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Introducing tax clients to additional services

Edward Mendlowitz 1942-

American Institute of Certified Public Accountants. PCPS Management of an Accounting Practice Committee

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Issued by the PCPS Management of an Accounting Practice Committee

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INTRODUCTION

This book has been prepared to help the tax practitioner better serve his or her clients and develop additional revenues from an expanded array of services that clients need. Many successful techniques for recognizing opportunities to offer the firm's capabilities to clients are illustrated in this book.

Operating a professional practice is no different from any commercial enterprise—it is a business that can best earn income from raising the level of sales from existing customers—clients in our case. That is the goal of this book.

The chapters in Section I, "Establishing a Cross-Sell Program," give an overview of how to prepare your firm and its staff to do effective cross-selling.

The chapters in Section II, "Cross-Selling to Individual Tax Clients" and Section III, "Cross-Selling to Business Tax Clients," describe specific types of services that can be developed from tax return preparation clients. Each chapter covers who needs the service, why the CPA is suited to provide the service, how to introduce clients to the service, and how to finalize the engagement. Where possible sample handouts and letters to clients introducing the service are included as well as engagement letters for those services and suggested methods of billing.

The book contains an appendix, "Industry-Specific Tax and Business Advisory Services," which gives an overview of industries that are ideal for developing additional services.

As with any discussion with another professional, there are always many ways of accomplishing a task. However, most everyone we talk with gives us some ideas we can use; and if you are like us, you are limited by the number of new things you can implement effectively and quickly. Use this book as a resource; grab a few ideas and try them—and if they work for you, try a few more. Hopefully, each time you'll end up a little richer while serving your clients more fully.

SECTION I

ESTABLISHING A CROSS-SELL PROGRAM

CHAPTER 1

PREPARING THE FIRM

The average tax return client thinks of accountants as being mainly involved in taxes. Also, a CPA firm's largest volume of clients is usually for tax return services. Therefore, a good part of the public image of your firm must come from the tax department.

The tax department must be involved in strengthening the firm's brand, name recognition, getting publicity, and introducing tax return clients to additional services. Unfortunately, many CPA firms provide very little guidance or training in this area.

There are important advantages to introducing tax return clients to additional services. Much of the extra work disclosed while preparing the tax return is not time-sensitive in that it could be done after tax season ends (which hopefully is April 15) and even stretched into the summer months. Also, any number crunching can be assigned to summer interns, which our office has been very successful with.

Generating the work during "slow" periods helps to even out the workload, create revenue where it wouldn't exist, and provide challenging, interesting, and satisfying services while truly helping clients.

This chapter covers identifying cross-sell candidates, setting goals, and marketing.

IDENTIFYING CROSS-SELL CANDIDATES

The best ways to identify clients who are excellent candidates for cross-selling are to:

1. Create an atmosphere or culture of better serving the clients by doing more for them
2. Develop an understanding of the types of services you can perform for the client along with the benefits to the clients

3. Use a post-tax season review of your clients' tax returns to uncover needed services that the clients can benefit from
4. Work to upgrade your clients from tax preparation to tax planning

These steps are discussed below.

Create a Cross-Selling Culture

Sometimes we, as accountants, become aware of important life-altering issues when we prepare tax returns, but we don't want to appear as if we are trying to generate fees, so we pass on the extra telephone call. We shouldn't act like that. Suppose you went to a dentist for a regular cleaning and you were not told that you need a periodontal consultation? How would you feel? Or if you finally brought your car in for servicing and weren't told that all your hoses should be changed? How would you feel? Suppose you went to an attorney for a prenuptial agreement and he or she did not tell you to revise your will? How would you feel?

Well, suppose a client came to you for tax return preparation and you did not tell them that their investments were not on track for them to accomplish their goals, or that their life insurance was inadequate based upon their stated needs? How do you think they would feel if you did not alert them to the issues and tell them you could help solve their problems?

Offering clients additional services is a good deed. The fact that you also will charge them for the advice doesn't lessen the value of the suggestions. The extra telephone call, away from the hubbub of tax season, will be a great favor for the client and should create a feeling of goodwill. Also, in some instances, you can even ask the client if they know of anyone else in their circumstances that you could be referred to. In many cases, increasing clients' awareness of services that they truly need fosters a feeling that you are more than just a tax preparer, but a trusted adviser that transcends tax preparation.

Educate Staff About Firm Services

Partners and staff members need to be informed about the firm's services and approaches for introducing them to the client. Our firm actually used a draft of this book to show staff the types of services we are not only capable of performing, but do perform on regular bases for our clients—for free in many cases. By becoming aware of it we can institute an additional billing opportunity while doing a more complete job for the client.

The opportunities to better serve clients can come from anyone in the firm. It is important for each person working on the return—the interviewer, preparer, reviewer, and partner—to understand what the firm can do, and how they can offer it to the client.

Do a Post-Tax Season Review of Client Tax Returns

Constructing a list of the client's needs can be easily prepared as you see each client and work on his or her tax return. While the return is going through the tax preparation process it is not too difficult to make a listing of any ideas for additional services for that client. Like anything else, a conscious effort to document clients' issues will be more than half the battle. Thinking and doing will get the list done. This list can then be reviewed and calls made to suggest the service to the client.

A post-tax season review of client tax return can also be used to identify what services to offer. It can be done best by having the contact person and someone else (usually the preparer) in the firm analyze the client return and list issues that may have been unearthed when the return was prepared. With a little extra effort during tax season, the firm can capture potential new service ideas.

Upgrade Current Clients Into Annual Tax Planning Clients

Sometimes people travel all over the world to find what they want next door. Some of your tax preparation clients should be upgraded to pre-year-end planning and projections as a regular course.

An advantage of this extra meeting is that it also leaves some time to chat in an unrushed atmosphere that is not possible during tax season. And that could also lead to additional services. Upgrading tax preparation only clients to annual tax planning clients establishes a different relationship where you become involved in changes of their circumstances, and the totality of their tax "lives."

Upgrading the client requires a more sophisticated approach to your work, and a different outlook toward the client. In our experience most clients appreciate the concern we express and the way we explain why they need the extra work—and changed relationship.

Stepping up your clients is not only easy, but it provides a service that the client may have gradually grown into, and where the client may be wondering if he or she has outgrown you.

You can protect your practice, better serve your clients, and generate more revenues. It is a win-win all around.

SETTING GOALS FOR CROSS-SELLING

Tracking the additional revenue generated by cross-selling is not as important as setting a budget to obtain the additional revenue. The budget should be something that can be reasonably attained. For example, a goal to generate at least one new engagement a month from May through December should not overwhelm anyone.

Set a goal of extra services next year for 8 percent to 10 percent of your clients, or 8 percent to 10 percent extra billing from tax return clients. If you can set the 8 percent to 10 percent goal, then 15 percent is just as easy—that's an extra job from every client over the next 7 years. An 8 percent to 10 percent goal is an extra service for each tax return client once every 10 to 12 years—not very ambitious and but very manageable and profitable.

MARKETING AND CROSS-SELLING

The firm should also engage in training everyone involved in client servicing in marketing and recognizing opportunities.

Marketing involves the totality of presenting the firm to the prospect so they want to do business with you. It should make you approachable and seem competent to solve their problems. Marketing involves the firm culture, and requires the adoption of a mindset where the ultimate goal is the client receiving the best your firm has to offer.

Marketing is the way you dress, respond, and follow up, the firm's brand, evident culture, and everything about you. Your image is established by your letterhead and type style of your letters and reports, the memos you write, and how you speak. Newsletters, press releases, and publicity affect and mold your image. Exhibit 1-1, "Sample Advertisement," is an ad that lists the complete range of services offered by our firm.

Many businesspeople—including accountants—spend great effort obtaining new clients. These efforts have a cost that includes time spent, lost billing time, and marketing expenses. The same expense on existing customers will usually yield a greater amount of new business. It is also easier since you've already been prequalified by the customer.

With a smaller cost and less time spent on marketing to existing clients you should have a greater return on investment. An example is a newsletter directed at getting business from current clients. The newsletter could feature many more services than an ad and could cover each service in greater depth. The newsletter mailing should be followed up by phone calls to those clients that you know have an interest in the services. A quarterly newsletter could have some firm information and stories about two or three services. This will also make you an "expert" in the eyes of your client. However, we want to stress that follow-up calls are essential. Don't sit by the phone waiting for it to ring.

Our firm publishes our own newsletter about five times a year. We write it ourselves, have it printed at a local copy center, and mail it at very low total cost. It is eight pages and follows a format that really only needs about four pages of new material for each issue. One of the things we do is run an economic indicator contest with about 120 people a year entering it. This creates widespread interest even among those who do not enter and the updates use a little over two pages an issue. The self mailer and actual ad takes another page, and now we are featuring a client in each issue. The first client is a retired golf pro who placed in the top 10 in the U.S. Open when Sam Snead and Ben Hogan played. The next client is a designer manufacturing his garments in India with distribution in 2,000 ladies specialty boutiques.

Client contacts are part of marketing. How often and how they are made will affect your image and are very important parts of marketing. I know of a firm that requires partners to have a client contact at least every two months, and the managing partner monitors it. I try to have contact with my largest clients at least once every three weeks, and with tax clients twice a year besides the tax preparation contacts.

EXHIBIT 1-1 Sample Advertisement

Complete Range of CPA Services

We offer services in the following areas:

Audits, reviews, and compilations; prospective financial statements and budgets; business plans; user-friendly financial and business consulting; financial, estate, and succession planning; IRA, pension, and retirement planning; payroll, sales, and income tax problem resolution; financial statements for banks, bonding companies, and investors; accounting software and computer consulting; outsourced and virtual office accounting; accounting and internal controls conceived, established, and implemented; income tax preparation and planning; representation at tax audits and at federal and state tax courts; audits of attorney's trust fund accounts; partnership and shareholders' agreement planning and mediation; litigation support; forensic and investigative accounting; business valuation and appraisals; merger, acquisition, and investment banking—planning, conceptualization, structuring, and team leading; and corporate and professional training and workshops.

Call us for a consultation.

Questions, inquiries, and comments can be directed to one of our partners:
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CHAPTER 2

RAISING CLIENT AWARENESS

Part of selling is to have existing clients use more of your services. To do this they must be told the breath and depth of your firm's activities. This should be a major goal of every meeting with a client.

This chapter covers ways to use client contacts to cross-sell. It discusses tax return preparation interviews, following up on issues raised during tax return preparation, and tax planning meetings.

TAX RETURN PREPARATION INTERVIEWS

The tax return preparation interview, which purpose is to gather information, is a tremendous opportunity to find out the concerns of the client and where you can help. The assistance you give can sometimes provide a life-changing benefit to the client while enabling your firm to increase its service base, gaining additional revenues.

Looking for Opportunities

When I first started preparing income tax returns, I would meet with the client to get his or her information.

Before 1987 it was pretty hard not to save our clients substantial taxes. If they didn't need tax shelters, we could still come up with overlooked items for miscellaneous itemized deductions. The in-person interview was quite important to getting the tax return prepared.

Today, most tax returns can be prepared without the interview. In fact, many of our clients mail in their information and, without us realizing it, we run a mail order type of operation.

However, for the clients that we do meet with, the interview becomes a document collection process with us asking many financial planning questions. And these questions lead to opportunities for additional services for the client.

Many of the questions we ask have to do with saving taxes by altering investment choices. For instance, clients in high brackets with a large amount of taxable interest should consider tax-free government bonds. Clients with unrealized capital losses should be told ways to realize these without substantially altering their investment positions. Those with children in college should be told how to maximize college cost tax breaks; and clients who give large cash donations should be given noncash alternatives.

How the interview proceeds is based on your value of your time and your appreciation about what you can do for the client. You can spend the hour opening envelopes or providing "free" personalized financial guidance to your clients. You should make your clients understand how they are spending their money and their time as well as your time. At the interview, be interested in the client, ask what they are concerned about, and *really listen*. Get the client to articulate what they care about and what "keeps them awake."

Another feature of the interview is to ask questions about the current year and then to prepare a projection or to get the information so that the projection could be prepared while the return is being prepared.

During this question period you should inquire about many life cycle events such as job plans; retirement plans; children's education cost funding possibilities; whether the client has a will, stock options, 401(k)s, and other job-related benefits; and whether the client has any interest in going into a business.

There are many opportunities during a tax return interview to discuss the client's concerns and to discuss the firm's role in that service area, how we've helped other clients in similar situations, and how we can help that client, at a later time, in a separate engagement.

