

WEBINAR

Year-End Planning for Businesses and Their Owners

Publication date: November 29, 2022



Possible *(Re)Defined*™



Confidence and Clarity



Integrated Solutions



Insight and Foresight



Business Disruption is Inevitable and Happening at an Accelerated Pace



Requiring a Recalibration of Vision to Uncover New Opportunities



Re-imagining
People Strategy



Empowering
Operations



Navigating
Disruption



Digital
Transformation

AREA OF FOCUS

Today, We're Covering

Empowering Operations

EDUCATION

Upcoming Webinar

Year-End Tax Planning for High-Net-Worth Individuals

December 8, 2022 | 11:00 AM CST



KNOWLEDGE

Learning Objectives



Discover year-end strategies for privately held businesses



Discuss state and local tax changes, as well as year-end strategies



Evaluate the current M&A landscape

CPE Information

**Program Level: Basic
Recommended CPE: 1
Field of Study: Taxes
Program Prerequisite: None
Advanced Preparation: None**

WELCOME

Today's Presenters



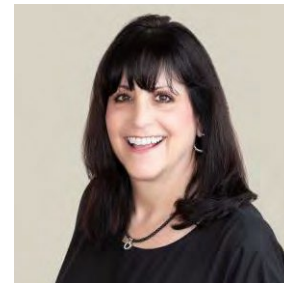
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LET'S TALK YEAR-END

Agenda

- Year-end strategies and tactics
- Review state and local tax changes
- Current M&A landscape
- Q & A

2022 Year-End Planning

Compare the Benefit of Deferring vs. Accelerating Income for 2022

- Evaluate tax rates in 2022 vs 2023
- 3.8% net investment income tax on investment on passive income
- Review tax loss carryover or tax credit usage

Installment Sale

- Will the usage of the installment sale treatment be useful for the sale of non-inventory property? Elect in or elect out?
- Income recognition will normally be deferred under the installment method until payments are received, so long as one payment is received in the year after the sale.

Review Year-End Bonus Liability for Accrual Basis Employer

- All the events have occurred that establish the fact of the liability (to pay the bonus)
- The amount (of the bonus) can be determined with reasonable accuracy
- Economic performance has occurred with respect to the liability

Rev Rul 2011-29

To be eligible for the bonus, an employee had to perform services during the tax year and be employed on the date that the employer paid the bonus after the end of the tax year. Any bonus allocated to an employee that was not employed on the date the employer paid the bonus was reallocated among other eligible employees. IRS determined that all events had occurred by the end of the tax year to establish the employer's liability to pay the minimum amount of bonuses.

Federal Bonus Depreciation on Expenses

- Certain fixed assets such as personal properties, land improvements and interior, non-structural parts of the building
- Claimable percentage drops to 80% in 2023
- Consider purchasing and placing the fixed assets in service before year-end

SECURE Act

- Employers now have until the business' income tax return deadline, including extension, to adopt a plan and may treat it as adopted at 12/31 of the prior year.
- Explore plan enhancement options for 2022

Qualified Business Income Deduction

- Review the 20% (QBI) calculation and components for non-C Corporation taxpayers for eligibility and maximization. The factors include wages and fixed assets.

Charitable Contributions

- Evaluate the deductibility and tax rates if your income is expected to change
- Consider a donor advised fund
 - Deduction may be claimed in 2022
 - Actual selection and contribution to charities may be deferred until 2023

R&D Credit

- The Inflation Reduction Act of 2022 increases the cap from \$250,000 to \$500,000 for payroll tax offset for tax years starting January 1, 2023.
- Application: \$250k may offset employer FICA and \$250k may offset Medicare tax
- To be a qualified small business, an eligible entity must have less than \$5 million in gross receipts over a five-year period and no gross receipts before the five-year period ending with the tax year.

Solar Tax Credit

- The Inflation Reduction Act (IRA) of 2022 restores the federal income tax credit % to 30% for installations made in 2022-2032.
- Pre-IRA was 26% in 2022 and 22% in 2023.

Questions?

State & Local Tax Planning

State Tax Trends: Nexus Standards

- **U.S. Supreme Court's Decision in *South Dakota v. Wayfair* ("Wayfair")**
 - Overturned *Quill Corp. v. North Dakota* (1992) and *National Bella Hess, Inc. v. Department of Revenue of Illinois*, noting that both decisions were an "incorrect interpretation of the Commerce Clause."
 - Vacated the South Dakota Supreme Court's decision in *Wayfair*, which invalidated a statute that required out-of-state sellers, who deliver more than \$100K in goods or services or engages in 200 or more separate transactions, to collect and remit sales tax.
 - Blesses economic nexus provisions enacted by states as constitutional provided they align with those at issue in this case.
- **State Reactions to *Wayfair* Decision**
 - **Sales/Use Tax:** States proceeded to enact economic nexus thresholds for sales/use tax using thresholds that either identical or very similar to the South Dakota sales/use tax law at issue in *Wayfair*.
 - **Income/Gross Receipts Taxes:** States that had not already enacted bright-line economic nexus thresholds for income and gross receipts taxes started enacting such thresholds and/or other economic nexus laws; and states who previously asserted economic nexus prior to the *Wayfair* decision either through enacting bright-line economic nexus thresholds or other related guidance felt vindicated in enforcing these provisions for prior, current, and prospective years.

State Tax Trends: Migration to Remote Workforce

- The COVID-19 pandemic forced companies to move employees out of the office and embrace a work-from-home environment.
- The length of the pandemic made employees comfortable working from home and made it easy to work remotely from locations outside of their home state (e.g., parent's house, vacation homes, even abroad in some cases).
- Many companies still have a large employee base working remotely due to employee preference to work from home, rather than at the company office; while other companies have gone fully remote.
- The permanency of these remote employee arrangements post-pandemic has increased the state tax footprint of many companies, thereby increasing state tax filing requirements and tax liabilities.
- Embracing a remote workforce offers many benefits to both the company (e.g., reduces rent expense) and employees (e.g., saves commute time, convenience factor); however, it presents potential risks to companies unless the company has a way to monitor working location.

