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FINANCIAL
Planning for Business

A Tax, Financial, & Investment Report

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Securing a Business Loan with Term Life

As a business owner, you have probably worked long and hard to help build a successful company. Yet, even when profit projections look good and a project is backed by a sound business plan, your banker may be reluctant to lend the funds necessary for expansion, particularly if the success of your venture depends too heavily on *your* personal involvement. The bank could stand to lose a significant sum should something happen to you. **Life insurance** may help you get the financial support you need.

A Life Insurance Strategy

Life insurance, an important element in many business arrangements, can help secure a business loan. Specifically, **term life insurance** is designed to help guard against financial risk for a specified period of time in the event of the insured's death. Your lender may require you to secure a loan if your company lacks collateral to back the loan or, as was mentioned earlier, if the lender is concerned that your company relies mainly on the talents of a particular individual.

With a term policy on your life for the duration of the loan, the bank's security requirements may be satisfied. In addition, term life could benefit you by providing a safety net that would help protect your estate if things do not work out as anticipated.

Policy Assignments

By assigning your policy, you transfer your rights to all, or a portion, of the

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Leadership: Building Stronger Companies

Motivating the people in your company to perform at top levels is most likely an ongoing objective. Once you attract the best and the brightest, the challenge becomes keeping them and effectively utilizing their skills to enhance and grow your business. Competitive benefits and compensation are great retention tools, but what about influences that transcend an individual's bottom line, like leadership? As a strong leader, you can enhance both commitment and performance, as well as define the work culture of your company.

Leadership plays an essential role in all successful organizations, from governments to Fortune 500 companies to baseball's World Series champions. And, it has a place in your business. Professionals who are highly skilled rarely

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A Rule of Thumb for Closely Held Business Valuation

For many small business owners, valuing a **closely held business** is an important part of estate and financial planning. Because valuation is a multifaceted endeavor, a comprehensive approach is needed to best appraise the worth of a business entity. Equity interests in a closely held business are not frequently sold or otherwise transferred, resulting in difficulty ascertaining a valuation. Therefore, when valuing a business (a **sole proprietorship**, a **partnership**, or a **corporation**), you must analyze specific conditions that uniquely affect closely held businesses in general.

Getting Down to Business

Whenever there is a need to perform a business valuation for estate purposes, there are potentially seven areas that must be researched in order to arrive at a fair value for the total business. Each area may address issues that are somewhat abstract and/or difficult to quantify. Here is a general overview:

1) The nature, scope, and history of the business operation must be reviewed. The product or service rendered must be evaluated by past performance, as well as the risks inherent in all phases of operations. While disregarding past events that are unlikely to recur in the future, capital structure, sales records, growth, and diversity of operations can speak volumes about past business performance and how the business might fare in the future.

2) By analyzing both related business sectors in the economy and current economic conditions, an appraisal can be made regarding the future potential for business profits. Generally, the greater the expectation of profits, the greater the value of the business. The appraiser should evaluate the industry, as well as the position of the particular business within the industry—the overall economic outlook may severely impact the ability of all businesses to generate profits. Often, much insight can be gained from looking at several competitors' past performance and future growth potential.

3) Book value, defined as assets minus liabilities, is readily obtained from the balance sheet. However, in most cases, balance sheet adjustments will have to be made to book value in order to accurately reflect economic versus tax depreciation.

4) Profit and loss statements must also be scrutinized to arrive at a determination of the company's earnings history. While the Internal Revenue Service (IRS) typically requires the past five years of profit and loss statements, it generally will not respect five- or ten-year earnings averages, using the opinion that averages generally do not produce realistic valuations. It is often common for appraisers to "capitalize" earnings as a means of reducing future income to a single number, otherwise referred to as present value. Capitalizing earnings is a method used to answer the question of how much an individual will pay for a business given the level of risk involved. Naturally, the greater the risk, the less the buyer will pay, and vice versa.

5) Where appropriate, the dividend-paying capacity of the company will be determined from financial statements. However, dividends may not be a reliable criterion of market value for a closely held company since the controlling stockholders may have used their discretion in opting to pay deductible salaries and bonuses as opposed to nondeductible dividends.

6) Most difficult for valuation purposes is goodwill, or the ability of a business to earn a return over and above what it could on its fixed assets alone. Consumer satisfaction, trust, and trademarks may be important factors in gross revenues. In addition, intangible goodwill value can come from such things as the location of the business, the reputation of the business, or a specific list of customers. While it might be difficult to determine a precise valuation, an independent appraiser should be able to discern the significance of the business's goodwill.