Acting on an Opportunity

When a new service possibility is mentioned, we coach the client to clearly identify what their concern is, how they think it could be dealt with, and what type of result they would like. We then do a number of things. First we make a note of it so we can follow up after tax season. We also send the client some fact sheets on the subject either a day or two after we meet with them, or a few days after April 15 with a note that we are following up on the discussion we had with them during tax season. A few days after that, we call to set a meeting and discuss the fee for the meeting or project. Some examples of these fact sheets are included in many of the chapters.

We also developed a series of basic, but probing, questions and answers about many financial events in a client's life that could help the client learn a little about areas that they are or will be affected by. What we do is use the questions to determine if there is an interest in additional information. If there is, we will send a follow up "answer" sheet either a few days after the interview, or just after tax season ends. These answer sheets are included in many of the chapters that follow. Note that while these included current tax information as of when they were prepared, they may not reflect current information when you are ready to use them. These checklists and answers are presented to show an effective technique to provide information to the client and to draw him or her into a more complete discussion.

Finalizing an Opportunity

With most of our tax clients we generally try to get them to come in for an hour-and-one-half consultation at a special fee for the meeting. We tell them that we will help them identify the problem and what they want, should want, or need, and will suggest solutions; we will also briefly review the data they have which we will use in our discussion. If additional follow-up is necessary, we discuss the timing and our charges. We usually try to set fixed fees.

TAX RETURN PREPARATION FOLLOW-UP

As you see each client keep a list of additional services you can offer them. Also continue this list when you review each return. I prepare a list of follow-up items during tax season on my Microsoft Outlook® task list. These items are entered as the issue or idea arises. It is simple, quick, mindless, and very satisfying. The next job is to make the time to follow up with the client, and do your "good deed."

Tax returns present a window into a client's total financial affairs, and many of their other concerns also. For instance, discussing a client's interest and dividend 1099s can lead to asking why they have certain investments or certificates of deposit (CDs). An obvious reason is to tell them about tax sheltered ways to invest such as tax-free bonds or annuities, or why corporate dividends might be something to consider. Other issues that can be developed are the purpose for the investing and asset accumulation. Is the client concerned about their children's educational funding, or retiring, or are they saving to buy a business? Each of these is an opportunity to follow up (after tax season) with enquiries of how you can help and to get the client to come in for an initial consultation.

Another area of interest that can be uncovered is where the client has young children or parents they are supporting. Have they made adequate arrangements in their will? Do they even have a current will? Is their life insurance coverage suitable based on the reliance others place on them? Estate taxes may or may not be an issue, but suitable financial arrangements for a guardian or for indigent relatives should be considered. Who is better qualified than you—their accountant—to advise them on how to get it done?

Another area is the designation of beneficiary forms for IRAs, 401(k)s, and pension plans. How they are filled out will affect the taxation and cash flow of those funds. Also, the client might need someone to tie together the asset allocation arrangements of those accounts with their overall financial plan.

Other issues include:

- Adjusting W-4 forms for withholding, or filing estimated taxes
- Considering business qualified retirement plans and possibly one-person 401(k)s
- The timing of exercising stock options, and how to ask an employer for stock options
- The need for serious estate planning such as family partnerships and grantor trusts
- Sophisticated charitable giving arrangements including donating appreciated stock
- Reporting and withholding for household employees
- The timing of the exercise of U.S. savings bonds
- The possible effect of the alternative minimum tax for the current year
- Transferring parents' residences to their children or why *not* to
- The tax effects of a contemplated marital separation

Call your clients after tax season and set up that consultation! Perhaps even walk the client through a tax return item by item (sometime in the summer) and outline what it tells you about the client's needs and potential future services. Following up is a key element to introducing clients to additional services.

TAX PLANNING MEETING

We use the summer to meet with some of our clients with more complicated tax returns to (1) review it with them so they understand their situation better, (2) initiate a tax planning discussion that could have the potential to save them taxes in the future, and (3) try to uncover issues that are on their minds that have financial planning implications.

One of the tools we use is the table in Exhibit 2-1, "Sample Tax Preparation Versus Tax Planning Table." This is used as an in-firm training element as well as a mind jogger with the clients. We also use it when we are asked to speak before a group on taxes.

EXHIBIT 2-1 Sample Tax Preparation Versus Tax Planning Table

	Topic	*Tax Preparation*	*Tax Planning*
1.	Taxpayers' names and address	Need for obvious reasons.	Usually husband is listed first as the taxpayer and wife is listed as spouse. However, in cases where the husband might owe large amounts of taxes (either delinquent income or payroll taxes), and the tax return is a joint return and there would be a refund because of wife's excess withholding tax, show wife as taxpayer, and husband as spouse. Did taxpayer move during the year? Determine if moving expense deductions are applicable. Look at any real estate closing statements to determine if there are extra interest, points paid, or real estate tax adjustment. Allocate days worked inside and outside of state for nonresident of state.
2.	Occupation(s)	Need to list on return.	If both husband and wife work and they have children, look for childcare credit (children under 13 years of age). Ask client to explain what they do. It might lead to additional deductions. A more descriptive explanation of occupation might make certain deductions seem more reasonable.
3.	Filing status	Check to see if filing status has changed (married, divorced, widowed).	Estate plan(s) or wills may need to be changed. If they support someone who lives in their home, they may qualify for head of household. If couple is separated and lived apart for last six months of year, custodial parent might be able to file as a "single" head of household instead of "married filing separate."
4.	Exemptions and dependents	Ask client their age (to determine if they are age 65 or over), and date of birth. Ask if there are any children or new children, if they are supporting any relatives, and so on. Social Security numbers of each dependent must be listed. If children under age 14 have income the Kiddie tax might be due.	Determine if noncustodial parent can claim exemption. Determine if the higher income parent who might be entitled to the exemption because of the divorce agreement (but who might not be entitled to an exemption deduction because of the phase out) would release the claim of exemption Form 8332. Ask if taxpayer participates in the joint support and pays their medical bills. The medical payments are deductible even if they don't qualify to be claimed as an exemption.

(*continued*)

	Topic	*Tax Preparation*	*Tax Planning*
			The dependent care tax credit is available for dependents who are under age 13, or incapacitated. Determine if the dependent children qualify for education credits.
5.	Wages, salaries	Get W-2s, 1099s, and so on.	If taxpayer qualifies as a statutory employee, put on Schedule C instead of using wages line. Deductions can then be taken and deductible in full. Also, deductions taken on Schedule C will decrease adjusted gross income (AGI) which might increase medical deductions, and reduce exemptions and itemized deduction phase out. Can also do a simplified employee pension (SEP) plan, SIMPLE or Keogh plan, instead of individual retirement account (IRA). If there was a different job from last year look for job-hunting expenses. If client is an employee with very high income and high unreimbursed business expenses (deductible to extent they exceed 2 percent of AGI), consider if they can incorporate. If client did not get a W-2 form consider reason and if necessary prepare IRS Form 4852—substitute for Form W-2.
6.	Interest	1099s, T-bill slips, brokerage statements, and so on. Watch for any withholding that might have occurred. Need to report all tax-exempt interest.	Is interest very high? ❏ Consider tax-free bonds. ❏ Consider investing for dividends that are now taxed more favorably. ❏ Consider series EE U.S. savings bonds to defer interest. ❏ Defer interest on treasury bills by selecting due dates of issue. ❏ Consider a Uniform Gifts to Minors Act account. Make sure that all documents have correct Social Security number. If amount on any 1099 is incorrect and client cannot obtain a corrected 1099 by the time return is ready to be filed, report incorrect amount on tax return and then subtract the incorrect portion on a separate line to avoid IRS correspondence questioning not reporting the amount on 1099.
7.	Dividends	1099s, brokerage statements, money market accounts. Watch for any withholding that might have occurred.	If dividends are very high, see 6 above. If dividends from mutual funds are high but taxed as “short term gains” consider switching to a pool of stocks or exchange traded funds that will pay dividends that will be taxed as capital gains.

	Topic	*Tax Preparation*	*Tax Planning*
			Claim credit for foreign withholding of income tax instead of a deduction.
8.	Refunds of state and local taxes	Look at last year's return. Get copy of 1099 issued by state or local government. If you took the standard deduction last year, then it doesn't have to be picked up as income this year.	Ask client if they received full refund: If they did not, include only portion received or credited to next year as income. If client did not get full benefit of deduction last year, they might not have to pick up entire 1099 amount as income. This occurs if they took standard deduction and were subject to alternative minimum tax in previous year. Always report the full amount on 1099 and subtract amount not received. Do not enter as a net amount.
9.	Alimony received	Look at copy of decree of separation agreement.	If alimony income, estimated taxes might have to be paid. If alimony is large enough, tax planning techniques such as in topics 6 and 7, above, might be used. Alimony qualifies for IRA contribution.
10.	Business income (loss)	Need income and expenses. May have to code checks to give to key punch operator, do bank reconciliations, review other deposits on bank statements, create any necessary schedules (documentation). Determine if all business deposits go into business checking account. If not, do a cash receipts analysis. Segregate entertainment expenses and exclude 50 percent.	Depending on occupation, look for expenses that client has overlooked that relate to his or her business: ❑ Business equipment—depreciation. ❑ Business auto—depreciation. ❑ Home entertainment. ❑ Expenses paid personally from personal checking account. ❑ Cash expenses not reflected in checks. ❑ Client should keep a diary of "4 Ws & $": WHO (name) WHAT (business discussion) WHERE (place) WHEN (date), and $-HOW MUCH SPENT. ❑ Retirement plans—25 percent limit except defined benefit which can be higher. ❑ Use of home office (but check out strict requirements). ❑ If client missed out on a Keogh plan, a SEP could be opened any time until April 15, or extended due date of tax return. ❑ Consider recommending a one-person 401(k) for the current year. ❑ Consider hiring children under 18 and avoid Social Security tax, and possibly avoid income tax for the children. ❑ Consider an S corporation, depending on circumstances.

(*continued*)

Topic	*Tax Preparation*	*Tax Planning*
		❑ Watch for (inquire about) hobbies that could lead to deductions as losses (that is, coin or stamp collections, baseball cards, and so on). ❑ Deduct a percent of health insurance premiums from gross income; deduct remaining amount as medical itemized deduction. ❑ Watch for self-employment tax. Use Schedule SE. ❑ Determine if taxpayer is eligible for a retirement plan. If so, determine amount of desired deduction. Alternatives include a SEP (can be opened up until due date of tax return including extensions); Keogh (must have been opened by last day of tax year); SIMPLE (must be opened three months prior to end of year and employees must be notified of choices two months before that); or IRA (must be opened by original due date of tax return); or a qualified pension or profit-sharing plan (must be established by last day of year). Clients could use prototype plans, or have tailor-made plans drawn up by an attorney or actuary.
11. Capital gain (loss)	Get brokerage statements and do reconciliation. For sale of business or property, get closing statement. Do schedule of carry-forward losses. Get copies of Form 1099-B transactions (sales of stock, commodities, through a broker).	Watch for possible ordinary loss (up to $100,000 if joint returns) on worthless Section 1244 stock. Gain is capital gain. Look for installment sales. Segregate and keep track of long-term gains. Gains on passive activities are not capital gains but passive activity gains.
12. Pension or IRA distributions	Get 1099s or other documentation. If a there was a premature distribution the client may be subject to 10 percent penalty.	Must start to take benefits by April 1 of calendar year following the year in which client reaches age 70½ and then must be one distribution a year. In the year taxpayer is 70½ there might be two distributions, one by April 1 and one by the end of the year.
13. IRA contributions	Get copy of documentation. Determine if client is eligible for deduction. Does the client qualify for a Roth IRA? Was there a (taxable) conversion of a regular IRA to a Roth IRA?	In general, this is recommended for everyone eligible for IRA deduction who is in at least a 25 percent federal tax bracket. Ask client if their employer has a 401(k) plan. If so, explain why they should contribute to it. May still be beneficial even if not deductible to contribute since money accumulates tax-free.