State Tax Trends: Apportionment & Sales Factor Sourcing

- States continue to move toward single sales factor and market-based sourcing methods to apportion multistate income.
- Market-based sourcing provisions vary by state in terms of language and application.
- Each state's statutory and regulatory language adopts varying criteria to define the taxpayer's market to determine the proper sourcing methodology.
- State-by-state analysis is typically necessary to determine the proper sales sourcing methodology for each revenue stream.



Sample market-based sourcing language

- Where the benefit is received
- Where the service is received
- Where the service is delivered
- Where the customer is located.

State Tax Trends: Public Law 86-272

- The Multistate Tax Commission (“MTC”) approved a revised *Statement of Information Concerning Practices of the Multistate Tax Commission and Supporting States Under Public Law 86-272* (“Revised Statement”) in 2021.
- The Revised Statement substantially narrowed P.L. 86-272 protection by including common internet-based activities on the list of unprotected business activities.
- **Protected Internet-Based Activities:**
 - internet solicitation of orders for tangible personal property, where orders are sent outside the state for approval, and then are filled by shipment or delivery from a point outside the state;
 - post-sale assistance to customers by posting a list of static FAQ with answers on website;
 - places internet “cookies” on customer computers or other electronic devices to gather information that is only used for purposes entirely ancillary to the solicitation of orders for tangible personal property such as to remember items in customer shopping cart, to store personal customer information, and to remind customers what products they have considered in the past.

State Tax Trends: Public Law 86-272

■ **Unprotected Internet-Based Activities:**

- post-sales assistance via electronic chat or customer click on icon to initiate email to business;
 - solicits and receives online applications for branded credit cards via website;
 - accepts on-line job applications for non-sales positions and allows upload of resume and cover letter;
 - places internet "cookies" or other electronic devices on customer computers to gather customer search information that will be used to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale;
 - remotely fixes and upgrades products previously purchased by customers by transmitting a code or other electronic instructions via internet;
 - offers and sells extended warranty plans to customers via website; contracts with Marketplace Facilitator ("MPF") that facilitates sales of products on MPF's online marketplace;
 - contracts with customers to stream videos and music to electronic devices for a fee.
-
- States have already started to adopt P.L. 86-272 revisions consistent with the Revised Statement by publishing state tax guidance and/or proposing draft regulations that mirror it (e.g., CA TAM 2022-01, NY draft regulations).

State Tax Questions to Ask Yourself at Year-End?

- Do you know where your company has nexus and/or state and local tax filing obligations?
 - Has your company hired, or does it plan to hire new employees in states where it currently does not file tax returns?
 - Does your company know where their remote employees are physically working?
 - Has your company been subject to any state audits, or received any state notices or inquiries?
-
- Does your company have a sourcing methodology for each of its revenue streams and do they vary by state?
 - Does your company apportion 100% of its income amongst the states regardless of its state nexus profile?
 - Does your company sell tangible personal property outside of its home state?
 - If so, has your company considered the impact of P.L. 86-272 on its business activities in remote states?
-
- Has your company experienced, or does it anticipate, any significant changes to its income or loss profile?
 - Has your company experienced, or does it anticipate, any ownership changes (e.g., new shareholders, new residency of owners, etc.), disposition of any significant assets, or a sale of the business?
 - Does your company anticipate any expansions into new states and/or significant investments in current ones?

New Pass-Through Entity Tax Elections

- Congress passed a new law in December 2017 that imposes a \$10,000 SALT deduction limitation on individuals, but not on pass-through entities. This new law was effective for tax years beginning on or after January 1, 2018.
- Many states have adopted an elective Pass-Through Entity Tax (“PTET”) to circumvent the negative impact the \$10,000 SALT deduction limitation has on individual taxpayers, especially in high tax states.
- PTET allows an electing qualified entity to pay PTET on a partner’s distributive share of income and deduct the tax paid on its federal partnership tax return, thereby reducing the partnership’s taxable income.
- The electing qualified entity’s reduced federal taxable income translates into a reduced distributive share of income reported on the consenting partner’s K-1.
- A partner in an electing qualified entity indirectly receives a federal tax benefit on the partner’s federal individual income tax return because PTET paid is deductible on the partnership tax return; whereas, if the tax was paid directly by the partner, it would be non-deductible due to the SALT deduction limitation for individuals.
- The partner typically receives a state tax credit for PTET paid on its distributive share of income to apply on its individual state tax return.

