

Buy-Sell Agreements — Protect Your Interests in A Variety of Situations

by **Erich Rail**
Partner

Buy-sell agreements generally are advisable for closely held businesses. They can prevent unwanted persons from joining the ownership group, ensure continuity of ownership and management and help provide a ready market for your ownership interest.

Just as important, a properly drafted agreement can offer significant estate planning advantages.

Any buy-sell agreement has major income tax implications as well. The applicable rules are complex and contain many traps for the unwary.



The agreement's terms are binding, even if they produce no tax benefits. Thus it is important to avoid pitfalls and to take advantage of available benefits.

A detailed checklist of factors may indicate a buy-sell agreement is advisable. Here are some factors to consider.

- **Desirability of liquidity of ownership interest**

The owners want to ensure a ready market for their ownership interest.

- **Elimination of uncertainty about ownership transfers**

A binding agreement can establish the rights and obligations of the various parties and removes the uncertainties of transfers to family members.

- **Foresight of future ownership conflicts**

If it is anticipated that the remaining owner(s) would have difficulties coexisting with the family of a deceased or withdrawing co-owner, an agreement can ensure that the remaining owners

gain control.

- **Undesirability of ownership by outsiders**

In the event of the insolvency of an



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owner, a creditor may become a member of the ownership group. A buy-sell agreement ensures that ownership interest cannot fall outside the existing group without the group's approval.

- **Lack of interest in ownership by owners' heirs**

Co-owners' heirs feel the business is too risky, or they have no desire to participate.

- **Desirability of valuation for estate tax purpose**

The owners are interested in establishing the value of their ownership interest for federal and state estate tax purposes.

A well-drafted buy-sell agreement can help the co-owners transform their ownership interest into a liquid asset, prevent unwanted or unintended changes in ownership and avoid expensive and time-consuming estate tax valuation hassles with the IRS after the death of an owner.

We welcome the opportunity to discuss setting up a buy-sell agreement or to review an existing agreement to ensure that the tax and non-tax consequences are as intended.

Charitable Car Contributions — Take Steps to Avoid ‘Crash’ With IRS

by Erica Lazzaris
Senior Accountant

The General Accounting Office recently released a scathing report on deductions claimed for charitable contributions of automobiles. It seems that the cash proceeds most charities receive from liquidating these gifts amount to *less than 5 percent of the claimed value*. (This is not a typo!)

That’s right; people are claiming deductions 20 times as high as the amount the charity actually receives.

IRS enforcement in this area will stiffen, and the IRS recently released two publications aimed at educating donors and charities about the rules. These are Publication 430 — *A Charity’s Guide to Car Donations* and Publication 4303 — *A Donor’s Guide to Car Donations*.

They are available on the IRS Web site (www.irs.gov).

Pending tax bills in both the House and Senate contain provisions to check these

abuses in vehicle donation programs. The House bill would require a qualified appraisal for deductions of \$250 or more (compared to \$5,000 under existing law).

The Senate bill limits any vehicle deduction amount in excess of \$500 to the eventual gross proceeds received and reported by the charity selling the vehicle.

If you want your deduction to hold up under an IRS audit, you’ll have to prove the real fair market value (FMV). A simple blue book valuation isn’t good enough, but it’s a starting point.

The IRS deems the FMV to be the price agreed upon between a willing seller and a willing buyer when both parties have knowledge of relevant facts.

Here are some steps to take to help make your deduction hold up when you donate a vehicle to a charitable organization.

- Document a detailed description of the vehicle and the factors used in determining FMV, including condition, mileage, unusual equipment and options.
- Take verifiable pictures of the car, inside and out, including the engine.
 - Obtain the blue book information.
 - Retain pages from your local *Auto Trader*, or similar publication,

that advertises used cars similar in make, looks and condition to the one you are donating.

- Keep maintenance records, vehicle inspection receipts and consider obtaining a statement from your local mechanic. A simple statement claiming the car is in running condition with no known malfunctions or an estimated cost to fix a known problem would provide good back-up information.



Erica Lazzaris

Warning: Some charities authorize a for-profit entity, such as a car liquidation business, to use the charity’s name for the purpose of soliciting donations. The charity receives a flat fee or percentage of the proceeds and has no control over the for-profit business activities.

In this case, the IRS will treat the contribution as having been made to the for-profit business and not to the charity.

Observation: In the event that, down the road, car donations are limited to what the charity receives as proceeds, look for charities that will actually use your car in their charitable operations and programs or will distribute the car to a needy individual. If you do, you will be able to claim a larger donation value.