Topic	Tax Preparation	Tax Planning
		Determine if client has an IRA rollover account, and amount. Determine what client has IRA amounts invested in, and discuss long-range plans. Find out when client will have to start distributions. If client has retired and is taking IRA distributions, is below age 70½ and has other savings, inquire why he or she is taking payments from IRA account instead of depleting other accounts where withdrawals will not be subject to income tax. If client is under age 59½ and needs to take funds out of IRA account, consider a plan of periodic distributions to avoid imposition of 10 percent penalty tax.
14. Rents and royalties, partnerships, estates and trusts	Location, description. Get rent records or other documentation: Rental Income Rental Expense Entire house or percentage rented: Apportion interest and real estate taxes. Ask if certain expense is included in tenant's rent or what expense tenant pays for: Heat Electricity Repairs Q. What if client tells you that property was not rented during the year? A. Efforts must have been made to rent the property. If they sell their rental property, get closing statement. Obtain K-1s and carefully check information on them. Remember to think of any state difference from federal (such as accelerated cost recovery system [ACRS] versus straight-line depreciation). Get investor's basis in partnership on S corporations: Cash outlay Loans Notes	If vacation home, ask if they occupy it for more than 14 days and more than 10 percent of the number of days during the tax year it is rented at a fair market rental. If client rents out home for 14 days or less in year, then rental income is tax-free. Determine if rental income that they are charging is reasonable for this property. Look for other related expenses that client might have overlooked. Example: Client rents furnished apartment—depreciation on furniture, fixtures, and appliances. Consider possibility of treating as a second home and deducting mortgage interest and real estate taxes. Consider refinancing the residence to pay off rental-property mortgages that may help the client avoid rental losses. (Offset passive losses.) Be aware of rule concerning rental losses of more than $25,000 (less if AGI is more than $100,000) of which the passive activity loss (PAL) rules may limit the amount of loss the client can claim. Long-term capital gain treatment. Watch for add-back of ACRS deductions. Consider new modified accelerated cost recovery system (MACRS) deduction system. Watch out for alternative minimum tax (AMT) for investor with various shelters producing losses.

(*continued*)

Topic	*Tax Preparation*	*Tax Planning*
		Consider passive activity rules. Watch out not to exceed basis where applicable.
15. Unemployment compensation	Obtain 1099s—all unemployment is taxable.	Ask if client has job-hunting costs. Inquire if client has vested pension benefits that could be rolled over into another plan. And consider whether it should be done while taking into account client's financial condition and if bankruptcy is a possibility. If client will have an extended period of unemployment, consider cashing in U.S. savings bonds, and taking premature distributions.
16. Any other income	1099s or other documentation	Depending on occupation or source, try to put on Schedule C and take deductions, if any, against the income. Fringe benefits reported on 1099s are generally subject to self-employment tax. All commissions, fees, and other types of compensation are subject to self-employment tax.
17. Tax calculation	Determine if AMT is due.	Tax planning is the opposite for AMT than it is for regular tax. Try to make client understand that a pre-end tax planning meeting is necessary. If client has incentive stock options, the untaxed appreciation upon exercising the options are a tax preference item subject to the AMT. Plan for the client to exercise enough options each year (before the year containing the expiration date of the options) so that they will not be taxed, that year, on the untaxed appreciation because the AMT calculation results in an amount lower than the regular tax.
18. Charitable contributions	Record cash and noncash contributions on Schedule A. Prepare Form 8283 for noncash contributions over $500. Appraisal required for noncash contributions over $5,000.	Make sure client has the required letter from the charitable organization for contributions of $250 or more. Consider the contribution of appreciated stock. Consider the immediate contribution of withdrawn IRA funds if client has to take distributions and doesn't need the money to live on, and would like to increase charity payments.

SECTION II

CROSS-SELLING TO INDIVIDUAL TAX CLIENTS

CHAPTER 3

ESTATE PLANNING

Estate planning is a vital service for many clients who do not have a will or a current will, or who have a will but did not consider major estate planning techniques.

We have found that many clients with wills had them hurriedly prepared just before a trip or vacation and had very little planning guidance. We also have many clients with young children without wills, or clients with grandchildren whose children do not have wills. You can perform a great service for them by "pushing" them to get proper wills prepared.

Many people associate estate planning with trying to reduce eventual estate taxes. That is a major reason for estate planning, but not the only reason and certainly not the most important in many situations. A young family with an infant child's most important estate planning move would be to choose a guardian and plan how they will be compensated, which can be incorporated into an easily prepared will. In the United States very few estate tax returns have taxes paid with them.

The issue is providing for a family's financial security and comfort, and a successful easing into a new lifestyle without a loved one. Getting a client who does not have a will to execute one can be one of the most fulfilling services you can perform.

Your role is that of an adviser. An attorney will have to prepare the will and any trust agreements, and also provide some guidance and advice.

WHO NEEDS THIS SERVICE

Identifying clients who need estate planning services can be as simple as asking clients if they have a current will when you work on their tax returns. Our experience shows us that most clients need some sort of estate planning at almost all times.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

The CPA is generally aware of a client's family situation, their wealth, and some of the intergenerational financial dynamics. That knowledge combined with a technical background in basic estate planning techniques can place the CPA in an excellent position to advise the client on getting started to seriously consider how to pass on what they accumulated to their family in the most propitious and low cost/low tax manner. Also, the CPA can easily inquire and find out about eventual estate assets such as life insurance and potential inheritances.

INTRODUCING THE CLIENT TO THE SERVICE

After the client identification process, you should call them with some reasons why they should meet with you to discuss their situation further. We do not charge for the initial information given when we meet with them to get their tax data, nor do we charge if we mention some ideas when they pick up their tax return, or when we call to tell them they should schedule a consultation with us. But we do charge for the specific consultation, and any follow-up meetings and phone calls.

There are some very simple questions you can ask to lead the client into seeking your guidance. The questions are:

1. Do you know the importance of having a will?
2. Do you know how to leave funds for your children?
3. Do you know how life insurance affects your estate?
4. Do you know what income in respect of a decedent is?
5. Do you know there is an alternative to a will?
6. Do you know how a family asset protection trust might benefit you?
7. Do you know how to use a will to choose a guardian for your children?

After some of these preliminary questions and a brief discussion, we follow up with a fact sheet with more answers, and then a call suggesting an initial consultation. A sample fact sheet is included as Exhibit 3-1, "Sample Fact Sheet for Estate Planning Service." We have found that we can generally advise about 75 percent of our clients with a single meeting. The other 25 percent need additional services and meetings leading to about half of them signing up for a full estate plan. This is a pattern that applies to all of the additional services flowing from our individual tax clients.

Estate planning is not as high volume a business as some of the other services. The individual fees are substantially higher than for other services, but we also have a higher number of the initial consultations because of the universality of the concern, or previous lack of attention to wills and organizing of "final" affairs.

Just start the discussion, or probing, by asking clients whether they've provided for guardians for their children and for adequate funds to maintain their present lifestyle for their family members.

Discuss items currently in vogue to let your client know you have not overlooked it and that you are familiar with that tool or gimmick. Right now this includes living trusts, IRA rollovers, 401(k)s, charity remainder trusts, family limited partnerships, valuation adjustments, and defective trusts.

To get the client to recognize the value of the service, you can prepare a simple asset distribution and estate tax calculation worksheet. A sample worksheet is included in Exhibit 3-2, "Sample Asset Distribution Worksheet for Estate Planning Service." When working with the client to fill in the worksheet use estimated amounts. At this stage, you do not want to get hung up with exact details. The final amounts will be different. You can add categories or expand on what is shown in the exhibit.

We consider the worksheet a client service as well as a marketing tool. The client gets specific usable information that can be immediately applied to their will and situation. The marketing part of it is because the worksheet usually shows the inadequacy of the will as measured against their stated goals and desires. This leads to many estate planning engagements.

FINALIZING THE ENGAGEMENT

Closing the engagement is quite easy after a client has been in for the initial consultation and really needs additional meetings with us. The numbers really speak for themselves.

We try to set fixed fees for estate planning engagements. We find that clients do not like open-ended fee arrangements, and the time-based fees inhibit client calls and questions. This reduces the free flow of information from the client to us. Many of our estate planning ideas and suggestions are developed from the needs the client states to us. We do not work in a vacuum taking textbook illustrations and retyping them on a sheet called an estate plan. For that reason it is usual for higher-level people at the firm to be primarily involved in the engagement.

We have tried many methods of pricing our estate planning engagements. We find that not only does time not work well for us, it fails to recognize the ultimate value to the client. We tried fixed fees for each stage of a multiple-stage engagement. We also did not like this. It indicates that the engagement can be rethought about at each stage, and gives an impression that each stage creates a completeness that does not really exist. Presently we are trying two approaches. One way is to charge a fee to get to know the client's situation and then we are in a better position to tell the client what we believe we can do to solve their problems. The other way is a fixed fee based on our knowledge or preassessment of their situation and probable needs. We also provide for additional fees depending on what we end up doing for the client. If you care to know what we are presently doing, you are welcome to call or e-mail the author.

A sample engagement letter is included as Exhibit 3-3, "Sample Engagement Letter for Estate Planning Engagement."

EXHIBIT 3-1 **Sample Fact Sheet for Estate Planning Service**

ESTATE PLANNING FOR CLIENTS WITH NO TAXABLE ESTATES

1. Wills

With no will, state statutes determine who inherits the deceased's remaining assets. A will provides for the designation of a guardian, a will chooses an executor, and it leaves assets in a trust. A will can also leave bequests to charities, a will simplifies the probate process, and a will can direct how taxes will be paid.

2. Leaving Funds to Children

Under state laws children cannot own financial assets until they reach majority, usually on their 18th birthday. A will can put a structure in place designating how and when income and assets will be paid to children. A separate trust should be established for each child. An example distribution plan can be that at age 21, the children will start getting annual distributions equivalent to the trust income. Upon reaching their 25th birthdays, they will each receive 1/3 of the total accumulated funds set aside for that child. The full income on the remaining funds will accumulate and be added to the undistributed principal. At age 30, half of the remaining funds will be distributed and the full remaining amount will be distributed at age 35.

3. Life Insurance

A person with no taxable estate could end up with a taxable estate if his or her life insurance is inappropriately owned. A policy owned by the decedent will be included in his or her estate. A policy owned by the decedent or the spouse will be included in the estate if there is a simultaneous death. A policy owned by the decedent with a former spouse or children as the beneficiaries will be included in the estate. Setting up an irrevocable life insurance trust (ILIT) is simple, relatively inexpensive, and a very effective first step to becoming acclimated to estate planning.

4. Income in Respect of a Decedent (IRD)

Individual retirement accounts (IRAs), pensions, annuities, U.S. savings bond interest, unpaid salaries, and commissions are IRD items. Capital gains are not IRD income. IRD is subject to income tax by the recipient. If a client wants to leave equal inheritance, then it should be made up of the same types of assets. Leaving $100,000 of stocks and bonds to one child and $100,000 of an IRA to another is not an equal inheritance.

5. Living Trusts

An alternative to a will, a will substitute, is a living trust. A living trust can ease probate in many states. In New Jersey, this is not too beneficial; however, living trusts can be very important in Florida and some counties in New York.

6. Family Asset Protection Trusts

Assets left outright to a beneficiary will become part of his or her asset pool in the event of a lawsuit or marital separation. Assets left in a trust with all the income to the beneficiary and liberal rights of invasion by the trustee for the favor of the beneficiary and/or his or her children could protect the assets and keep them in the family. The trust might also save estate taxes when the income beneficiary dies. The assets placed in the trust would have been subject to estate taxes and would not be subjected to additional taxes when the primary income beneficiary dies.

7. Choosing a Guardian for Your Children

Without a will, litigation decides the guardian and what payments or reimbursements they get, the trustee who manages the money eventually passing to children, and when the distributions will be made. A will can put a structure in place designating how and when income and assets will be paid to the guardian.

EXHIBIT 3-2 Sample Asset Distribution Worksheet for Estate Planning Service

ESTIMATED ASSETS TO BE INCLUDED IN ESTATE AND POTENTIAL DISTRIBUTION TO BENEFICIARIES

Use estimated amounts. Do not get caught up with exact details. The final amounts will be different. You can add categories or expand on what is shown below—the format is illustrated to get you started.

		Distribution of estate assets							Items passing outside of estate but subject to estate taxes	
Item	Amount of asset to be included in estate	Used to pay debts	Used to pay taxes	To trusts for children	To QTIP trust for spouse	To spouse outright	To specific individuals	To charities	Amount	Beneficiary

EXHIBIT 3-3 Sample Engagement Letter for Estate Planning Engagement

Date

Mr. and Mrs. John Smith
Street Address
City, State, and Zip Code

Dear John and Jane,

This letter sets forth a proposal of the terms and objectives of our being engaged to provide estate planning services to you. The scope and nature of the services to be provided are as follows:

Review and Evaluation

We will determine the amount of your projected estate assets, what the estate tax on both of your estates will be, and what your current cash flow income and expenses are expected to be. We will also make the same projections for a period some time in the future. A major concern will be your comfort and the "security" of your future cash flow needs. We will also discuss the probable estate asset distribution to each of you as well as to your intended heirs. We will determine if there are sufficient assets in the appropriate hands to accomplish what you say you would like to accomplish. We will also point out basic estate tax reduction techniques and make suggestions on how to take advantage of them. We will also indicate ways to use any "excess" cash flow to save further estate taxes. We will also review distribution plans for IRA and pension funds under your control and discretion. We will also make suggestions on how to leave funds, and which funds to leave, to charitable organizations, if you are interested in this. We will further review your ownership in your real estate interests to determine if there are possibilities to save taxes through lifetime planning with respect to these assets.