New Pass-Through Entity Tax Elections

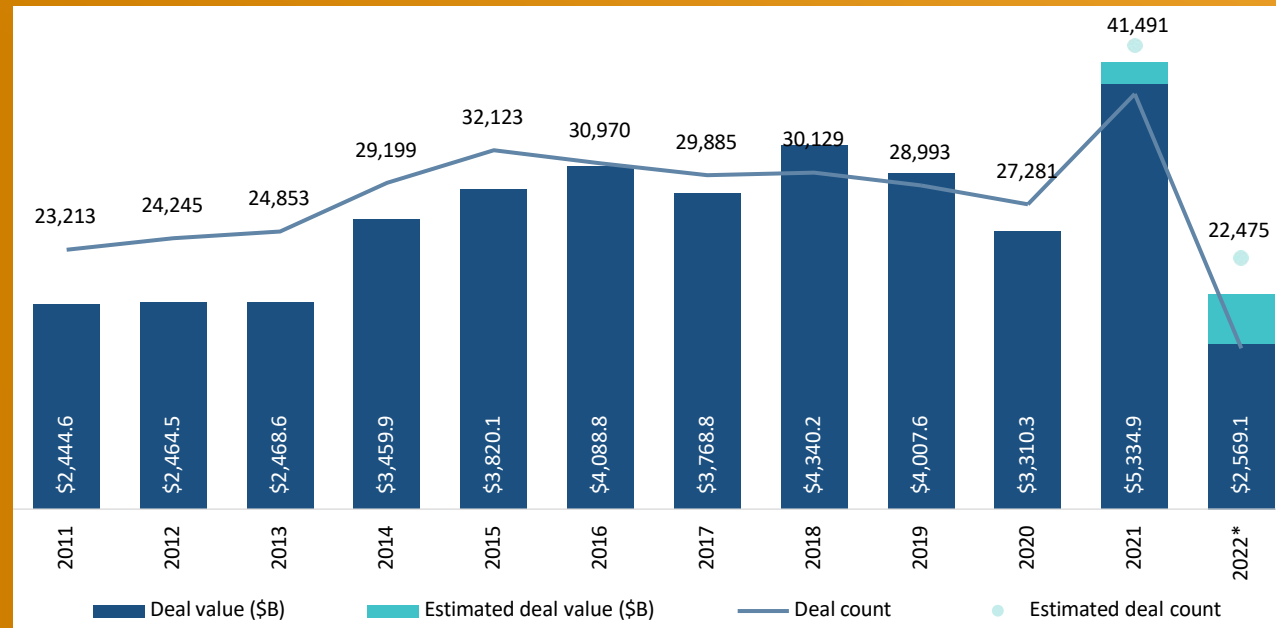
- Each state PTET regime has unique and varying qualification requirements, effective dates, legal entity requirements, other state tax credit treatment, election process, payment dates, and other procedural requirements.
- Any pass-through entity contemplating participation in a PTET opportunity should vet their individual facts against the PTET of the relevant jurisdiction.
- List of 29 states and 1 city with PTET elections as of 11/15/2022:
 - Arizona, Alabama, Arkansas, California, Colorado, Connecticut;
 - Georgia, Idaho, Illinois, Kansas, Louisiana, Maryland, Massachusetts;
 - Michigan, Minnesota, Missouri, Mississippi, North Carolina, New Jersey;
 - New Mexico, New York, Ohio, Oklahoma, Oregon, Rhode Island;
 - South Carolina, Utah, Virginia and Wisconsin.

Questions?