7) If shares were purchased in the last three years, the price paid for an interest in the business may

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Extenders Package Renews Energy Incentives

The Tax Relief and Health Care Act, signed into law on December 20, 2006, extends popular tax breaks that expired in 2005 and 2006. Delivering good news to business owners, this latest reform continues the Research and Experimentation (R&E) credit, the Welfare-to-Work (WtW) credit, and the Work Opportunity Tax Credit (WOTC). This tax relief act also extends through 2008 the New Markets Tax Credit for equity investments in economically distressed communities. In addition, the Tax Relief and Health Care Act renews through 2008 certain tax incentives of the Energy Policy Act of 2005, including the following:

- The deduction for energy-efficient commercial building property.
- The business credit for energy-efficient new homes.
- The credit for business installation of qualified fuel cells, stationary microturbine power plants, and solar energy property.
- The renewable electricity production credit.
- The issuance of clean renewable energy bonds (CREBs).
- The reduced excise tax on methanol or ethanol fuel derived from coal.

This energy reform does not, however, extend or enhance tax breaks for hybrid cars, and some models are no longer eligible for the maximum tax credit. Toyota, having sold more than 60,000 fuel-efficient vehicles, has exceeded a limit set by the Energy Policy Act of 2005. The tax credit for Toyota models will eventually phase out, as will the credit for hybrids produced by other manufacturers once they sell 60,000 fuel-efficient vehicles.

For more information on the latest business tax incentives and how they may affect your tax situation, please contact your tax professional. $

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proceeds to the bank. The extent to which these rights are transferable depends on the assignment provisions in the policy, the intention of the parties as expressed in the assignment form, and the actual circumstances of the assignment. Two common types of insurance policy assignments are the following:

- **Absolute assignments**—These normally assign *every* policy right the policyholder possessed prior to the assignment. Once the transaction is complete, the policyholder will have no further financial interest in the policy.
- **Collateral assignments**—These are more *limited* types of transfers. They can protect the lender by using the policy as security for repayment. When the loan is fully repaid, the bank releases its interest in the policy.

Life insurance policies generally can be freely assigned, unless some limitation is specified in the contract. To fully protect the assignee, the insurance company must be notified that the assignment has been made. It is also important to notify the insurer if future assignments are made and/or terminated.

Benefits after the Loan Is Repaid

Term life offers benefits even after the loan has been repaid. At that point, you could convert the policy to **permanent insurance** to be used for a number of other business purposes. These may include funding a **buy-sell agreement**, a **disability buyout agreement**, or a **deferred compensation plan**. If you have no further need for the insurance, you could simply decide to let the term policy lapse.

To succeed in the long run, small businesses need to take advantage of their opportunities to grow. A term policy can be an economical method of making a business loan possible by providing a safety net that secures repayment for a lender. $

Leadership: Building Stronger Companies

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benefit from heavy-handed management, but strong leadership can inspire them. And with motivated people working with you, you position yourself to more effectively sustain your daily operations and affect positive change for the future of your company.

Charisma is often the most notable trait of a leader, but not necessarily the most effective. You may achieve powerful results by tapping the following qualities:

- **Vision.** Defining short- and long-term objectives establishes direction for the business. When you communicate your vision, you create a culture of inclusion. People feel they have a stake in the future and a role to play in the company's success. In this atmosphere, it is much easier to tap your human resources and develop strategies to accomplish your goals.
- **Humility.** While leaders benefit from having confidence in their abilities, arrogance can have an eroding effect on morale. In contrast, humility cultivates respect and fosters an environment where self-interest takes a backseat to shared objectives, where one person's accomplishments are everyone's success.
- **Integrity.** It is easier to motivate people when they trust your motives. One of the best ways to lead is by example, holding yourself to the same standards you set for others. People tend to thrive when they feel supported, when they feel you are rooting for their success rather than waiting for their failure. Make a concerted effort to acknowledge the contributions of others, maintain a consistent sense of fairness, and take responsibility for your actions and decisions.

Leadership styles vary, and successful strategies will run the gamut from business to business. The challenge often lies in recognizing and addressing the psychological aspects of the workplace. Energizing and mobilizing the people in your company with strong leadership will inevitably have a favorable impact on profitability and growth. $

A Rule of Thumb for Closely Held Business Valuation

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be a significant factor in valuation planning for a closely held business. In this case, the IRS scrutinizes when the sale was made, whether the interest sold was controlling or a minority block, and whether or not the sale was forced by other conditions in the business or circumstances linked to the buyer or seller.

Where possible, each area must be reduced to specific numerical values. The cautious stance of the IRS toward averages prevents the appraiser from simply averaging factors such as book value, goodwill, and capitalized earnings and coming up with a figure. Courts generally have agreed with the IRS in not respecting averages and formulas. As a result, valuation has become more sophisticated and complex.

Professional Assistance a Must

While the valuation of a closely held business may seem daunting, it is not impossible, and likely will prove to be useful in estate and financial planning, as well as **business succession planning**. The valuation process is complex and involves many variables that should be undertaken only by qualified professionals. $