We will consider your company ownership and your wishes as to the succession of your ownership in it to your heirs. We will make suggestions as to techniques that could accomplish your objectives. (Please note that our services in performing a business valuation and review and structuring a buy-sell agreement would not be included in this engagement.)

This stage will supply you with "real" information that we feel would be usable by you, family members if you wish to involve them in the process, your attorney, and any other adviser you choose to consult with. It will not leave you with definite plans or courses for you to follow. That will be developed in the next phase. Review and Evaluation is primarily an exploratory information gathering and idea producing process.

Review and Evaluation will generally consist of two meetings.

Estate Planning Recommendations

We will suggest specific estate tax savings alternatives and plans and discuss their application to you, and your wishes. This stage will develop ideas that you think you would be comfortable with and determine which estate tax reduction ideas you think you want to proceed with. We will then work those out with numbers regarding the estate tax savings and cash flow implications. When you are fully comfortable with the plans developed in this phase we will proceed to the next phase.

Estate Planning Recommendations can consist of from one to four meetings depending upon the complexity of your estate and what you might want to do. In many instances one meeting is sufficient because of the ideas developed in Review and Evaluation.

(*continued*)

Written Estate Plan

We will put everything discussed and decided upon by you in a written report expressing the ways and means of achieving what you decided you would like to do. We will prepare a road map for your attorney (and other advisers, if any) to follow in their discussions, analysis, recommendations, and document drafting. This written report will be reviewed thoroughly with you to make sure it completely expresses your views and wishes. Only when you are completely satisfied will we give you final copies to distribute.

This phase will consist of one meeting to discuss and review a draft of the written report to be followed by the final copy being sent to you. The time frame between this meeting and the conclusion of Estate Planning Recommendations will be about three weeks.

Review of Documents and Attorney Recommendations

We will review any recommendations made by your attorney or others you consulted. We will also review the legal documents drafted to see that they meet with the objectives you said you wanted to achieve. We will, of course, be available to discuss any thoughts or questions you may have.

This stage may or may not require a meeting.

Implementation

We will assist you in implementing the plan in any way you want. Accordingly, we will be available for a period of up to 90 days after the completion of the Review of Documents and Attorney Recommendations phase, by telephone or in person, to answer questions, to assist you or your other advisers to take necessary actions, and to make recommendations regarding these matters.

Fees

Our fee for these services will be fixed at $xx,xxx. A $x,xxx retainer will be required when we begin; $x,xxx will be due upon completion of Estate Planning Recommendations; and the balance of $x,xxx will be payable upon conclusion of Review of Documents and Attorney Recommendations.

Post-Completion Follow-Ups

We recommend that you have annual checkups or a revisiting and review of your situation to see if there should be any changes in your plan as measured by your situation at that time. We will review how any changes in the tax laws would affect you. We will look to see if there have been any changes in your family's situation, thinking, needs, or desires, or how any changes in the economy might interface with your previous planning. There would be additional fees for this service at a predetermined agreed-upon fixed price.

Limitation on Scope of Services

These services are not designed, and should not be relied upon, as a substitute for your own business judgment nor are they meant to mitigate the necessity of an ongoing review. These are not investment advisory services. These services are designed to supplement your own planning and analysis and aid you in fulfilling your estate planning objectives. In addition, these services are not designed to discover fraud, irregularities, or misrepresentations made in materials provided to us.

The services described in this letter do not include other services that may also be provided by us, upon your request, including but not limited to:

1. Tax compliance services, including income tax and gift tax return preparation;
2. Accounting and auditing services;
3. Appraisals and business valuations;
4. Review and analysis of proposals to purchase life insurance; and
5. Any other services not specifically outlined herein.

We will bill separately for any such additional services provided, based on time expended at our standard hourly rates or at your option on a predetermined agreed-upon fixed price.

Additional Professionals Needed

Please note that after we have completed our work, you will need to obtain the services of an attorney to review our findings, discuss the legal ramifications of the estate plan, and to draft all legal documents such as your wills, possible trusts, and any other agreements and contracts. Depending on the plan, you may need to engage the services of appraisers to value real estate, the business, and your ownership in other entities.

Conclusion

If this letter correctly sets forth your understanding of the terms and objectives of the engagement, please so indicate by signing in the space provided below and returning a copy to us.

Cordially,

CHAPTER 4

INHERITANCE ADVICE AND GUIDANCE

Inheritance advice and guidance is a valuable service for clients who have lost a loved one and are remembered in the will. Most times accountants are not the first ones clients call. Usually the attorney is the first person and then a financial planner. We get involved after the fact to "record" the results of what was done on the tax return, or via a phone call asking about the taxation of what they either received or think they will receive.

Inheritance advice and guidance has to do with helping ease the client into their new situation, applying some brakes to what other professionals suggest they do, working out the tax plan, advising on pension and individual retirement account (IRA) alternatives, and maybe even offering some postmortem estate planning. This is a wide area where the accountant's skills are used to the fullest.

WHO NEEDS THIS SERVICE

Identifying clients needing this service is not that difficult if you are alert to clients' situations and are in occasional touch with them. Also, the tax return interview will usually disclose the changing situation. Many times we get phone calls asking about the amount of tax they have to pay and when we inquire further, we are able to get them to see the benefits of coming in for a consult.

Other ways to identify them, or rather getting them to identify themselves, is by continuous promotion in firm newsletters, other mailings, and in conversations with them throughout the years. We find that most clients remain oblivious to the "ads" in newsletters and mailings, and need constant reinforcement about the type of services you perform. Calling occasionally, reading the obituary pages, and tax return interview and tax planning meetings are the most effective for us.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

The inquiring CPA at a tax return interview can find out if the client is expecting to inherit anything in the near future. If the client answers in the affirmative, you can give a short exhortation about the care that must be taken making the initial decisions when the inheritance is received, particularly if the inheritance is from an IRA or pension plan which is taxed when withdrawn. The client can be told to call you as soon as they know they will receive an inheritance because there are early tax elections that should be considered that will preserve the assets and keep the taxes at a minimum. Who is more knowledgeable in tax savings than the CPA who prepares their returns?

INTRODUCING THE CLIENT TO THE SERVICE

Telephone calls are the most effective. Try calling a tax return client a couple of times during the year to ask how they are doing, and if anything is new. Coincide one of these calls with a birthday or anniversary greeting, and you get two hits for one swing.

How many times do you get a call asking how a client can handle an inheritance? Be alert of these calls. What we also have found is that many calls are directed to the staff person handling their taxes. You cannot make this into an additional service and billing unless staff associates are coached on how to identify needs and when they should tell the partner about the call. In-firm marketing is a neglected area. Work at that.

When there is a death in the family the immediate concerns are clearing up the initial tumult, helping them through their feeling of how they will get through whatever has to happen, and determining how they will make do financially. You should let the client get a feeling of how you can be in control and will guide them in the right, and secure, direction.

Other areas of concern for clients are how the process works; what the time table is; whom they can turn to for assistance; what the costs are; how they will manage financially with the children; who will run the business, or buy it, or sell it for them; how they will manage through the mess of papers; whom they can trust; and what they are supposed to know.

Exhibit 4-1, "Sample Handout Article for Inheritance Advice and Guidance Service," is a reprint of an article we wrote that we give to clients. We especially give them to clients who tell us they might be inheriting something.

FINALIZING THE ENGAGEMENT

This is usually not going to occur until it happens. Most of the time there is not much preplanning. We try to hammer into our clients' heads that they should not do anything—*anything!*—until they call us. We have an initial meeting where we get an overview from the client of what they perceive the inheritance to be, and then lay out a listing of what they need to get for us to be able to properly evaluate their situation and to advise them on maximizing the benefits from what they are inheriting. We give the client a ballpark range of the fee and tell them we will need a retainer and will bill them periodically. In some situations where the inheritance seems straightforward we will quote a fixed fee and payment schedule, with qualifications of what is not included should it pop up—such as unexercised employer stock options.

EXHIBIT 4-1 Sample Handout Article for Inheritance Advice and Guidance Service*

10 TAX LOOPHOLES FOR INHERITANCES

Loophole 1: No personal tax:
The recipient of an inheritance does not pay estate tax. Estate tax is paid by the estate on the assets left by the decedent. However, some states do tax inheritances.

Loophole 2: No capital gains tax:
The recipient does not pay capital gains tax when they sell assets that they inherit. This is because of a tax break known as "step up in basis." The recipient uses as their cost basis for capital gains purposes the value on the estate tax return—not the property's cost to the decedent.

Example: You receive by inheritance a house that cost the decedent $20,000 and that's worth $150,000 when they died. You pay no tax when you receive the house by inheritance. And if you immediately sell it for $150,000, you pay no capital gains tax. Reason: Your tax cost is considered to be the property's value when the decedent died (or six months later if the estate chose that date). Since the house was sold for the same price at which you inherited it, you pay no capital gains tax. If you sell the house for more than $150,000, you'll have a taxable gain for the excess.

Loophole 3: Capital losses:
If you sell inherited property at a loss, you'll have a tax deduction for the loss. Suppose you sell the house in the above example for $120,000. You'll have a deductible $30,000 capital loss, subject to annual deduction limits. (Capital losses are deductible dollar for dollar against capital gains and up to $3,000 of ordinary income each year. Excess losses can be carried forward to subsequent tax years.)

Loophole 4: Disclaiming inheritances:
It sometimes pays to give up or disclaim an inheritance. In some situations, a great deal of estate tax can be saved when a beneficiary disclaims (gives up) an inheritance.

Example: A wife leaves $500,000 to her husband, who has an estate of $5 million. No estate tax would be owed on the wife's death because of the unlimited marital deduction. But on the husband's death, the extra $500,000 would be taxed to his estate at 50 percent. The tax would be $250,000. That tax could be saved if, on the wife's death, the husband were to disclaim the $500,000 inheritance and let it pass to the couple's children or other beneficiaries. The gift would not be taxed in the wife's estate because of her equivalent exemption—her right to leave up to $1,500,000 (the 2004 to 2005 amount) estate-tax-free to beneficiaries other than her husband.

Loophole 5: QTIP property:
Sometimes a life interest in an inheritance qualifies for the unlimited marital deduction. Property in which a spouse is given only an interest for his or her life may qualify for the unlimited marital deduction as qualified terminable interest property or QTIP. If it qualifies, the property will pass to the surviving spouse estate tax free. It will be included in the surviving spouse's estate at death. One of the requirements for qualification as QTIP property is that the executor make an unequivocal election on IRS Form 706, Schedule M, to have it qualify.

Loophole 6: Estate expenses deduction:
Deciding whether estate administration expenses and losses should be deducted on the income tax return or the estate tax return. If the estate is in a higher tax bracket than the decedent, it pays to take the deductions on the estate tax return rather than on the income tax return. The deductions produce a bigger tax benefit because the rate is higher.

Example: If the estate is in the 50 percent bracket and the individual in the 31 percent bracket, it would pay to take the deductions on the estate tax return rather than on the income tax return.

Loophole 7: Fiscal year:
Estates can have a fiscal year—any year of the executor's choosing—rather than a calendar year. Choosing a fiscal year can delay the time the beneficiary has to report the income earned on estate assets.

Example: Suppose the executor chooses a March 31 fiscal year. Any income earned from the date of death to March 31 will be taxed to the estate or beneficiaries in the calendar year that the first March 31 falls in. The income earned from April 1 to the following March 31 will not be taxed until the following calendar year.

Loophole 8: Business stock:
If the decedent owned stock in a C corporation that had high retained earnings, the stock can be redeemed income-tax-free by the estate. The redemption is treated as a capital gain. There would be no income tax payable because the value of the stock is "stepped up" to its value on the date of the decedent's death. Alternatively, if you take money out of a corporation's retained earnings without liquidating the corporation, the money is taxed as a dividend.