M&A Landscape

MARKET ACTIVITY

Global M&A Activity

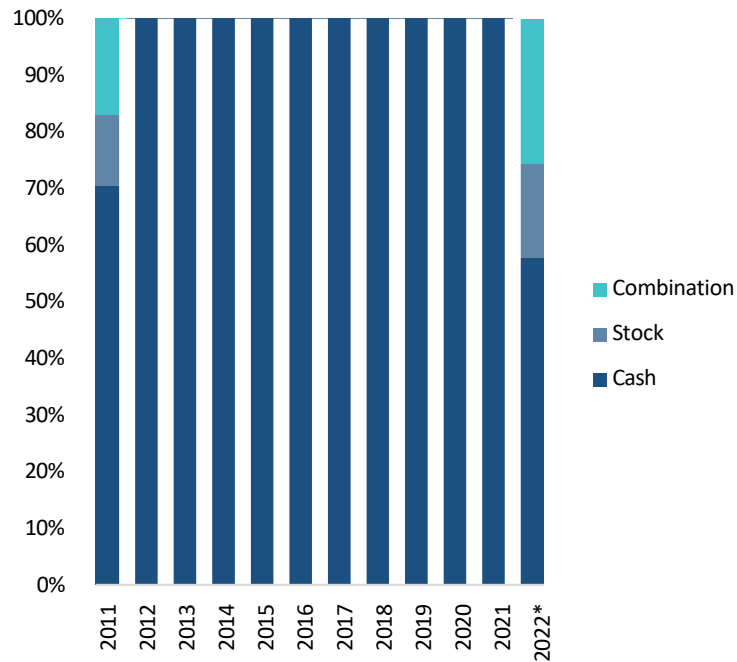


Source: Pitchbook
*As of June 30, 2022

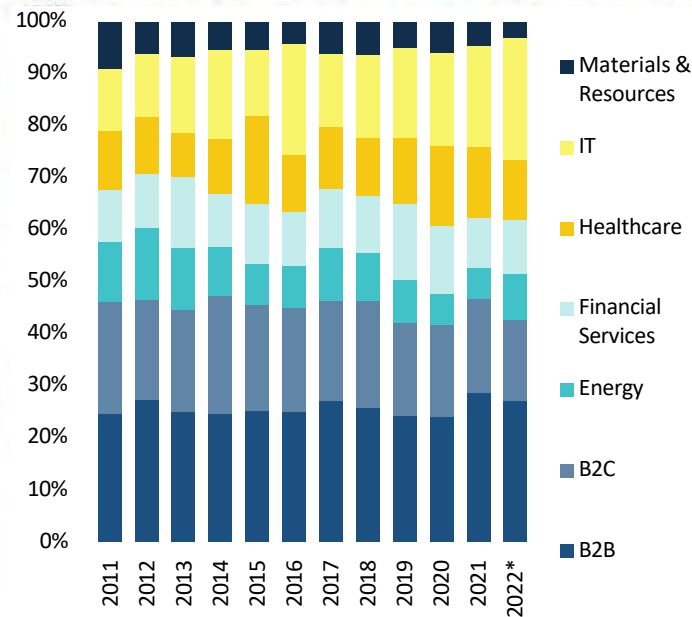
MARKET ACTIVITY

Global M&A Activity

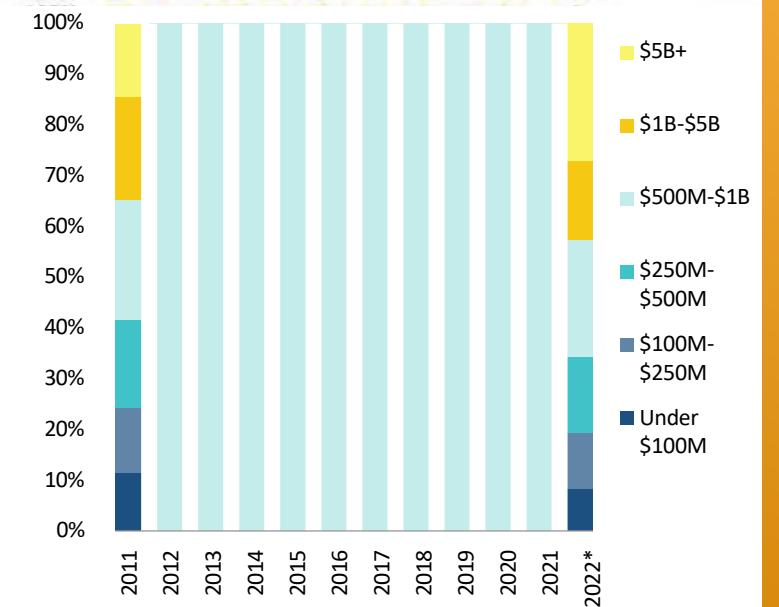
M&A deal count by payment type



Share of M&A deal value by sector



Share of M&A deal value by deal size

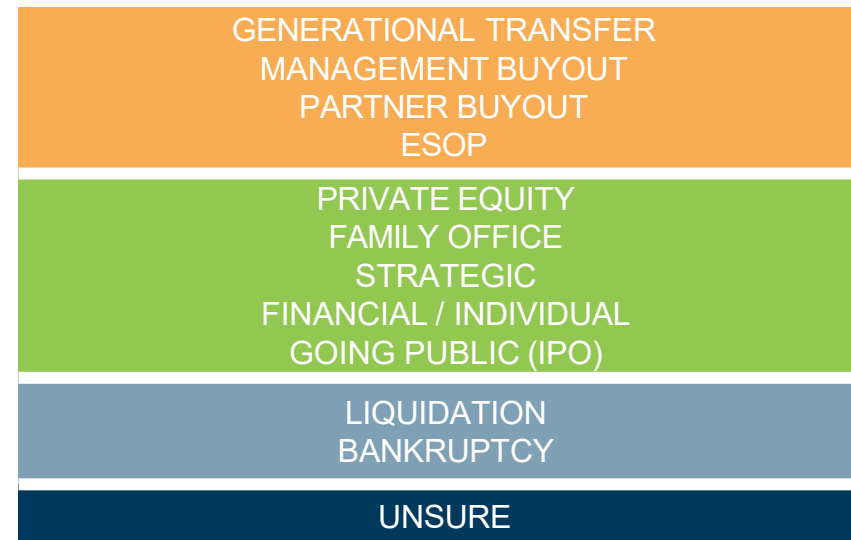
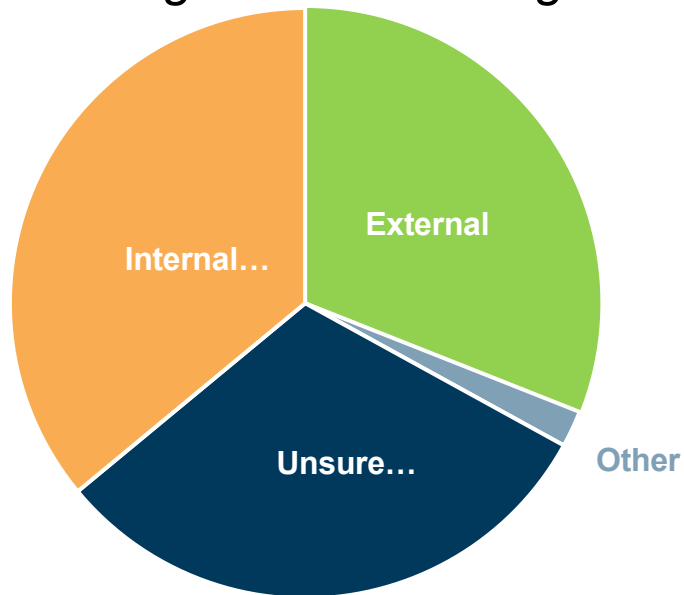


Source: Pitchbook
*As of June 30, 2022

REVIEW YOUR OPTIONS

Exit Options Analysis

“What best describes how you are planning on transitioning?”



Source: Exit Planning Institute (EPI)

THE CHALLENGE

State of Owner Readiness

ONLY 20-30% OF
BUSINESSES THAT GO TO
MARKET END UP
SELLING*

ABOUT 19% OF FAMILY-
OWNED BUSINESSES
SURVIVE INTO THE
SECOND GENERATION**

ONLY 56% OF OWNERS
STATE THERE IS FAMILY
ALIGNMENT ON COMPANY
DIRECTION*** (WHY
QUALITY ADVISORS ARE
SO IMPORTANT)

Sources:

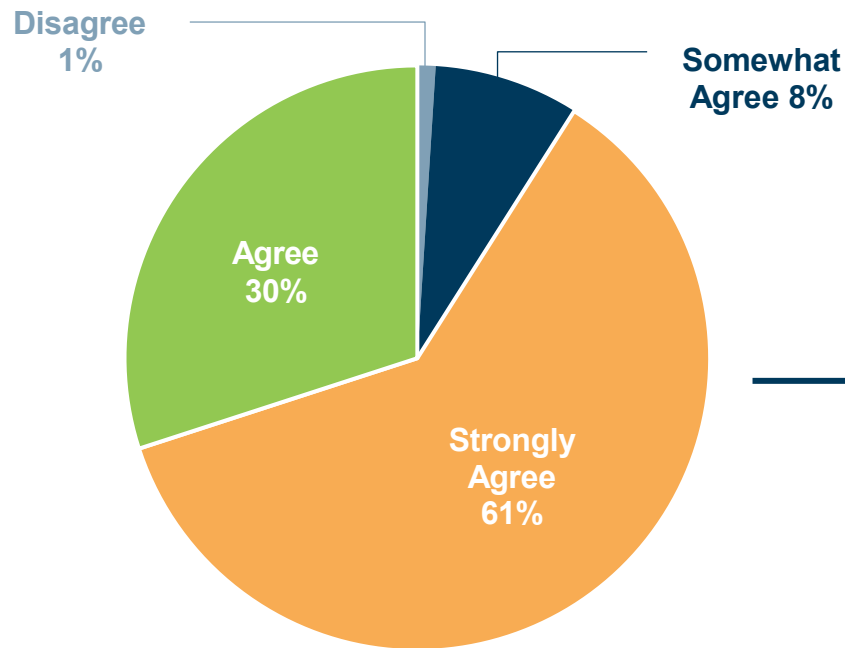
*Exit Planning Institute (EPI)

**PwC

***PwC 10th Family Business Survey, October-December 2020

99% of owners **agreed** with this statement:

*“Having a transition strategy is important both for my future and for the future of my business.”**



And yet...

66% OF OWNERS HAVE **NO** DOCUMENTED AND COMMUNICATED PLAN IN PLACE**

MANY OWNERS HAVE 80-90% OF THEIR FINANCIALS ASSETS BASED IN THEIR BUSINESS*

Sources:

* Exit Planning Institute (EPI)

** PwC 10th Family Business Survey, October-December 2020

THE SOLUTION

Exit Planning

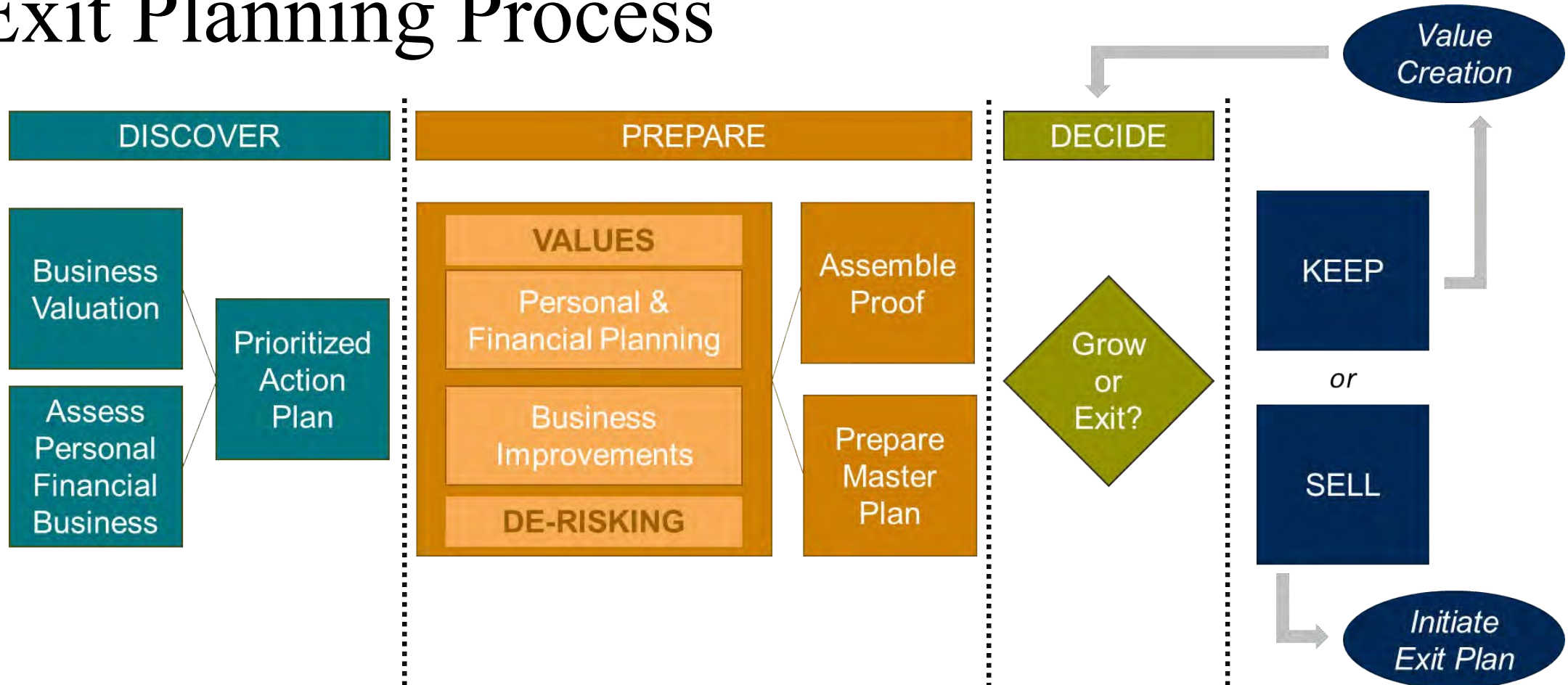
Exit planning combines the plan, concept, effort and process into a clear, simple strategy to build a business that is transferable through strong human, structural, customer, and social capital. The future of you, your family, and your business are addressed by exit planning through creating value today.

Exit planning is
BUSINESS STRATEGY

“You really only have 2 choices, you can plan for your exit or not plan, but eventually you are going to exit”

GETTING STARTED

Exit Planning Process



How Much Is My Business Worth?

