you'll die. Disability insurance is particularly important for professionals and self-employed individuals.

6. Not considering insurance as part of your personal financial planning. For example, life insurance can be used to generate interest income or to reduce estate taxes.

7. Doing business with a disinterested insurance company agent. You're much better off dealing with an independent agent who'll shop around for the best coverage at the lowest cost.

8. Buying insurance you don't really need. **Examples:** life insurance for children, travel insurance that probably duplicates coverage you already have, collision insurance for an old car, and car rental insurance that might be included in your homeowner's policy.

Better Cash Management

SPEED UP RECEIPTS

- Charge interest on late payments
- Require partial advance payment on large order
- Speed up order processing and billing procedures

SLOW DOWN DISBURSEMENTS

- Renegotiate unit costs and order quantities
- Eliminate slow-moving inventory

UTILIZE CASH BETTER

- Invest temporary excess cash in a money market account



If Your Marriage Fails...

No one likes to think that their marriage might not work out, but half of today's marriages end up in divorce. So even if you think your marriage was made in heaven, it's wise to protect yourself from the unexpected by taking some key defensive steps as early as possible. Look for ways to protect yourself that don't require your partner's participation or knowledge and keep in mind that assets in your name are subject to disclosure in the event of a marital breakup.

Maintaining privacy

Here are two examples of simple but effective steps you can take to safeguard information about your personal financial affairs.

- Get your own safe deposit box. If you own a business, you can make the box even more private by opening it in the name of the corporation. Give access to another person who you trust and leave instructions for

your spouse to contact that person in the event of your death.

- Have certain mail delivered to your business address or to a post office box rather than to your home. Credit card bills, statements from your stockbroker, and similar sensitive mail usually contain information you might prefer to be kept confidential.

Taxes and trusts

There's nothing that reveals more about your financial situation than your income tax form. If you file a joint return, look for some investments that yield tax-free income which doesn't have to be reported. Or you might consider filing separate tax returns even if your taxes are slightly higher.

One of the best ways to conceal assets is through a Living Trust, which guarantees secrecy while you are living and avoids probate when you die. You can act as its trustee and can designate an alternative trustee to administer and

distribute its assets according to your wishes after you die. Another advantage to a living trust is that although you must report income earned by the trust, you do not have to report the source of that income.

You can also protect your assets by putting them in your children's names and designating yourself as the custodian of the children's accounts.

Pre-nuptial agreements

Pre-nuptial agreements have become quite common and are an accepted way to protect the interests of both husband and wife. They detail exactly how all finances, including child support and alimony, will be handled in the event of a divorce. Pre-nuptial agreements also segregate assets owned before marriage.

Pre-nuptial agreements are yet another way to spell out the distribution of assets if there's a divorce, but certain states do not enforce them as stringently as others.

How to Lose a Customer

Don't contact the customer:

When customers don't hear from you, they don't think of you.

Change salespeople frequently:

It takes time for a salesperson to gain a customer's confidence. Frequent sales personnel changes make it difficult to establish a good relationship with a customer.



Resist change: Customer needs change, and if you stick with the same old policies, you won't be able to satisfy their changing needs.

Ignore financial responsibilities:

Some sure ways to lose a customer are slow or arbitrary credit adjustments, budget overruns and incorrect invoicing.

CONTINUED FROM PAGE 1

Tax Loopholes for Buying a Business (continued)

assets are listed in the sales contract and that a specific amount is assigned to each. You'll need this information to support your deductions.

Handling Critical Assets

Goodwill is the amount you pay for a business in excess of the value of all the other assets of the business. The amount you allocate to goodwill is amortized over a 15-year period beginning in the month of acquisition. Be careful to assign a reasonable value to goodwill and to include it in the sales contract. If goodwill is left out of the contract, the IRS can assign a value to it and lower the value you allocate to another depreciable asset.

Seller's agreements not to compete often assign a specific value to this item and typically cover a fixed time period. The IRS allows agreements not to compete to be amortized over a 15-year period regardless of the fixed

time period stated in the contract. Be careful not to overvalue an agreement not to compete of less than 15 years since it must be amortized over a 15-year period.

Consulting fees are often paid to sellers who remain active in the business over a period of time. If you allocate a portion of the purchase price to a consulting fee the amount is fully deductible.

Employment contracts are sometimes given to key employees before a business is sold. You acquire these contracts when you buy the business, so you can allocate a portion of the purchase price to them. The cost can be amortized over the life of the contracts and is deductible.

Lease purchase premiums are amounts paid by the buyer to acquire an existing lease at an attractively low rent. You can write off lease premium costs over the remaining term of the lease.

Subscription lists and customer lists may be amortized if its value can be ascertained and the list has a limited useful life, the duration of which can be determined with reasonable accuracy.

Business-buying traps to avoid

Don't forget that while buildings are depreciable, land is not. If you buy buildings and land, be sure that the sales contract separately states the price of the buildings and the price of the land so you can determine depreciation deduction for the buildings.

To maximize depreciation deductions, some buyers often seek a relatively high purchase price allocation for fixed assets such as machinery and equipment. However, fixed assets may be subject to state sales tax and a high valuation can result in a higher sales tax. Some simple advance calculations will help you avoid this trap.



Better Ways to Check Credit

Today, more than ever, it's vital not to take unnecessary credit risks. In addition to Dun & Bradstreet's credit information services, you can get even more complete information from credit agencies that specialize in certain industries. Retailing, the garment industry, and automotive parts are some of the businesses with credit agencies that offer reliable information developed by industry experts.

Do Your Own Credit Investigation.

A call to the customer's bank can be very helpful. A loan officer will usu-

ally give you an idea of the company's average account balance, the company's borrowing history, whether loans are secured or unsecured (unsecured loans indicate excellent credit standing), which of the company's assets have been used as collateral, and whether the bank has liens against key assets such as accounts receivable.

You can also ask the company for a financial statement. Many companies will not give this information to credit agencies to keep it from their competitors. However, if a company knows

your inquiry is legitimate and its credit is good, it should be willing to supply a financial statement and any other credit information you need.

You can also ask the company for the names of some of its suppliers. Most suppliers will gladly tell you how much credit they extend the customer and whether the customer pays promptly.

Your lawyer can do a lien search of the county clerk's records for liens that might be placed on a company's assets because of failure to pay its bills. IRS liens will also show up in a search.