Loophole 9: Income tax deduction for estate tax paid:
Personal income tax paid on income in respect of a decedent is deductible as an itemized deduction on your personal tax return. Generally, when you inherit assets they are subject to the step up in basis rule, your tax cost is stepped up to the asset's date of death value. However, this does not apply to income that was earned by the decedent but was not paid before death. This includes pension, 401(k), 403(b), and IRA funds. This after-death income may be subject to both estate tax and income tax in the recipient's hands. The income tax deduction mitigates some of this double tax. Caution: The deduction is only for the federal estate tax and not your state's estate or inheritance tax which can be about 1/3 of the total estate tax payment.

Opportunity: A surviving spouse can elect to roll over a pension distribution into an IRA and defer the payment of income tax.

Loophole 10: Life insurance:
Life insurance proceeds are not subject to income tax by the beneficiary. They are also not subject to estate taxes if the policy was properly owned by someone other than the decedent or a life insurance trust.

*Updated since original publication in April 1995. Reprinted with permission from *Tax Hotline*.

CHAPTER 5

SECOND MARRIAGE ASSISTANCE

This is primarily a financial planning service for people who are in or entering second marriages, and where there are children from prior marriages.

WHO NEEDS THIS SERVICE

This is a valuable service for every remarried client who has children from a former marriage.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

These services utilize the tax and financial planning skills we have. We also have extensive experience with clients in such relationships and are usually familiar with conflicts that can arise and which ones can be avoided with some sound prior planning.

INTRODUCING THE CLIENT TO THE SERVICE

Ask second marriage clients whether they have made suitable financial arrangements for their spouse and whether they understand the legal financial rights each party has. Following are some preliminary questions you can ask clients about to remarry. These questions can help lead the client to seek your guidance:

1. Who will inherit your company pension and retirement accounts after your remarriage?
2. Have you considered whether you should change your pension payout method when you remarry?
3. Will your new extended family be adequately covered under your will?

4. Does your will specify whether the estate tax should be apportioned against each bequest or paid from your residuary estate?
5. Can you minimize taxes by allocating value-discounted estate assets to various beneficiaries?
6. Should you leave discounted assets to your children to avoid a drastic distortion in their net bequests?

We follow up the discussion with a fact sheet and call. A sample fact sheet is included as Exhibit 5-1, "Sample Fact Sheet for Second Marriage Assistance Service."

Clients should also be told how this is an involved area—particularly where there are children from a first marriage and inheritances left in "trust" for the second spouse. This can lend itself to some very interesting cash flow and estate tax consequences. For instance, what happens when the second wife is about the same age as the children from the first marriage, and the funds are left in a qualified terminable interest property (QTIP) trust? Are the children effectively disinherited? If the funds are invested in a manner to have low dividends and high eventual capital appreciation, what happens if the remaining income invested funds are providing a relatively low yield based on the total value of the portfolio?

FINALIZING THE ENGAGEMENT

We use the same pattern of an initial consultation that we use for most of our other services. We charge a flat fee for the initial consultation. About half the time, all issues are resolved in the initial consultation. For the other half, we are usually able to quote a fixed fee. We always request an initial retainer—approximately 40 percent and two additional equal monthly payments. Many times this leads to complicated estate planning expanding the engagement.

EXHIBIT 5-1 **Sample Fact Sheet for Second Marriage Assistance Service**

TAX AND ESTATE PLANNING FOR INDIVIDUALS WHO REMARRY

1. Company Pension and Retirement Account Inheritance

Federal law requires that spouses who will not inherit at least half of their spouse's pension and retirement accounts waive their rights to the money in writing. But very few individuals who remarry bother to ask for a written waiver. In order to avoid unintended consequences, ask your new spouse to sign a separate agreement governing the pension money immediately after the marriage. A prenuptial agreement waiving a share of pension is not binding because it is signed before the marriage.

2. Pension Payouts

Typically for payout, you can choose a "one life annuity" which would make payments to you for life. You could also choose a "two life annuity" which would make smaller payments during your lifetime but continue to pay your spouse until he or she dies. In many second marriages, it isn't necessary to provide lifetime payments to the surviving spouse, who could very well be covered under a pension plan from his or her first marriage. You should buy a term-certain fixed-premium life insurance policy that will pay the children the amount they otherwise would have received from the pension payments after your death. When you must cover a second spouse under your pension plan, make sure your children from your first marriage do not lose financially.

3. Wills

Many people neglect to prepare new wills when they remarry. However, most states have laws that automatically give a portion of an estate outright to a surviving spouse. You should set up a qualified terminable interest property (QTIP) trust for your new spouse. This trust provides income solely to the spouse over his or her lifetime. At the time of your death, trust assets are distributed to your children or other beneficiaries designated under your will.

4. Estate Tax Apportionment

Estate tax apportionment has become increasingly important as the amount of money in pension and individual retirement accounts (IRAs) increases. This is because retirement account assets pass outside the taxable estate. Without apportionment, nonretirement account beneficiaries would pay the full amount of the estate tax on assets inherited by the retirement account beneficiaries. Apportionment requires that beneficiaries pay their share of the taxes according to how much they inherit. Otherwise, taxes are paid from the remaining estate assets.

5. Value-Discounted Estate Assets Allocation

Estate tax valuation discounts apply to family partnerships, corporate stock, and other assets in which the decedent owns a noncontrolling interest. Discounted assets carry reduced estate tax liability. You should use undiscounted assets to fund a QTIP trust for your surviving spouse and give discounted assets to children on which estate tax is to be paid. There is no current tax on the assets left to the spouse.

6. Discounted Assets Left for Your Children

You should leave discounted assets to your children to avoid drastic distortions in their net bequests. You would fund a QTIP during your lifetime with trust provisions that mirror the provisions in your will.

CHAPTER 6

UNMARRIED COUPLES LIVING TOGETHER PLANNING

This is a very hot issue with many different tax consequences—financial, and income and estate taxes. This can be performed for same sex and opposite sex couples living together.

WHO NEEDS THIS SERVICE

This service is applicable for every client in a live-in unmarried relationship, or those contemplating it.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

These services utilize the tax and financial planning skills we have. We also have extensive experience with clients in such relationships and are usually familiar with conflicts that arise.

INTRODUCING THE CLIENT TO THE SERVICE

Asking unmarried clients whether they have made suitable financial arrangements for the person they are living with is an easy way to raise the issue.

FINALIZING THE ENGAGEMENT

We use the same pattern of an initial consultation that we use for most of our other services. We charge a flat fee for the initial consultation. About half the time, all issues are resolved in the initial consultation. Where one of the individuals has substantial assets, or where large life insurance policies are to be purchased, it opens up opportunities for serious estate planning.

CHAPTER 7

PERSONAL FINANCIAL PLANNING

Financial planning is the service clients need to better handle and manage their finances, investments, and long-range plans. Financial planning is what will provide a client with the right degree of individual security about their future and that what they are doing is on target to achieve whatever it is they wish to achieve.

Financial planning involves helping a client define and articulate their goals, setting a method of attaining those goals, investing in a propitious manner, proper family budgeting, and sound tax planning.

Following are some additional personal financial planning areas of involvement besides many of the services mentioned in this book:

- Divorce tax planning
- Life insurance proposal analysis
- Personal bankruptcy advice and explanations
- Social Security optimum starting date
- 401(k) and 403(b) investment decisions
- Explanations of various types of mutual funds
- Certificates of deposit (CDs) and bond investments
- Mortgage refinancing decisions
- Buy versus lease choices
- Risk and insurance needs assessment

WHO NEEDS THIS SERVICE

Everyone needs personal financial planning. Financial planning is something we generally give away for nothing while we are getting tax information or doing year-end tax planning.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

The CPA is probably the best qualified all around to advise and guide the client. We certainly have the tax part mastered. Our experience with taxes also makes us not only extremely knowledgeable in investment alternatives, but our range of clients and their continuous calls makes us a clearing house for real time data about what clients are thinking and doing, and what is available in the marketplace. The accountant is called upon many times to advise clients on family budgeting and assistance in helping them plan for all stages of their life—a child's college, assisting their parents in their final years, their own retirement, the business they might want to buy or start, the possibility of an early and untimely death, and the eventuality of death.

CPA continuing education provides much of the background that supplements our hands-on everyday experience.

INTRODUCING THE CLIENT TO THE SERVICE

Many times we have important preliminary discussions when we obtain a client's tax information. Skilled interviewing, or effective follow-up techniques, can make these into an additional engagement.

This should follow a typical pattern of making note of client needs when you prepare their tax return. After tax season there should be a systematic follow up with a phone call suggesting that they might need additional services in this area and why; followed by a brief fact sheet being mailed to the client.

Following are some general financial planning questions you can ask tax clients that relate directly to taxes. Getting their responses can lead you to reasons the client would need additional services.

1. Have you considered certain tax-deferred retirement plans to shelter part-time business income?
2. Did you know you can deduct the full market value of appreciated securities donated to charity without paying taxes on the appreciation?
3. Did you know you should account for future taxes when transferring shares in a family business as part of a divorce settlement?
4. Did you know you can get a full deduction for donated art, if it is done in a particular manner?
5. Have you considered having shares of stock in your employer's company that are held in your 401(k) plan distributed directly to you when you terminate your employment, rather than rolled over to an IRA?
6. Did you know you can minimize your capital gains taxes by choosing the most favorable method of calculating your profits when you sell shares of stock or mutual funds?
7. Have you considered whether you should convert a regular IRA to a Roth IRA?

The follow-up fact sheet that is mailed to the client is included in Exhibit 7-1, "Sample Fact Sheet for Financial Planning—General."

Following are some financial planning questions regarding diversifying a portfolio and taxes:

1. Do you know how to harvest your losses on some holdings so you can diversify your portfolio?
2. Did you know you can borrow against your concentrated portfolio to get the funds for diversifying?
3. Did you know a charitable remainder trust can be used to diversify your portfolio?
4. Did you know buying certain types of puts may cause your deferred gains to be taxed immediately?
5. Do you know what a variable prepaid forward contract is?
6. Have you considered equity swaps offered by brokerage firms as an opportunity to diversify your portfolio?
7. Have you considered exchange funds as an effective means of diversifying your portfolio?

The follow-up fact sheet that is mailed to the client is included in Exhibit 7-2, "Sample Fact Sheet for Financial Planning—Diversification."

Following are some financial planning questions regarding how a client can get tax-free income. This is an area that we are frequently asked about even though it doesn't apply to most clients. This can open many areas of discussion, but in some cases it is more important as establishing your expertise in tax savings techniques *should* the client ever need such benefits.

1. Did you know home rentals of up to 14 days are tax-free?
2. Did you know expense reimbursements are tax-free?
3. Do you know when gain on the sale of a home is tax-free?
4. Did you know frequent-flier miles are tax-free?
5. Have you considered like-kind exchanges as a way to trade an appreciated property to a similar property while deferring the realization of taxable gain until the second property is sold?
6. Are you aware education savings accounts and plans are tax-free?
7. Do you know how Social Security benefits may be taken tax-free?
8. Did you know government bonds are tax-favored?

The follow-up fact sheet that is mailed to the client is included in Exhibit 7-3, "Sample Fact Sheet for Financial Planning—Tax-Free Income."

After mailing the fact sheet make another phone call about two weeks later asking if the client has thought about it and what they have started doing. You can also suggest at that time they come in with their spouse for an initial hour-and-a-half consultation at a fixed fee. Don't forget to tell them what they should bring with them to the meeting (or can send to you beforehand). Note that we don't usually ask the client to send us information before the meeting, because it delays the meeting until the client can get it done. We try to make things as user-friendly as possible—and that includes making it extremely easy for the client to get the process rolling by coming in to see us.

After the initial consultation, we usually suggest what the process would entail if additional meetings are necessary—in about half of the instances they are not.

FINALIZING THE ENGAGEMENT

For those engagements that are ongoing, such as continuing investment monitoring, we charge a flat fee. A sample engagement letter is included in Exhibit 7-4, "Sample Engagement Letter for a Personal Financial Planning Engagement."

EXHIBIT 7-1 Sample Fact Sheet for Financial Planning—General

FINANCIAL PLANNING

1. Tax-Deferred Retirement Plans

You can shelter part-time business income in a tax-deferred retirement plan. You do not pay tax on the money you put into the plan until you take it out. You can contribute maximum amounts per year to a defined-contribution plan including Keogh's and the easier-to-use simplified employee pension plans (SEPs). If your net income from a part-time business is less than certain amounts, you may be better off with a SIMPLE plan or a one-person 401(k) might be more appropriate. Also, taxpayers over age 50 can add additional catch-up contributions in certain plans.