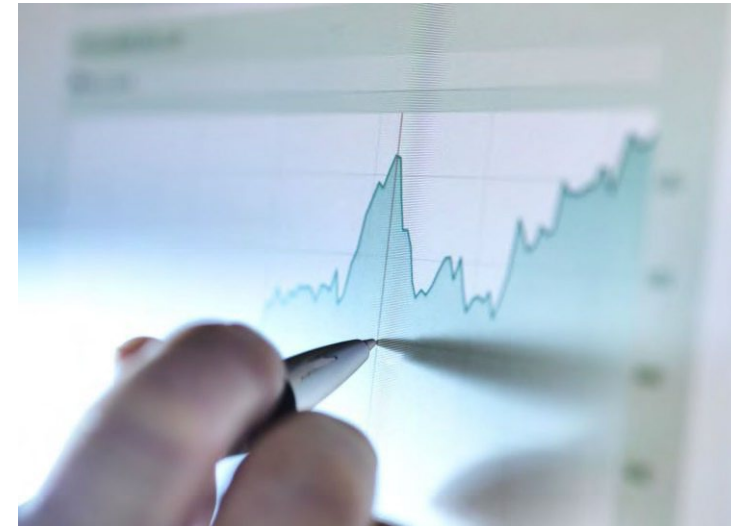
versus

How Much Will Someone Pay for My Business?

VALUATION

The Purpose of Valuation

- Is the business salable and what should it sell for?
- Determine a starting point for negotiation
- Determine characteristics that “add” and “detract” from value



VALUATION

The Process of Estimating Value

- Review 3 years of monthly financial statements
- Analyze the company's operations
- Research the company's industry
- Estimate the company's adjusted cash flow
 - High level adjustments
- Search for industry valuation multiples
 - Deal Stats, Capital IQ, BRG
- Consider "value drivers" specific to the company
- Apply market-based multiple to subject company metric



MAXIMIZING YOUR METRICS: IT'S ALL ABOUT DRIVERS

Value Drivers & Other Important Items

Value Drivers

- Competent, autonomous management teams
- Contracts in place with key customers and suppliers
- Key employees covered under non-compete agreement
- Proven track record of revenue and profit growth
- Clean and comprehensive books and records
- Assets are in good operating condition

Other Important Items

- Valuation should be performed very early in the process
- Valuation should only include the assets intended to be sold
- Strategic buyers often pay a premium over financial buyers

Preparing for an Exit – The Financials

THE WHY

Why Prepare Financial Statements for a Sale?

- Financial statements are the key driver of valuation in a sale
- Poor quality financial statements can lead to a lower valuation
- Do you want the buyer to know more about your financials than you do?
- What is the best way to go about preparing your financials?



Having quality financials won't necessarily increase the value of your business, but having poor financials can negatively impact the value of your business and increase the risk the sale doesn't go through.

THE WHO

Who Needs to Prepare Seller-Ready Financials?

- Everyone can benefit from preparing their financials for a sale process
- A quality of earnings ("QofE") analysis helps to identify key issues and quantify risks as it relates to the transaction since many issues may not be uncovered until diligence is performed
- A QofE analysis can also identify items that will end up driving value through the process

THE HOW

Process & Preparation Steps

- Getting your accounting in shape
- Applying the tools of finance to improve your performance and boost your value
- Robust, multi-year forward looking forecast model
- Understanding the metrics that matter in your exit
- The sale/partial buyout process itself
- Don't forget about communication!



Quality of Earnings Analysis				
	FY 21	Rolling Sep-22	YTD Sep-21	YTD Sep-22
<i>\$000s</i>				
Reported Revenue	45,019	45,967	34,633	35,580
Diligence Adjustments				
2 Project Revenue & COGS Recognition	NQ	NQ	NQ	NQ
3 Bill and Hold Adjustment	NQ	NQ	NQ	NQ
Diligence Adjustments (+/- NQ)	-	-	-	-
Diligence Adjusted Revenue (+/- NQ)	45,019	45,967	34,633	35,580
EBITDA Reconciliation				
Net Income	3,873	4,228	3,073	3,428
Depreciation & Amortization	370	432	242	304
Interest Expense	12	19	7	14
Taxes	1	3	1	3
Reported EBITDA	4,257	4,682	3,324	3,749
<i>% of Reported Revenue</i>	<i>9.5%</i>	<i>10.2%</i>	<i>9.6%</i>	<i>10.5%</i>
Management Adjustments				
1 Owner Compensation & Personal Expenses	298	353	209	264
Management Adjustments	298	353	209	264
Management Adjusted EBITDA	4,555	5,036	3,533	4,013
Diligence Adjustments				
1 Owner Compensation & Personal Expenses	(13)	(13)	(10)	(10)
2 Project Revenue & COGS Recognition	NQ	NQ	NQ	NQ
3 Bill and Hold Adjustment	NQ	NQ	NQ	NQ
4 Pro-forma Rent Expense	(37)	(14)	(30)	(7)
5 Transaction Related Expenses	9	20	6	17
6 Business Consulting Expense	18	27	15	24
7 Non-operating Income	(39)	(40)	(14)	(15)
8 Commission Expense Normalization	NQ	NQ	NQ	NQ
9 Employer 401k Match	(140)	(10)	(130)	-
10 Bonus Expense Normalization	(9)	23	(53)	(21)
11 Workers Compensation Normalization	(144)	(81)	(115)	(51)
12 Unrecorded Accruals	NQ	NQ	NQ	NQ
Diligence Adjustments (+/- NQ)	(356)	(88)	(330)	(62)
Diligence Adjusted EBITDA (+/- NQ)	4,199	4,947	3,203	3,951

