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Tax-Savings Opportunities And Risks in 2014

Tax-Advantaged Retirement Plans Offer Beneficial Options

When it comes to taxes, owning a business provides both opportunities and risks. For example, you may be able to set up a tax-advantaged retirement plan that allows you to make larger contributions than you could make if you were an employee participating in an employer-sponsored plan. But if you don't carefully plan for your exit from the business, you could lose much of the net worth you built up in the business to taxes.

Retirement saving

Saving for retirement can be a challenge for many business owners, particularly for those who have much of their money tied up in their companies. If you haven't already done so, 2014 is a good year to consider a tax-advantaged retirement plan. With the new 3.8% Medicare tax on net investment income, this may be particularly beneficial as retirement plan contributions can reduce your modified adjusted gross income and help you reduce or avoid the 3.8% tax. Keep in mind that employees must generally be allowed to participate in the plan (provided they work a certain number of hours).

Following are a few options that may enable you to make substantial contributions to a tax-advantaged retirement plan:

Profit-sharing plan

This is a defined contribution plan that allows discretionary employer contributions and flexibility in plan design. You can make deductible 2013 contributions (see chart for limits) as late as the due date of your 2013 income tax return, including extensions — provided your plan exists on Dec. 31, 2013.

SEP

A Simplified Employee Pension is a defined contribution plan that provides benefits similar to those of a profit-sharing plan. But you can establish a SEP in *2014* and still make deductible 2013 contributions (see Chart 3) as late as the due date of your 2013 income tax return, including extensions. Another benefit is that a SEP is easier to administer than a profit-sharing plan.

Defined benefit plan

This plan sets a future pension benefit and then actuarially calculates the contributions needed to attain that benefit. The maximum annual benefit for 2013 is generally $205,000 or 100% of average earned

income for the highest three consecutive years, if less. Because it's actuarially driven, the 2013 contribution needed to attain the projected future annual benefit may exceed the maximum contributions allowed by other plans, depending on your age and the desired benefit.

You can make deductible 2013 defined benefit plan contributions until the due date of your return, provided your plan exists on Dec. 31, 2013. ***Warning:*** Employer contributions generally are required and must be paid quarterly if there was a shortfall in funding for the prior year.

PROFIT-SHARING PLAN VS. SEP: HOW MUCH CAN YOU CONTRIBUTE?	
PROFIT-SHARING PLAN	**SEP**
2013 maximum contribution: $51,000 or $56,500	**2013 maximum contribution:** $51,000
2014 maximum contribution: $52,000 or $57,500	**2014 maximum contribution:** $52,000
Eligibility: You can't contribute more than 25% of your compensation generally, but you can contribute 100% up to the 401(k) limits if the plan includes a 401(k) arrangement. To qualify for the maximum limits, your plan must include a 401(k) arrangement and you must be eligible to make catch-up contributions (that is, be age 50 or older).	**Eligibility:** You can't contribute more than 25% of your eligible compensation (net of the deduction for the contribution if you're self-employed). So to make the maximum contribution, your eligible compensation must be at least $204,000 for 2013 and $208,000 for 2014 ($255,000 for 2013 and $260,000 for 2014, if you're self-employed).
Note: *Other factors may further limit your maximum contribution*	

Exit planning

An exit strategy is a plan for passing on responsibility for running the company, transferring ownership and extracting your money from the business. This requires planning well in advance of the transition. Here are the most common exit options:

Buy-sell agreements

When a business has more than one owner, a buy-sell agreement can be a powerful tool. The agreement controls what happens to the business when a specified event occurs, such as an owner's retirement,

disability or death. Among other benefits are a well-drafted agreement.

- Provides a ready market for the departing owner's shares,
- Sets a price for the shares, and
- Allows business continuity by preventing disagreements caused by new, unwanted owners.

A key issue with buy-sell agreements is providing the buyers with means of funding the purchase. Life or disability insurance often helps fulfill this need and can give rise to several tax issues and opportunities. One of the biggest advantages of life insurance as a funding method is that proceeds generally are excluded from the beneficiary's taxable income. There are exceptions, however, so be sure to consult your tax advisor.

Succession within the family

You can pass your business on to family members by giving them interests, selling them interests or doing some of each. Be sure to consider your income needs, how family members will feel about your choice, and the gift and estate tax consequences.

Now may be a particularly good time to transfer ownership interests through gifting. If your business has lost value, you'll be able to transfer a greater number of shares without exceeding your $14,000 gift tax annual exclusion amount. Valuation discounts may further reduce the taxable value. And, with the lifetime gift tax exemption at a record-high $5.34 million for 2014, this may be a great year to give away more than just your annual exclusion amounts.

Management buyout

If family members aren't interested in or capable of taking over your business, one option is a management buyout. This can provide for a smooth transition because there may be little learning curve for the new owners. Plus, you avoid the time and expense of finding an outside buyer.

ESOP

If you want rank and file employees to become owners as well, an employee stock ownership plan (ESOP) may be the ticket. An ESOP is a qualified retirement plan created primarily to purchase your company's stock. Whether you're planning for liquidity, looking for a tax-favored loan or wanting to supplement an employee benefit program, an ESOP can offer many advantages.

Selling to an outsider

If you can find the right buyer, you may be able to sell the business at a premium. Putting your business into a sale-ready state can help you get the best price. This generally means transparent operations, assets in good working condition and no undue reliance on key people.

Sale or acquisition

Whether you're selling your business as part of an exit strategy or acquiring another company to help

grow your business, the tax consequences can have a major impact on the transaction's success or failure. Here are a few key tax considerations:

Asset vs. stock sale

With a corporation, sellers typically prefer a stock sale for the capital gains treatment and to avoid double taxation. Buyers generally want an asset sale to maximize future depreciation write-offs and avoid potential liabilities.

Tax-deferred transfer vs. taxable sale

A transfer of *corporation* ownership can be tax-deferred if made solely in exchange for stock or securities of the recipient corporation in a qualifying reorganization. But the transaction must comply with strict rules.

- Although it's generally better to postpone tax, there are some advantages to a taxable sale:
- The parties don't have to meet the technical requirements of a tax-deferred transfer.
- The seller doesn't have to worry about the quality of buyer stock or other business risks of a tax-deferred transfer.
- The buyer enjoys a stepped-up basis in its acquisition's assets and doesn't have to deal with the seller as a continuing equity owner.

Installment sale

A taxable sale may be structured as an installment sale, due to the buyer's lack of sufficient cash or the seller's desire to spread the gain over a number of years (which could also help you stay under the thresholds for triggering the 3.8% Medicare contribution tax on net investment income and the 20% long-term capital gains rate) — or when the buyer pays a contingent amount based on the business's performance. But an installment sale can backfire on the seller. For example:

- Depreciation recapture must be reported as gain in the year of sale, no matter how much cash the seller receives.
- If tax rates increase, the overall tax could wind up being more.
- Of course, tax consequences are only one of many important considerations when planning a sale or acquisition.

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If you have any questions, please feel free to contact your Seiler professional at (650) 365-4646 or email info@seiler.com. We would be happy to discuss appropriate courses of action for your particular circumstance.

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