2. Appreciated Securities Donated to Charity

You should deduct the full market value of appreciated securities donated to charity. Not only do you get a market value deduction for such gifts, you also avoid paying tax on the appreciation. To get the full write-off, make sure you have owned the securities for more than 12 months. Otherwise, your deduction will be limited to your tax cost (basis) in the securities.

3. Divorce Settlements and Future Taxes

You should account for future taxes when transferring shares in a family business as part of a divorce settlement. There are no tax consequences when stock in a closely held company is transferred from one spouse to the other as part of a divorce settlement. However, the person receiving the shares takes the same tax cost as the person transferring them, along with any built-in capital gains. The recipient must pay tax on those gains when he or she disposes of the stock.

4. Donated Art

To get a full deduction for donated art, if the art is worth more than $5,000 you must get a valuation from an independent appraiser. In addition, the art must be used for the charity's basic purpose.

5. Company Shares of Stock

You should have shares of stock in your employer's company that are held in your 401(k) plan distributed directly to you rather than rolled over to an IRA. Employees who receive shares of corporate stock that have been contributed to their 401(k) account have two choices when it comes to taking the shares out of the plan. They can roll over the shares into an IRA and pay no tax, or have the shares distributed to them (the employees) and pay taxes with a possible early withdrawal penalty. When you roll over company stock into an IRA, you or your IRA beneficiaries will pay tax on the full value of the shares when they are eventually withdrawn from the account. By having company stock in a 401(k) plan distributed directly to you and paying tax at the time of distribution, the tax will be based on the actual value of the shares at the time they were put into the plan and not their value when you receive them. If the stock has greatly appreciated, and you hold the shares for more than one year, the sales proceeds will be taxed at favorable long-term capital gains rates.

(*continued*)

6. *Minimizing Capital Gains Taxes*

You can minimize your capital gains taxes by choosing the most favorable method of calculating your profits when you sell shares of stock or mutual funds. The IRS requires you to use the first-in, first-out (FIFO) method to figure your gain on security sales—unless you elect a different method. FIFO assumes that the shares you sold were the first ones you bought—usually the ones with the lowest cost and the highest built-in gains. You can also use the specific identification method. When you identify the shares you are selling, you can pick which ones to sell to control the amount of tax you pay. By keeping detailed records when you buy shares of stock or mutual funds, you can sell those that will produce the lowest taxable gain. When you sell them, designate in writing which shares are to be sold by the date of purchase.

7. *Converting Regular IRAs to Roth IRAs*

A regular IRA can be converted to a Roth IRA. Your modified adjusted gross income must be no greater than $100,000 in the year you convert. Income in subsequent years does not matter. After five years and age 59½, whichever comes later, all Roth IRA withdrawals are tax-free. No lifetime minimum required distribution rules apply.

EXHIBIT 7-2 **Sample Fact Sheet for Financial Planning—Diversification**

DIVERSIFYING YOUR PORTFOLIO AND TAXES

1 Harvesting Losses

If you hold securities in addition to your concentrated position, take losses on your outside losses whenever possible. After you take a capital loss, sell enough of your concentrated position to take an equivalent gain. No net tax obligation will result. The proceeds from the sales can be reinvested to provide you with a diversified portfolio.

2. Using Leverage

If your concentrated position makes up most or all of your portfolio, you can borrow against your concentrated portfolio to get the funds for diversifying. Borrowing the money does not trigger a tax bill, and the interest payments may be deductible. If the other securities you acquire increase considerably in value, you'll benefit from the appreciation. If those securities lose value, you can harvest capital losses and take offsetting gains on the concentrated position.

3. Charitable Remainder Trusts

Donating appreciated shares to a charitable remainder trust (CRT) will not trigger a taxable gain. The trust can then sell your shares tax-free and reinvest the full amount in a diversified portfolio. You may end up being able to deduct a portion of the market value of the shares you donate as a charitable contribution. Moreover, you and/or your spouse can receive lifetime income before the remainder of the trust fund goes to charity.

4. Puts

Sophisticated use of options may help you diversify a concentrated portfolio. A put gives you the option to sell specific securities at a given "strike" price during a certain time period. You might be able to borrow against the shares you own. The proceeds of the loan can be reinvested in a diversified portfolio while you defer paying tax on any gains from your shares until you exercise the put. You must be careful, however, because an "in-the-money" put may cause your deferred gains to be taxed immediately, so you must consult your tax adviser. In addition, many other tactics with options can be taxed immediately under "constructive sale" rules, so you must get professional advice before proceeding.

5. Variable Prepaid Forward Contracts

A variable prepaid forward contract allows you to agree now to a future sale, with a minimum and a maximum price. By doing this, you are not actually borrowing money and you do not have to worry about margin calls or loan documentation. However, there will be an implied interest rate which will affect the amount of money you receive up front. You may receive more money this way for portfolio diversification than you would by borrowing against the position. By borrowing against securities, you'll probably be limited to a 50 percent loan; whereas with a variable prepaid forward contract you typically will receive 80 percent to 85 percent of the value of the shares you've sold to invest in other securities. At the end of the period, when you settle with the brokerage firm, you'll owe tax on the money you've received for your shares, minus your basis in the shares you deliver.

(*continued*)

6. Equity Swaps

In an equity swap, you enter into a contract in which you keep the legal title to your concentrated holding. The financial firm assumes most of the risk of any losses on those shares as well as the rights to most of the gains, for a period of time. As the other part of the contract, you get the risks and rewards from another asset. The key is that you may have to pay if you swap for an index which lags your stock, but you will still own your shares and you will not have paid capital gains tax. When the contract expires, you may be able to renew it, continuing to defer the taxable gain on the appreciated stock you still hold. You can maintain your participation in broad market returns.

7. Exchange Funds

Exchange funds are typically private partnerships formed by Wall Street firms, usually limited to 99 investors. Each investor might contribute $1 million or more worth of appreciated stock, so the partnership will own many companies. After several years, exchange funds are terminated. The ultimate outcome will differ from one transaction to the next, but the general goal is to distribute diversified holdings to the investors while deferring taxes. To qualify for a tax-free exchange, less than 80 percent of the assets in an exchange fund can be publicly traded stocks. The other 20 percent-plus must be other types of permissible assets, such as certain real estate interests and commodities.

EXHIBIT 7-3 **Sample Fact Sheet for Financial Planning—Tax-Free Income**

HOW TO GET TAX-FREE INCOME

1. *Home Rentals*

Home rentals of up to 14 days are tax-free. If you rent out your home or second home for no more than 14 days, you do not have to report to the IRS the rent you receive. If there are any popular tournaments or attractions scheduled near you, consider renting your home to an attendee and using the money you receive tax-free to pay for a vacation.

2. *Expense Reimbursements*

Expense reimbursements from an employer are tax-free. Negotiate for reimbursement from your employer if you currently incur out-of-pocket business costs—for items such as publications, professional dues, meals, driving, purchases of supplies, and so on. You and your employer both benefit by converting salary to reimbursements. You pay your expenses with pretax rather than after-tax dollars and your employer does not owe employment taxes.

3. *Selling Your Home*

Gain on the sale of a home is tax-free up to $250,000 ($500,000 on a joint return) when you have used the home as your main residence for at least two of the prior five years.

4. *Frequent-Flier Miles*

Frequent-flier miles are untaxed by the IRS. This will not change without advance warning to the public.

5. *Like-Kind Exchanges*

Like-kind exchanges allow you to trade an appreciated property for a similar property—such as one real estate property for another—while deferring the realization of taxable gain until the second property is sold. That property, too, can be disposed of through another like-kind exchange, so deferring taxation on gain can occur indefinitely.

6. *Coverdell Education Savings Accounts and Section 529 College Savings Plans*

Coverdell Education Savings Accounts allow investment returns earned in them to be used tax-free to pay for college costs and even elementary and high school costs including books, supplies, after-school programs, tuition, tutoring, and even home computers. Section 529 College Savings Plans allow investment earnings to be used tax-free for education costs.

7. *Social Security Benefits*

If you invest in appreciating assets, Series EE and I savings bonds, and cash-value life insurance, Social Security benefits may be taken tax-free. The increase in the value of such investments adds to your wealth but is excluded from your current income until cashed in. It does not push your income over the threshold that makes your Social Security taxable.

8. *Government Bonds*

Government bonds are tax-favored. State and municipal bonds are generally free of federal income tax and may be free of state tax as well. Federal bonds are exempt from state taxes.

EXHIBIT 7-4 **Sample Engagement Letter for a Personal Financial Planning Engagement**

Date

Name
Street Address
City, State, and Zip Code

Dear Tom,

This letter sets forth a proposal of the terms and objectives of our being engaged to provide continuing financial planning services to you.

Please note that this is a fee for professional services engagement. No financial products will be sold, and no commissions of any sort will be received. Any reviews made of your investments will be on a completely independent basis. The only compensation we will receive are the fees you pay us. All fees are payable at the inception of the service period.

The objectives and plans developed during our initial meetings will be considered a "work in progress" and will serve as a road map directing you toward your long-range goals. This will undergo constant review, supervision, discussion, and measurement.

Our engagement will be for 12 months service starting November 200X.

The following specific services will be performed:

- We will review duplicate monthly brokerage account statements that will be sent to our office directly by your brokerage firm.
- We will call you periodically to discuss comments we have regarding your portfolio and financial plan.
- You may make periodic telephone calls to us regarding your portfolio.
- Three additional one-hour meetings during the year as necessary, or one approximately every three months beginning three months after the start of these services.

The fee for these services will be $x,xxx payable at the inception of the services.

If this letter correctly sets forth your understanding of the terms and objectives of the engagement, please so indicate by signing in the space provided below and returning a copy to us.

Cordially,

CHAPTER 8

INVESTMENT ALLOCATION CONSTRUCTION

This is a valuable service that helps a client get a perspective on his or her investments, their projected assets, and the current and prospective cash flow from the investments, and measures this against the client's individual risk tolerance and broad long-range goals. Many times the client has to be "taught" basic investment principles, techniques, and vehicles and have these related to what might be best for the client. Then a portfolio model has to be constructed that will provide the right degree of risk with the feelings of security the client needs.

WHO NEEDS THIS SERVICE

Every client who invests in any manner needs assistance in his or her investment allocation construction.

Many of our tax clients may not have much savings or personal investments, but they might have 401(k) accounts and other employer-sponsored accounts. These are usually not serviced by so-called independent financial planners since there is no opportunity for commissions on sales of new products or management fees since the employer (or their agent) manages these accounts. Despite the employer control clients are usually given ranges of choices which they may find to be a complete maze, so they use the default provisions.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

We find that while most CPAs are not the best qualified to offer these services, they can do a fine service helping the client understand why they need help, and how to get it. We usually have the easiest access to all of their data if we would just ask for it.

Providing information in a user-friendly manner is sometimes the best service we can perform. Collecting and laying out all of the client's financial assets in an easy-to-follow way can lead to discussions about the asset allocation that the client has and that which would be the most appropriate. This goes back to the financial planning goals that we can help a client determine for themselves. Many of the additional services are interrelated and should be considered jointly and not on a one-service-at-a-time basis.

Our training as accountants equips us with the best tools to show clients where they stand and how they can measure it against where they want to go. Once the present situation is held up against the future goal and if additional assistance is then needed, financial planning specialists can be recommended.

INTRODUCING THE CLIENT TO THE SERVICE

Clients can be asked very simply how much of their total assets they have in the stock market. They will either know it, or won't.

If they know it, ask them why it is that amount. This would usually lead to them describing their goals and risk tolerances and why they chose that percent for their equities. If they appear to be in control and you feel their goals are well considered, then they are not a candidate for your assistance.

If they do not know why, then you might ask them some questions about their goals and how they expect to attain them with their investing philosophy. (Refer to some of the questions in Chapter 7, "Personal Financial Planning.") This could open up an evident need for additional services.

To get more specific, following are some basic questions to ask clients about the mutual funds they own. Their responses can indicate how savvy they are in their investment choices.

1. Did you know you should wait until after the mutual fund makes its distribution to buy shares?
2. Do you own any tax-managed funds?
3. Did you know if you reinvest sales proceeds in the same fund within 30 days you lose the tax deductions?
4. Did you know investments in municipal funds that buy "discount" bonds are taxable as ordinary income?
5. Are you keeping good enough records to prevent paying double taxes on your mutual fund dividends?
6. Did you know a gain on the sale of bonds is taxable capital gains?
7. Did you know phone switches among funds are taxable transactions?
8. Did you know you can deduct investing expenses?