QUESTION

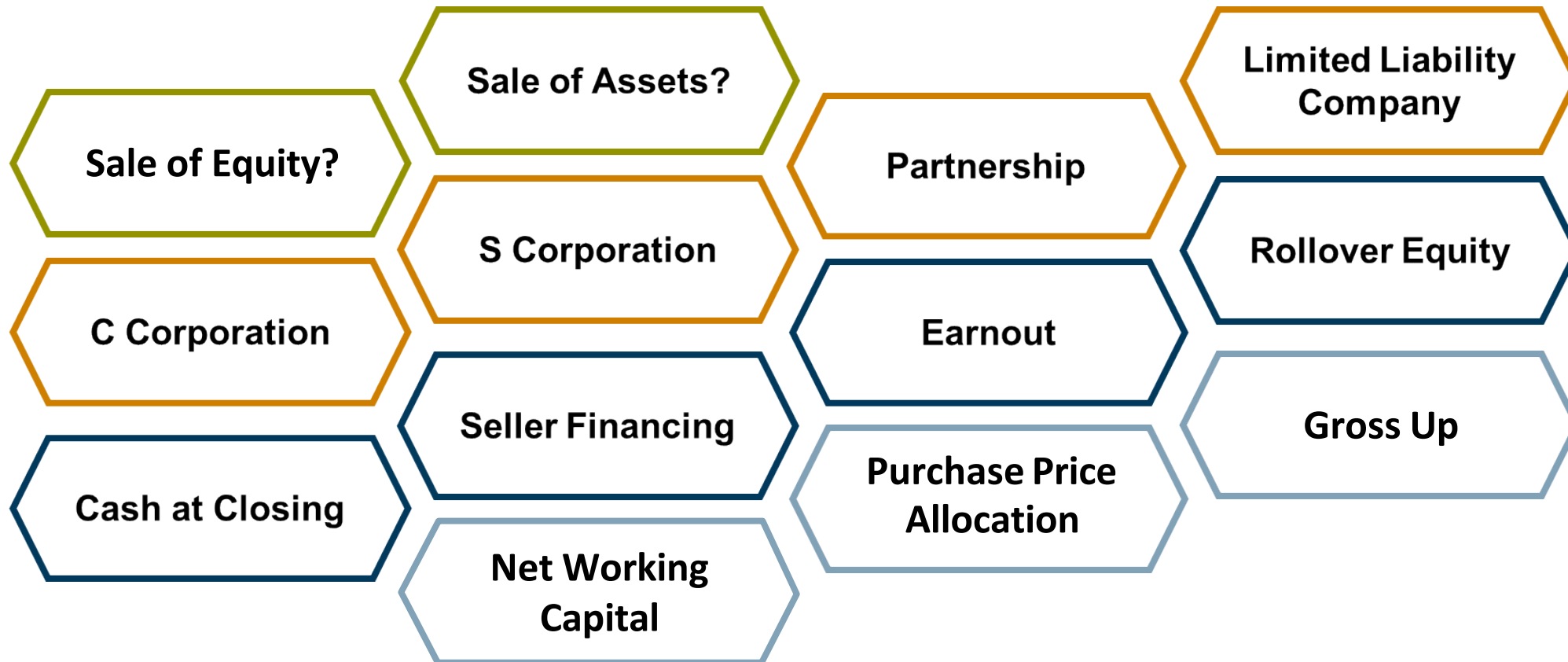
What is Quality of Earnings?

- Financial accounting analysis of a business to report its recurring rate of earnings.
- Focuses on Earnings Before Interest, Taxes, Depreciation & Amortization, not GAAP earnings.
- Analyzing the sustainability of historical cash flow.

Tax Implications of an Exit

CONSIDER THIS

Deal Structure & Entity Type



Installment Sale

- Seller can defer overall gain and buyer can defer cash outlay
- Risky with the potential increase in cap gains rates, but seller can elect out

Pre-Sale Estate Planning if Goal is to Move Some Value of the Business to Future Generations

- It may be more tax efficient to transfer assets before sale
- Transfers or sales to IDGT – Intentionally Defective Grantor Trusts

Post-Sale Ideas/Issues

- Opportunity Zones
- Protect your Proceeds
- Review your liability protection
- Diversify your holdings

Working Capital

The Overriding Concept

Working Capital represents what is needed to run a business at a normal operating level throughout the year

Working Capital = Current Assets less Current Liabilities

Adjustment Mechanism

- Rationale: Protection for Buyer and Seller for the economic impact of movements in working capital between signing and closing
- What is included in the definition of Working Capital and the Target Working Capital must be defined in the SPA
- Working capital adjustment = actual working capital at closing less target working capital (“normal” level as agreed in the SPA)



POST DEAL

After-Tax Cash Proceeds

A tax "waterfall" estimates the seller's net cash after payment of taxes, transaction fees, and debt.

The purpose of this exercise is to educate the seller on how purchase price compares to net cash.

	Asset Sale Scenarios		Stock Sale Scenarios	
	Purchase Price	Purchase Price	Purchase Price	Purchase Price
	\$45,000,000	\$80,000,000	\$45,000,000	\$80,000,000
Gross Cash Proceeds	\$ 45,000,000	\$ 80,000,000	\$ 45,000,000	\$ 80,000,000
Debt Paydown	(29,257,040)	(29,257,040)	(29,257,040)	(29,257,040)
Unpaid Transaction Fees @ Closing				
IB Success Fee	(900,000)	(2,350,000)	(900,000)	(2,350,000)
Advisor Fees	(240,000)	(240,000)	(240,000)	(240,000)
Executive Bonuses	(730,148)	(2,407,648)	(730,148)	(2,407,648)
Before Tax Proceeds	13,872,812	45,745,312	13,872,812	45,745,312
Taxes				
Federal Ordinary Income Tax from Sale	(1,561,300)	(1,135,699)	-	-
Incremental Medicare Tax from Sale	(59,883)	(43,579)	-	-
Federal Capital Gain Tax from Sale	3,000	(6,560,805)	(994,629)	(7,369,129)
Primary State Tax from Sale	(279,910)	(2,196,574)	(296,349)	(2,208,699)
Incremental State Tax from Sale	(15,947)	(125,144)	(16,884)	(125,835)
Tax from Continuing Operations	(3,065,198)	(3,065,198)	(3,065,198)	(3,065,198)
Estimated Tax Payments	615,000	615,000	615,000	615,000
After-Tax Proceeds	\$ (4,364,239)	\$ (12,511,999)	\$ (3,758,060)	\$ (12,153,861)
<i>ETR</i>	36.7%	28.9%	32.2%	28.1%
Seller net cash	\$ 9,508,573	\$ 33,233,313	\$ 10,114,752	\$ 33,591,451

Q&A

Thank you for
attending

Additional Questions?

