

SMALL BUSINESS CONNECTIONS

HOW HEALTH CARE REFORM WILL AFFECT SMALL BUSINESS

BY KAREN E. KLEIN

The health-care reform law, all 2,400-plus pages of it, will take eight years to be fully implemented. Some self-employed people and small employers will begin to feel the impact almost immediately. Others won't notice changes for a few years. Here are the major adjustments.

Preexisting Conditions

[A] temporary high-risk pool will be established so that uninsured people with medical conditions can buy insurance coverage at reduced rates. Starting this fall, insurance companies will no longer be able to put lifetime limits on coverage or rescind coverage, except in cases of fraud. By 2014, insurance companies will be barred from rejecting individuals because of preexisting conditions.

Health Exchanges

Beginning in 2014, individuals and small businesses will be able to shop for coverage in new state-run health exchanges. About 25 million people are projected to use the exchanges.

Companies with Fewer Than 50 Employees

These small ventures, which make up 96% of U.S. businesses, are exempt from the mandate [...] to provide health benefits by 2014

or pay a \$2,000 penalty per employee.

[This] may discourage growing enterprises from adding full-time employees, says Jim Garland, CEO of Sharp Details. Garland predicts that many small companies will find a way to stay under 50 employees because of the insurance mandate. "They'll break up their operations into separate companies, hire more part-timers, or do whatever they have to" to stay in business, he says.

Another result of reform [...] is a tax hike for high-income individuals, starting in 2013. The law is funded in part by a 0.9% (from 1.45% to 2.35%) tax increase on wages over \$200,000 for individuals and \$250,000 for married couples. The same taxpayers face a 3.8% tax on unearned income, starting in 2013.

Tax Credits for the Smallest Companies

Businesses that pay more than 50% of employees' health benefits, have fewer than 26 employees, and pay average annual wages of less than \$50,000 can claim a tax credit of up to 35% of the cost of premiums from the 2010 tax year through the 2013 tax year. The credit will go up to 50% in 2014 and can be used for two consecutive years after that.

Some 4 million businesses are expected to be eligible for the credit this year, and the Congressional Budget Office estimates

IRS MAY WATCH S CORPORATIONS' WAGE REPORTING TACTICS MORE CLOSELY

BY PETER DEMARCO

Business owners operating under the S corporation structure should be aware that their tax returns and rulebooks have become fertile ground for authorities looking for new ideas on where to shore up compliance and raise new sources of revenue.

The U.S. Government Accountability Office (GAO) recently completed a study on how well S corps generally are complying with tax rules. The findings suggest S corps are under-reporting income and may be enjoying some tax advantages that Congress should reconsider.

The S corp structure is a common choice of legal entity for owners of small businesses, in large part because of the way it is taxed. The income of an S corp is not taxed at the corporate level, but is passed through to the tax returns of its individual shareholders. That means earnings, losses, and credits are reported by individual

shareholders, rather than the corporation, resulting in a single level of taxation at the individual level, instead of at the corporate and individual levels.

It also means that whatever amount S corp owners are not paying themselves in salary is retained by the corporation as undistributed earnings, which means those earnings are not subject to payroll, Social Security, or Medicare taxes. This is a distinct difference between S corps and C corps or other types of partnership or sole proprietor structures.

The IRS has long held that S corp owners are expected to pay themselves reasonable salaries so that their income is fairly

(Continued on p. 3)

ESOPs ON THE RISE AMONG SMALL BUSINESSES

BY KAREN E. KLEIN

An ESOP (Employee Stock Ownership Plan) is a tax-advantaged, qualified employee retirement plan, similar to a stock bonus plan except that it can borrow money. ESOPs are typically created to buy out all or part of an owner's interest in an established, profitable company. The stock is held in a trust, and employees can cash in their shares when they retire or leave the company.

While ESOPs are costly to establish and operate, they have gained in popularity during the recession. There were 11,400 ESOPs in the U.S. in early 2009, up about 400 over 2008 and 800 over 2007, according to statistics compiled by the National Center for Employee Ownership. As of 2006, the most recent year for which statistics were available, more than 13 million U.S. employees had ESOPs.

ESOPs have become a more appealing way for owners to cash out their equity because the downturn has lowered what most companies would fetch in a merger or acquisition.

ESOPs are not for every small or midsize business. They are best for long-established companies in which the owner is ready to retire—although these days some middle-aged entrepreneurs who simply want to diversify their holdings or pull cash out for things like vacation homes are setting up ESOPs. Often, the best ESOP candidates don't have family members waiting to inherit the company.

ESOPs are highly regulated under ERISA (the Employee Retirement Income Security Act) and operate through a plan trust. Generally, all full-time employees (1,000 hours or more annually) become participants in the plan. They receive allocations of stock in their accounts from contributions made by the company.

It takes about six months, a minimum of \$75,000, and a great deal of complexity (in hiring multiple attorneys, advisers, and trustees) to set up an ESOP. Of course, there are costs involved in ownership transfer of any sort. Take, for example, a business sale, in which lawyers, accountants, brokers, and other advisors will be involved.