*You’ll have to
prove the real fair
market value*



Investors Beware — Signs Warn of an Ailing Company

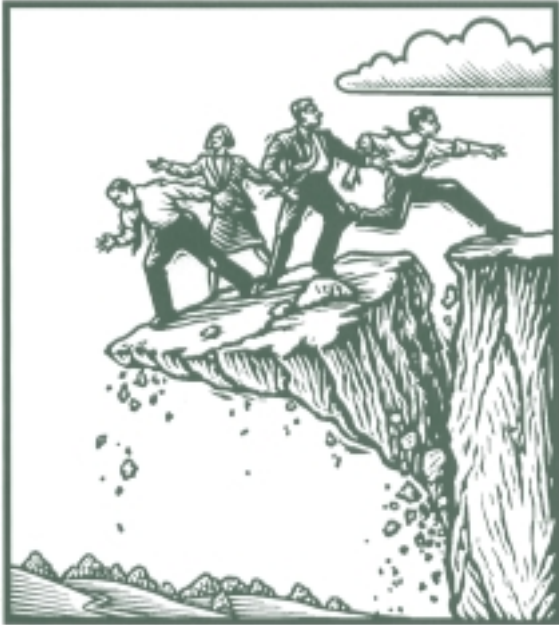
by Paula Darbyshire
Senior Accountant

The Enron, WorldCom and similar catastrophes corroborate the opinion that the average investor needs to personally take a deeper look into a company's financial situation before he or she decides to invest.

Investment advisers offer simple tips to investors to help them prevent bad investment decisions and lost funds. Both qualitative and quantitative factors should be considered in determining whether to invest.

Some of the quantitative factors that can be derived from any financial statement and can foretell possible future trouble follow.

- A comparison of cash and short-term investments against debt will indicate whether the company is operating off of borrowed money.



- A comparison of current assets with current liabilities will indicate whether the company has enough liquid funds to pay off its short-term debt.

- An examination of inventories, receivables and sales could indicate a

decline in the company's financial strength. If inventories and receivables are growing each year, but sales are not growing or are growing at a much slower rate, rising receivables and inventories on the balance sheet will drive down cash from operations on the cash flow statement.

- A check of both the income and cash flow statements may reveal that while the income statement shows positive net income, the cash flow statement shows negative cash flows from operations. In this case the cash flow statement is a better indicator of the company's health.

- A review of accounts receivables to sales figures could indicate future cash flow problems. If a company's accounts receivables are high in relation to sales, it may be an indication that it is having a problem collecting from customers.

- A showing of high debt to equity and negative earnings could indicate the financial insecurity of a company. High debt to equity is okay as long as you have a high return on equity to justify a high borrowing level.

A company that reveals evidence of the preceding factors should be viewed with skepticism.

Also, don't ignore the notes to the financial statements. Embedded in the plethora of technical accounting verbiage, investors will find valuable qualitative information. Useful note disclosures could include those that follow.

- **Related party transactions:** Investors should consider the possibility that related party transactions



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might have been motivated by a desire to improve reported earnings or financial position.

- **Litigation:** The notes to the financial statements will disclose any pending lawsuits, which could involve claims for substantial amounts.

- **Going concern:** The accountant may have disclosed that there is substantial doubt about the firm's ability to continue as a going concern.

These and other possible note disclosures should be viewed as a red flag to investors.

Investors should also search for any additional information, which, if the company is public, can be found in 10Qs, 10Ks and proxy statements. These statements often tell more than the basic financial statements as the company faces possible securities fraud if they conceal anything.

Useful information to investors contained in these statements can include:

- Customer and supplier concentration.
- New, strong competitors.
- Historical trends of financial data.
- Frequent restructuring.
- Executive compensation.
- Director bibliographies.

When an investor considers all of the information obtained from these simple indicators, they can get a clearer picture of the financial stability of the company.

Company information can be found at the Web sites that follow:
<http://www.sec.gov> and
<http://finance.yahoo.com>.



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“Men occasionally stumble on the truth, but most of them pick themselves up and hurry off as if nothing had happened.”
—Sir Winston Churchill

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Thank You

With the completion of the 2003 tax season behind us, we want to thank you for your business. This past tax season the firm and our clients were faced with the compulsory e-filing requirement imposed by the State of California, and we more than met the challenge.

Year to date, 40 percent of the individual tax returns we prepared and completed have been electronically filed, and our success rate for returns accepted electronically (no rejections) is 99 percent.

The last three years have ushered in a host of changes in the tax arena. From the massive 2001 Tax Act to a more modest 2002 Economic Recovery Tax Act and the taxpayer-friendly Jobs and Growth Tax Relief Reconciliation Act of 2003, we have seen major changes in nearly every area of the

tax code that affect all of us.

With most of these changes phased in and out over a number of years, the complexity of tax law continues to increase with no end in sight.

For example, Congress and the president currently are discussing several more legislative proposals that contain significant tax provisions.

Even with the current level of partisan bickering and the fact that it is an election year, some of these provisions could be enacted by year-end.

Our firm is pleased you have allowed us to handle your tax matters. As potentially major legislative developments take place, we are always available to discuss the impact of a new or pending tax law on your personal or business situation.

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