Reach out to us at

Experts@armanino.com

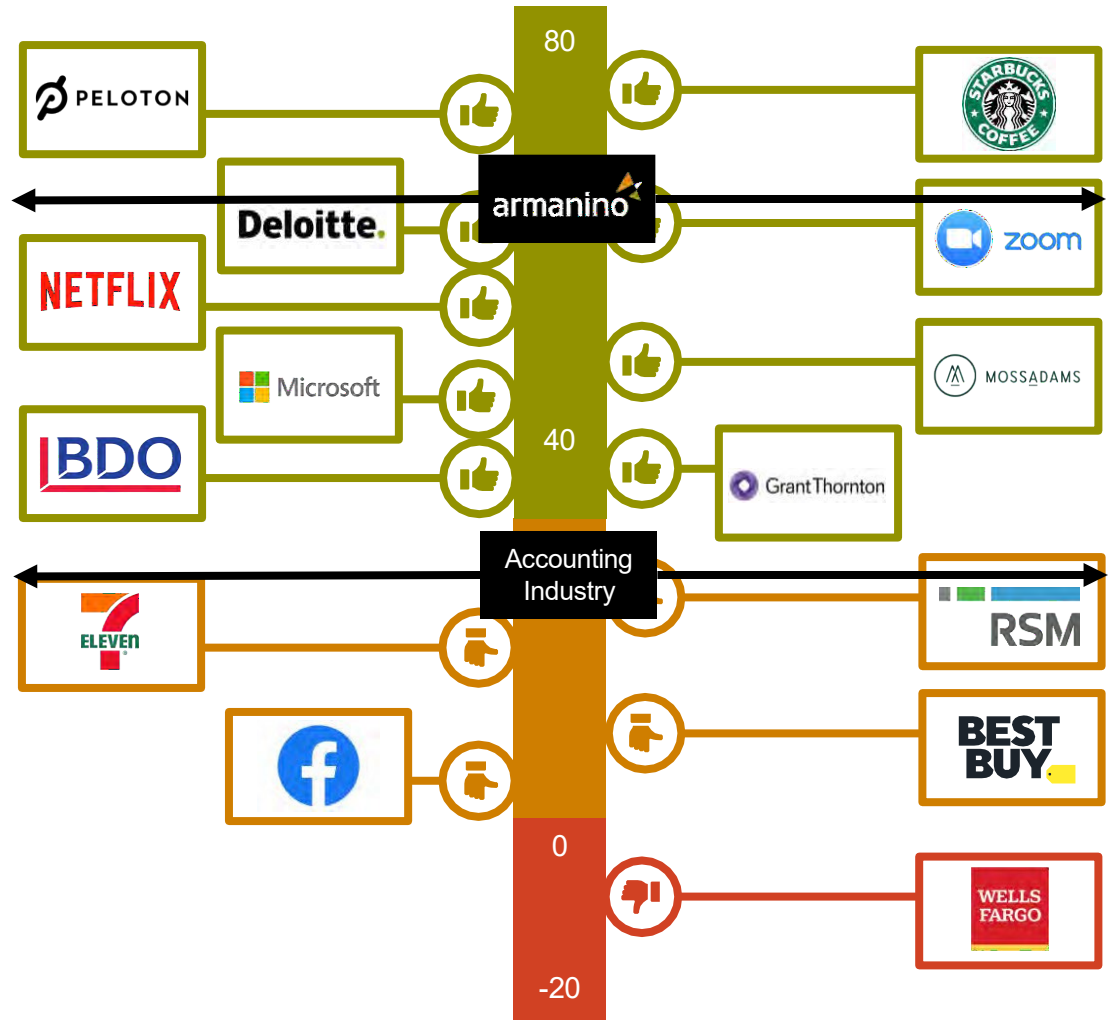


OUR CLIENTS' VIEW

We Know You'll Love Us

A Net Promoter® Score (NPS) is used by more than two-thirds of Fortune 1000 companies.

Armanino's NPS (68) is almost two times higher than the accounting industry average (38), and it places the firm scores closest to household name brands such as Starbucks, Peloton and Zoom.



Armanino offers clarity in a disruptive, ever-evolving world

Equipping you with the insights and tools needed to succeed today, and in the future



COMPLIANCE & REGULATORY

- Tax Planning
- Trust & Estate
- SOX
- Contract



ASSURANCE & ADVISORY

- Cybersecurity
- SOC
- Restructuring
- Revenue Recognition



STRATEGY & PLANNING

- Corporate Strategy
- Strategic Advisory
- Benchmarking
- Business Transformation



STAFFING & DEVELOPMENT

- Payroll
- Health Benefits
- Executive Search
- Interim Placement



TECHNOLOGY SYSTEMS

- ERP
- CRM
- Business Intelligence
- Managed Services



ACCOUNTING & BACKOFFICE

- Bookkeeping
- Budgeting/Forecasting
- Account Receivable
- Accounts Payable



Possible *(Re)Defined*TM

Armanino Operates in an Alternative Practice Structure:

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