ESOPs come with significant tax benefits. When an ESOP borrows money to buy stock, both interest and principal payments are tax-deductible. In a C corporation, stock dividends held by the ESOP can be deducted from corporate taxable income. In S corporations, which most ESOP companies are, the ESOP becomes a tax-exempt shareholder.

Companies that use ESOPs tend to perform better than those that do not. Annual sales, employment, and productivity grow 2% to 3% faster after employees are transformed into owners. Additionally, employees in ESOP companies typically earn more and have greater retirement assets when they retire than do employees of non-ESOP businesses

For the full story go to: http://www.businessweek.com/smallbiz/content/mar2010/sb20100325_591132.htm

TOP 10: BUILDING YOUR REFERRAL NETWORK

1. Become active in two types of associations - one related to your industry, and one with a general business focus. You'll meet experts in your area and successful entrepreneurs from all areas.

2. Share your knowledge freely; give presentations for a local associations. Write articles for publications that reach your target audience.

3. Provide referrals to not only highlight your credibility and connections, but to generate referrals from those for whom you've generated business.

4. Recruit cheerleaders - a group of friends, family members, or colleagues who not only cheer you along, but sing your praises to others they know.

5. Create an informal advisory board to help you plan and solve problems. They may be associates from a trade show or conference, someone you've volunteered with, or former clients.

6. Do a good job for your clients - most important of all. When you do a good job, you'll get repeat business

and new clients.

7. Be visible at the local level. Be active in your local business community. Volunteer for nonprofits in your field, attend Chamber of Commerce mixers, and participate in other activities.

8. Use technology to stay connected to your market and accessible to your customers. Voice mail, cell phones, desktop publishing, email, and the Internet can all help.

9. Have a backup network. If you can't complete a customer's work, have a method in place to handle the situation. This ensures the work is finished, and the customer will appreciate your professionalism and reliability.

10. Ask for your client's business again, and suggest that they give your name to others. Let them know that you'd like to work with them again, and that you'd like more customers just like them.

By Terri Lonier. For additional information, visit http://www.score.org/m_pr_15.html

Some of the Tax Changes for 2010

Section 179 Expense Deduction

The maximum amount of equipment placed in service that businesses can expense drops by nearly 50%, to \$135,000 (was previously \$250,000).

Domestic Production Activities

This deduction increases to nine percent of qualifying business net income. Applies to businesses engaged in construction, engineering or architectural services, film production, or the lease, rental, or sale of equipment you manufactured. The rate remains six percent for oil and gas companies.

Sales Tax Deduction for New Vehicle

Buyers of new vehicles no longer get a tax benefit for sales tax paid on new vehicles, unless they itemize and elect to deduct sales taxes instead of state income taxes.

Mileage reimbursement rates –

The updated mileage reimbursement rates effective for January 1, 2010 are \$0.50, \$0.165 and \$0.14 for miles incurred for business purposes, medical purposes and charitable purposes, respectively.

Roth IRA Conversions

Individuals with any amount of modified Adjusted Gross Income can switch from a traditional IRA to a Roth IRA. Conversions are fully taxable at ordinary tax rate. For conversions in 2010, taxpayers can spread the tax due over two years. Half the tax will be due in 2011, and the remaining half will be payable in 2012.

Removing the limit on conversions effectively eliminates the income limit on contributions to Roth IRAs. A taxpayer with income too high to use a Roth will be able to contribute to a traditional IRA (which does not have income limits for contributions) and immediately convert to a Roth.

Sunbelt Book Club

The Future Arrived Yesterday: The Rise of the Protean Corporation and What it Means for You by Michael S. Malone

The central idea here is both simple and powerful: The global economy has entered a new era, and a mercurial corporate form Malone calls the "Protean Corporation" will become the dominant species by the middle of the next decade. "These Protean Corporations," he writes, "will behave like perpetual entrepreneurial startups, continuously changing their form, direction, even their identity. They will be true corporate shape-shifters."

Crown Business; 295 pp; \$27.50

Animal Spirits: How Human Psychology Drives the Economy, and Why it Matters for Global Capitalism

By George A. Akerlof and Robert J. Shiller

Their main thesis is simple. Akerlof and Shiller argue that conventional macroeconomics is wedded to the idea that people and businesses are rational actors. But this model falters during booms and busts. Instead, the authors say, the only way to understand today's crisis is to focus on noneconomic motivations and irrational behavior, or what they call "animal spirits."

Princeton; 230 pp.; \$24.95

How Health Care Reform Will Affect Small Business (Continued from p. 1)

that the credit could save small businesses \$40 billion by 2019.

Risk: Tax Increase on Unearned Income

Lani Hay is president of Lanmark Technology, an IT company that specializes in government contracting work. The [company] employs 150 people. Hay already provides insurance but worries that her costs will increase dramatically from now to 2014, when she'll gain the option of buying into an exchange.