The follow-up fact sheet that is mailed to the client or used to form responses is included in Exhibit 8-1, "Sample Fact Sheet for Investment Allocation Construction Service—Mutual Funds."

Many clients have some U.S. savings bonds. Following are some asset allocation door opener questions that you can ask.

1. Have you considered which type of U.S. savings bond you wish to buy?
2. Have you compared the competitive yields of U.S. savings bonds to five-year certificates of deposit (CDs) and Treasury bonds?

3. Did you know there is an annual purchase limit on savings bonds?
4. Did you know you can defer taxes and be exempt from taxes if you invest in savings bonds?
5. Did you know if you use your savings bonds to pay for college tuition, the interest is free of federal tax?
6. Did you know you can use your savings bonds in retirement?
7. Did you know if you do not need savings bond funds for your retirement, you can work them into your estate plan?

The follow-up fact sheet that is mailed to the client or used to form responses is included in Exhibit 8-2, “Sample Fact Sheet for Investment Allocation Construction Service—Savings Bonds.”

We have also found a basic discussion based on the information in Exhibit 8-3, “Sample Discussion Guide for Investment Allocation Construction Service,” to be a great door opener.

FINALIZING THE ENGAGEMENT

When a tax return is prepared, the CPA has a window into all the nonretirement plan investments since the income is reflected on the tax return. A few short questions about retirement plan investments such as IRA and 401(k) accounts can give an almost full picture of the client’s asset allocation among the various investment categories. Many CPAs involved in financial planning can quickly determine the risk tolerance of the client by the type of income reported on 1099s and brokerage statements. Applying this overview to the client’s near and long-term goals can lead to suggesting a thorough review that will help the client determine if they have made proper investments for themselves.

EXHIBIT 8-1 **Sample Fact Sheet for Investment Allocation Construction Service—Mutual Funds**

MUTUAL FUNDS AND TAXES

1. When to Buy Shares of Mutual Funds

Distributions are taxable to shareholders of record as of the distribution date. They are taxable even if reinvested in the fund. Even if you did not own shares when the fund earned its gains, you will pay tax on the distribution if you own shares on the distribution date. The value of your shares will decline in an amount equal to the distribution. If you buy shares just before the distribution, your original investment after tax will shrink immediately. Wait until after the fund makes its distribution to buy shares. Call the fund or check its Web site to learn the exact distribution date. If you are planning to sell fund shares, sell before the distribution date to maximize the sale price.

2. Tax-Managed Funds

Mutual funds are required to distribute at least 90 percent of their total income to shareholders. Shareholders must pay tax on these income distributions. This reduces your after-tax return. Research funds that are tax-managed or tax-efficient limit buying and selling. The ultimate practitioners of this are index funds. They buy low-dividend, high-growth stocks, postpone selling to qualify for long-term capital gains rates, sell their most costly shares first, and take losses strategically.

3. Reinvesting Sales Proceeds

If you sell shares in a mutual fund and buy shares in the same fund within 30 days before or after the original sale, you can't deduct the loss. The "wash-sale" rule prohibits it. You can fall into the wash-sale trap if you automatically reinvest dividends in a fund within the wash-sale period. To secure the loss, invest the proceeds in a similar, but not identical, fund—one with similar investment objectives and performance records. You can also avoid the wash-sale rule by waiting 31 days to reinvest in shares of the original fund. If you reinvested dividends, you need not defer the entire loss—only the amount of the loss equal to the dividends.

4. Municipal Funds That Buy Discount Bonds

Bonds that are sold for less than face value are bought by some municipal bond funds. When held to maturity, the difference between the purchase price and the maturity price is taxable as ordinary income—not capital gains. Before buying, check to see if the fund owns "discount" bonds.

5. Paying Double Taxes on Your Dividends

If you are not accurate in your record keeping, you could pay taxes twice—when the dividends are paid, and when you sell your shares. Keep good records; add reinvested amounts to your basis in the fund shares. Increasing your basis reduces your tax bill when you sell. When shares are received by gift, document the donor's tax basis—this carries over to you.

6. Gains on the Sale of Bonds

Most income earned by municipal bonds is tax-free, but a gain on the sale of bonds is not. If a fund manager earns capital gains by selling bonds, it may be passed on to the fund's shareholders. Before you purchase a municipal bond fund, look at the turnover ratio found in the fee table in the fund's prospectus. A large turnover ratio indicates a high frequency of buys and sells that can lead to taxable capital gains.

7. Phone Switches

Most fund families let you switch money among their stock, bond, and money market funds by phone. Many investors do not realize that a switch is a taxable sale. The IRS considers it a sale in the first fund when you move money between funds—even if you reinvest all the money in the second fund. You owe taxes on any gains the sale produces. Before making a telephone switch, decide whether it makes sense tax-wise.

8. Deducting Investing Expenses

Investing expenses are deductible as "miscellaneous expenses" to the extent they exceed 2 percent of your adjusted gross income (AGI). You can deduct subscriptions to investment-related publications, investment advice, management services, postage, and telephone costs related to investing. Costs related to buying or selling a fund—either a front- or back-end load—are not deductible. If you paid a fee to buy a no-load fund through a discount broker, add the fee to your basis to reduce your capital gains when you sell.

EXHIBIT 8-2 **Sample Fact Sheet for Investment Allocation Construction Service—Savings Bonds**

BUYING SAVINGS BONDS

1. I Bonds and EE Bonds

There are two kinds of U.S. savings bonds. "I" bonds are sold at face value in denominations ranging from $50 to $10,000 and they pay two types of interest—a fixed rate that remains constant throughout the life of the bond and a rate that is adjusted every six months (on May 1 and November 1) depending on the rate of inflation. "EE" bonds are sold at a discount of half their face value in the same denominations as I bonds; for example, a $50 EE bond costs $25. EE bonds issued after May 1, 1997, earn 90 percent of the five-year Treasury bond rate for the prior six months.

2. Competitive Yields

An illustration of the differences follows: When I bonds yielded 2.57 percent and EE bonds yielded 3.96 percent, the average rate on five-year certificates of deposit (CDs) was 4.81 percent and the average yields on Treasury bonds were 4.49 percent for five-year bonds and 5.17 percent for ten-year bonds.

3. Annual Purchase Limits

Federal law limits the amount you can invest each year in savings bonds. You can purchase up to $30,000 in I bonds and $15,000 in EE bonds each year. Gifts you make of savings bonds are not counted toward these limits.

4. Deferrals and Exemptions

By investing in savings bonds, you could defer federal income taxes. You do not have to report savings bond interest annually, although you can if you choose to. You would do this only if your income was so low that no tax was due. Interest can be deferred for as long as you hold the bond, up to the final maturity date. Interest on U.S. savings bonds is never subject to state or local taxes. Investors in states with income tax should take that into special consideration.

5. College Tuition and Tax-Free Interest

Savings bond interest is tax-free if the bonds are redeemed to pay tuition and other qualified higher education costs for the bondholder or his or her spouse or dependent, as long as the bondholder's income is below a set amount as determined annually by the IRS.

6. Savings Bonds and Retirement

I bonds and EE bonds only accrue interest; they do not pay interest currently. They must be cashed in to obtain retirement income. If you have purchased bonds throughout your working years, they will not mature at the same time, and can be held until their final maturity dates. If you purchase the bonds in your 40s, they would be available for retirement income in your 70s.

7. Savings Bonds and Estate Planning

If you do not need savings bond funds for your retirement, you can work them into your estate plan. When you purchase a bond, you can designate a beneficiary who will inherit the bond upon your death. Since the bond passes directly to the beneficiary, it is not subject to probate expenses.

EXHIBIT 8-3 **Sample Discussion Guide for Investment Allocation Construction Service**

ASSET ALLOCATION

Asset allocation is a very important factor in investing. Many times it is not as much what you invest in as how your assets are allocated. The purpose of asset allocation is diversification. And with diversification should come safety or security.

The diversification in asset allocation is in the broad categories you invest in, and not the specific assets. You should also spread your investments into the different subcategories within each category.

We have one starting comment about asset allocation. We only recommend asset allocation for long-term portfolios, and we are defining long-term as a minimum of seven years. If your needs are for less than seven years, we are afraid you will have to use different criteria. Seven years is an arbitrary number. We could have selected five years or a longer period. We chose seven years simply because money doubles in seven years using a 10 percent yield. We feel that is a sensible target. One of the elements of investing is time. Given enough time, any bad choice can be made right. For that reason asset allocation maneuvers for someone age 40 would be completely different than for someone at age 60 with the exact same total of funds to invest.

There are many ways of constructing an asset allocation model for your portfolio. Some allocation formulas include a wide variety of categories such as:

- Stocks (equities)
- Bonds (fixed income)
- Cash (money market funds, certificates of deposit [CDs], or short-term commercial paper)
- Real estate (including real estate investment trusts [REITs])
- Collectibles and art
- Venture capital investments
- Foreign currency
- Commodities
- Precious metals

Formula variations sometimes approach differential calculus with percents to allocate running into four decimal places. We have found that for most people two broad categories are all that is needed and the percentages run in 25 percent increments. It is simple, much less confusing, and it works. As portfolios change, the percentages could be refined or adjusted.

Also, most people have a major real estate investment in their homes. This is not an alterable portion of the portfolio and we don't count it as part of the allocation. We do discuss it, and make note of it, but not as an includible item. Also, we do not feel that collectibles are suitable investments for most people, so we do not include these. For those who have such investments, no allocation formula is going to affect what they put into their "hobbies." We also don't recommend to many people venture capital investing, foreign currency, commodity, or precious metal trading or investing.

We discuss with clients how much cash they should have in a "rainy day" fund—usually something like six months expenses. We don't count this as part of investable assets. It is usually kept in interest-earning accounts, but we keep it out of the funds available for investment.

(*continued*)

That leaves the two broad categories of stocks and bonds. Asset allocation is a method of balancing a portfolio and providing some insulation against extremes at either end. If stocks start dropping, the income provided by the bonds provides a safety net of income or cash flow. If stocks rise rapidly that is good, but there still isn't much cash flow from them, so the bond investments provide that.

This being said, there are then only four choices—all stocks or all bonds; 50 percent of each; or 25 percent of one and 75 percent of the other.

Let's start with the extreme choice of all stocks or all bonds. For most people, we do not think it is prudent to completely exclude one of these categories.

The next choice is 50 percent of each. This is a good middle ground for many people, particularly those who are ambivalent about which path to choose.

The 25:75 choices are for those tending toward either end. It represents a good balance, or a good beginning, however you want to look at it.

Following is a *sample asset allocation model* assuming the fixed income return is 5 percent and the equity return is 20 percent.

Equities portfolio desired allocation	100%	75%	50%	25%	0%
Fixed income portfolio desired allocation	0%	25%	50%	75%	100%
Equities return	20%	15%	10%	5%	0%
Fixed income return	0%	1.25%	2.5%	3.75%	5%
Total portfolio return	20%	16.25%	12.5%	8.75%	5%

As is evident from the above table, how you allocate your assets will greatly affect the total portfolio return.

CHAPTER 9

INVESTMENT MANAGEMENT

This is a service that actually manages the client's funds. Almost every brokerage firm, many financial planners, and some CPAs perform this service. This service ranges from making suggestions about what to invest in to complete control over all maneuvers.

WHO NEEDS THIS SERVICE

Every client who invests in any manner and is not an investment professional probably needs this service. One of the problems with this service is the unavailability or inaccessibility of good people for many of our clients. We also find that many clients in dire need of such services are not willing to pay reasonable fees for independent advise. Instead they prefer to use the usually no-cost or low-cost services of the organization that sells them the products or manages their money for annual fees based on the value of the assets managed.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

Most CPAs are not suited to offer these services. However a small number have entered the financial services business by either managing money, selling financial products, or receiving fees for referrals.

Discussions of the range of services and the reasons for or against it have filled many books. Most of the CPAs we know who are doing this have been, or are, tax people, or it was the tax people who introduced the idea to the firm. This certainly is a service that grows out of the tax compliance work we all do.

Our training as accountants along with the added investment advisory training that must be obtained equip CPAs with the best tools to help clients in their investment management.

INTRODUCING THE CLIENT TO THE SERVICE

Clients with substantial marketable security investments can be approached after tax season to see how they would feel about turning over the active management of their assets to a dedicated professional—either someone in the firm who has acquired this specialty, or an affiliate or alliance member.

FINALIZING THE ENGAGEMENT

Fee arrangements vary and include commissions on products sold and wrap fees based on asset value. Occasionally performance bonuses are also used.