"In the past three years, my health costs have increased each year by double digits. That cuts right into the profit margins of my company," Hay says. "For any small business...it's a challenge having enough working capital. But to be competitive and attract the same employees as the bigger guys, we have to offer the same benefits package they do."

Another worry plagues R. Michael Johnson, president and CEO of Cox Industries, a midsized lumber company. He provides a generous benefit package for his 400 employees, but the company relies on family shareholders and outside investors, some of whom will be affected by the tax increase on un-

earned income for wealthy individuals.

"The 3.8% tax on unearned income will increase the earnings requirements on [subchapter S corps] such as Cox to satisfy the risk our shareholders take by investing in small businesses like ours. This small percentage seems benign, due to the small number and putting it on 'unearned income,' but this income is earned. In fact, our team works hard every week to earn this income and reward the shareholders that patiently leave their capital in the business."

Another thing that worries Johnson is his calculation that he might save up to \$2 million if he were to drop his employee benefits and instead pay the \$2,000 per-head penalty. "We are not even remotely considering this option, but I hate to think that new legislation would actually make dropping our plan more appealing to businesses like ours," Johnson says.

Karen E. Klein is a Los Angeles-based writer who covers entrepreneurship and small-business issues.

For the full story, go to <http://www.businessweek.com/smallbiz/content/apr2010/>

IRS May Watch S Corporations' Wage Reporting Tactics More Closely (Continued from p. 1)

taxed, but it hasn't been rigorously enforced. There is plenty of room for shareholders, their tax preparers, and the IRS to judge what might constitute a reasonable salary.

The GAO report said some S corps in 2003 and 2004 failed to pay adequate wages to shareholders for their service to the corporation, estimating the underpayment at \$23.6 billion. That raises serious questions about whether employment taxes have been underpaid as a result, and whether perhaps the IRS might consider some new focus on this issue in its examinations and audits going forward.

Other tax studies also have show that inadequate shareholder compensation is a significant issue. The IRS has provided limited guidance on what is often a highly subjective issue, prompting the GAO to suggest the IRS consider providing some new guidance to help improve compliance.

The GAO also reported that about 68% of S corporation returns filed for the 2003 and 2004 tax years contained at least one misreported item, and 80% of those errors favored the taxpayer. The most frequent errors

involved deducting expenses for which there was no legitimate eligibility.

Also disturbing, the report says 71% of noncompliant tax returns were prepared by professional tax preparers. Preparer mistakes may result from a lack of standards to follow or a general misunderstanding of the tax rules, both of which could become the subject of future rulemaking or enforcement action to improve compliance.

There are a number of moving parts to the debate in Washington over how Congress and various regulators should respond to current conditions with new tax rates, new rules, and new reporting requirements. Owners of S corps should plan to stay tuned for what are certain to be some meaningful changes that may affect how they structure and operate their businesses going forward.

Mr. DeMarco is VP and Director of Tax Services for the accounting and business consulting firm Meaden & Moore.

For the full story, go to: <http://www.crainscleveland.com/article/20100308/SUB1/303089986>

SUNBELT ATLANTA PROFILE:

Sunbelt is the dominant business brokerage firm in the Atlanta area providing valuation and marketing services to sellers and facilitating financing to buyers all the way from listing to closing in an ethical, discreet and confidential way based out of a professional office setting with easy access off of and adjacent to the I-285 Atlanta perimeter highway at Chamblee Dunwoody Rd.

Sunbelt offers professional expertise and reliable service to our clients in areas of Buying and Selling privately held businesses, Mergers and Acquisitions, affiliated Financial Support Services, including Loans, imaginative methods of Raising Capital and Cash Flow, Tax Reduction Strategies and related Commercial Real Estate services. We assist both Sellers in preparing and packaging their business for marketing and Buyers looking for a specific acquisition or merger. The company is a fully licensed Real Estate and Business Brokerage operation with only trained professionals, all holding Real Estate Salesperson or Real Estate Broker licenses in compliance with the Georgia Real Estate Commission Rule # 520-1-19 for business brokers and intermediaries. The Sunbelt Business Broker Network has been established since 1979 and is the largest business brokerage network in the world.

Sunbelt provides free consultations to both sellers and buyers in all aspects of selling and purchasing a privately held business from Main Street to Middle Market including exit strategies; market values; financing and the negotiation process all the way to the closing table.

If you are a Seller please call us for a free confidential consultation or if you are a Buyer please contact us to help you find that special business you are looking for.

Affiliations:

Member of IBBA (International Business Brokers Association) since 2000

Member of the ACFA (American Cash Flow Association) since 1995

Sunbelt Business Brokers Network consisting of approximately 300 offices coast to coast in the USA and worldwide

See our
advertisements in
Inc. Magazine.



Visit us online at www.sunbeltatlanta.com.



4470 Chamblee Dunwoody Road, Suite 445

Atlanta, Georgia 30338

Tel: 770-936-9099

Fax: 770-936-0405