CHAPTER 10

INVESTMENT CLUBS

Investment clubs are a social activity where people of similar backgrounds or interests get together, contribute funds in a periodic manner, and research and discuss suitable investments for the group. Investment clubs invest the money collectively and maintain a single brokerage account with separate records kept within the club. Costs are usually lower than if each investor acted separately with the amounts they put into the investment club.

WHO NEEDS THIS SERVICE

Every investment club needs to file annual tax returns and provide tax information to its members. Lately some states have complicated this process with added fees and taxes.

Many clients are in investment clubs, or are thinking about it. The numbers seem to be declining because of the ease and lower cost of Internet trading, but it is still a viable vehicle and provides a social background to the stock picking.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

The CPA is best suited to offer these services because that is what we do. The work is usually among the easiest entity returns we do, and the work provides us with an introduction to potential clients or referral sources.

Some years ago we were preparing the partnership returns for a friend's investment club at work for a very nominal (say, below cost) fee. Mainly this was an accommodation that also put our name in front of about a dozen or so people.

After a few years of this, the company's controller needed to outsource the tax return preparation. We were asked if we were interested or if we could recommend someone if we were too busy, or if the fee they wanted to pay was too low.

We met with the controller and ended up with the job. Three years later we were receiving fees over $100,000 from this client.

INTRODUCING THE CLIENT TO THE SERVICE

Clients in investment clubs provide us with the Schedule K-1 when we obtain their tax information. We can inquire about the service and involvement of the accountant they are using and mention we are always available should they need any additional assistance.

Clients who are not in investment clubs can be asked if they ever thought about joining one, or starting one. You can then offer to assist.

We usually do not charge for the organizational work we do, intending better to meet the new members and perhaps spread our sphere of influence.

Following is a checklist of some entry-level questions you can ask your clients.

1. Did you know there are over 36,000 National Association of Investors Corporation investment clubs in the United States?
2. Did you know the best way to organize and set up an investment club is as a general partnership?
3. Did you know there are annual tax returns that an investment club must file?
4. Have the members of your investment club thought about a valuation unit approach, rather than contributing initial amounts followed by monthly additions?
5. Did you know there are many club expenses an investment club can deduct?
6. Did you know individual club members can treat certain expenses as miscellaneous itemized deductions?
7. Did you know members are not subject to self-employment tax?

Exhibit 10-1, “Sample Fact Sheet for Investment Club Services,” gives some responses to these questions you can offer your client.

FINALIZING THE ENGAGEMENT

These engagements are usually limited to an annual tax return that is at a reasonably low fee since the club gives access to its members. Occasionally the CPA will attend a pre-year-end tax planning meeting and will explain the tax effects of the year’s transactions and ways to offset any gains. Unfortunately, these services are usually purchased as a commodity service with the fee being the determining factor.

EXHIBIT 10-1 **Sample Fact Sheet for Investment Club Services**

INVESTMENT CLUBS

1. Number of Clubs Nationwide

There are over 36,000 National Association of Investors Corporation investment clubs in the United States today, with over 550,000 members.

2. Investment Clubs as General Partnerships

Most investment clubs are organized as general partnerships. One reason for this is that they are easy to set up. There are no legal requirements for putting together a general partnership. Another reason for a general partnership is that they are inexpensive. No lawyers are required and there are no state organization costs. Finally, general partnerships are tax-efficient. Partnership income is taxed only once, to individual partners. Deductions, credits, gains, and losses are passed through to members or partners.

3. Annual Returns

An investment club must file Form 1065, U.S. Partnership Return of Income, by the April 15 deadline. The form will list the club's income, expenses, and so on. The club will give each member a Schedule K-1, Partner's Share of Income, Credits, Deductions, and so on to use when they file their individual tax returns.

4. Valuation Unit Approach

Rather than agreeing to contribute an initial amount plus regular monthly additions, investment club members should consider a valuation unit approach. Members' contributions purchase units at the current unit value. This makes it easier for members to be added to or to withdraw from the club and it is fairer when members fail to make required contributions or pay late. It does create different recording requirements.

5. Deductible Club Expenses

Any ordinary and necessary expenses an investment club incurs in the course of its trading activities can be deducted. Examples include subscriptions to investment newsletters and magazines, dues to the National Association of Investors Corporation, accounting and tax software, and even the cost of club meetings.

6. Miscellaneous Itemized Deductions

Club members who incur out-of-pocket expenses with regard to membership activities can treat them as miscellaneous itemized deductions. Since these deductions are subject to a 2 percent of adjusted gross income (AGI) limit, there might not be a tax benefit from these expenditures.

7. No Self-Employment Tax

Even though members are general partners of an investment club, they are not subject to self-employment tax on their share of partnership income. This is because interest, dividends, and capital gains and losses, where the members' income comes from, are all exempted from the definition of net earnings from self-employment on which this tax is imposed.

CHAPTER 11

DIVORCE SETTLEMENT PLANNING

Divorce settlement planning attempts to help clients realize the reality of the financial situation and to suggest ways of settling the financial arrangements before extensive, expensive, and drawn out negotiations, depositions, and litigation.

WHO NEEDS THIS SERVICE

Divorce today has become commonplace. With 50 percent of first-time marriages ending in divorce it is a good bet that many of your clients are either in the process of getting divorced or considering it. A simple inquiry can tell you where the client is in the process.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

The CPA is best suited to offer these services because the three financial elements of divorce fall into our expertise:

1. Allocating support payments into taxable alimony and nontaxable child support
2. Assisting in determining the value of the property settlement and the tax attributes and basis of the divided assets
3. Working out the postdivorce budgets and cash flow

We are also called upon to value operating businesses and to determine the actual income and cash flow from a business that one or both of the parties might own.

Another thing CPAs do is help the parties place the finances in perspective. This is because of our years of experience with them and their finances and the understanding that comes with that. Certain conflicts can arise because the relationship is usually with both parties, even if you have only been working with one spouse. However, this should not create a conflict when working with both spouses to try to settle it. We recognize that there will be conflicts in a litigation situation, and because of that, we usually decline to represent only one of the parties and we tell them that they should ask their respective attorneys to recommend a suitable financial adviser.

Forensic or investigative accounting is something else that is used extensively in divorce and marital separation litigation. However, this is a specialty that requires, in addition to great adeptness in performing the work, a poised credible manner for articulating positions and findings under cross examination in court.

INTRODUCING THE CLIENT TO THE SERVICE

Introducing the service is not that difficult. We find that people going through a divorce like to talk about it. They especially like to talk about the "excessive" money they will have to pay out, or the "paucity" of the money they will receive. Their desire to talk combined with familiarity with the accountant, and the accountant's financial and tax prowess, make for easy introductions into the type of things CPAs can help them with. To get the ball rolling here are some questions you can ask clients about divorce and taxes.

1. Did you know there is a difference between alimony and child support in reference to taxes?
2. Did you know payments not made directly to a spouse can still be deductible alimony?
3. Did you know property settlements are not subject to gift tax?
4. Did you know you could end up owing capital gains taxes on property settlements?
5. Did you know remarriage bonuses should be part of property settlement agreements?
6. Did you know the custodial parent might be able to use head-of-household filing status?
7. Did you know the noncustodial parent might be able to claim dependency exemptions for the children?
8. Did you know you can deduct medical insurance payments made on behalf of your children even if you don't claim dependency exemptions for them?
9. Did you know the beneficiary spouse should own the life insurance policy on her ex-spouse's life?

Exhibit 11-1, "Sample Fact Sheet for Divorce Settlement Planning Services," can be sent to the client as a follow-up or used to continue the discussion with the client.

FINALIZING THE ENGAGEMENT

We charge for initial consultations. Existing business clients usually are not billed for initial meetings or discussions. At the point that it appears they will move forward, we then set a fixed price, or a basis for billing.

When it appears we will have to testify we charge hourly fees with estimates paid in full in advance. We have a four-hour minimum for meetings or appearances outside of our office. If preparation work is needed beforehand, and we are able to have staff associates prepare any of it, the billing will be at their lower rate.

EXHIBIT 11-1 Sample Fact Sheet for Divorce Settlement Planning Services

DIVORCE AND TAXES

1. Alimony and Child Support

In general, alimony is deducted by the person who pays it and taxable to the person who receives it. Child support is neither deductible by the payer nor taxable to the recipient. When divorcing spouses earn very different incomes, it pays for the higher earner, who is making the payments, to have as much of them as possible treated as tax-deductible alimony. The spouse can cover the other spouse's tax and still save taxes by paying alimony rather than nondeductible child support. Note that child support does not terminate upon a remarriage as alimony would.

2. Deductible Alimony

Payments made on behalf of your spouse are deductible as alimony—such as a direct payment of medical and life insurance premiums or mortgage payments.

3. Property Settlements and Gift Tax

In general, property settlements are not subject to gift tax because of the unlimited marital deduction. One spouse can give any amount of assets to the other spouse gift tax-free. Property settlements can be made in a lump sum or periodically. If they are made periodically, there is no tax effect unless the payments are considered to be alimony. Often, the only difference between alimony and property-settlement payments is the label the parties put on them.

4. Property Settlements and Capital Gains

While gift taxes don't apply to property settlements, you may owe capital gains taxes, depending on the types of assets being distributed in the property settlement. When the asset is sold by the party who receives it, capital gains tax is payable on the difference between the sale price and the tax cost of the asset—the other spouse's basis.

5. Remarriage Bonuses and Property Settlements

Legally, alimony payments must stop when the recipient remarries or dies. If the payments continue, they won't be considered deductible alimony. Some agreements provide for a bonus to be paid to the ex-spouse when he or she remarries. This isn't considered alimony because it is not paid over a number of years. Worse, the bonus would be a taxable gift. By making the remarriage bonus part of your property settlement agreement, it will not be a taxable gift because property settlements are not subject to gift tax.

6. Head-of-Household Filing Status

Couples who are legally married on the last day of the year must file either a joint tax return or separate returns as married people filing separately. But a person who has not lived with his or her spouse for the last six months of the year and has a dependent child living at home can file the return as head of household. The tax rates for this filing category are lower than those for married people filing separately.

7. Noncustodial Parents and Children Exemptions

The parent who has custody of the children is automatically entitled to claim dependency exemptions unless the divorce agreement says otherwise, or the parent gives it up for a particular year. In the case of joint custody, it's the parent with physical custody for the greater part of the year. The exemptions can be signed over to the noncustodial parent on IRS Form 8332. The release of exemptions can be made for one tax year, a number of years, or all future years. One year at a time is recommended to maintain flexibility.

8. Medical Insurance Payments on Behalf of Your Children

For the purposes of the medical expense deduction, a child who is supported by one of the parents can be considered to be a dependent of both parents. Insurance payments are deductible as medical expenses on the tax return of the parent who paid them.

9. Life Insurance Policies and Beneficiaries

Often, as part of the divorce agreement, a husband takes out a life insurance policy that names his ex-wife as beneficiary. But when the husband dies, the insurance proceeds are included in his taxable estate. The ex-wife should own the policy on the husband's life. Have the husband pay additional alimony or nondeductible property settlements to cover the insurance premiums the ex-wife has to pay. If the husband does not want the ex-wife to own the policy, he can set up an irrevocable life insurance trust to own it. This will keep the policy out of his taxable estate.

CHAPTER 12

EMPLOYMENT COMPENSATION ASSISTANCE

This service includes employment contract negotiations and executive compensation review and planning.

WHO NEEDS THIS SERVICE

Every client employed by a mid- to large-size company or a public company will need some sort of employment compensation assistance.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

CPAs acquire an extensive knowledge of employment compensation arrangements from the wide range of tax clients they service. This knowledge can be applied to clients in situations similar to other clients. Many times CPAs have more than one client working for the same company. Without abusing any confidential information, their knowledge of what the company does can give them a good sense of how far their client can go in suggesting arrangements and compensation grids.

INTRODUCING THE CLIENT TO THE SERVICE

The CPA is usually the client's closest financial adviser. If you meet with the client to do a tax projection, and again to get tax information, and call with a few words about his or her tax return or to follow up something that was said at one of your two meetings, you will pretty much know what's going on with the client.

During these meetings and discussions you might find out that the client is looking for a job or negotiating for one. If the job is a high enough, or important enough, position the client might need some advice or guidance from you. Again, the hook is the tax advice in connection with the new job, but your involvement can reach to negotiating the entire contract.

Some of the areas clients want to discuss are stock options, deferred compensation, life insurance benefits, employer stock benefits, tax-free fringe benefits, and nonqualified compensation plans.

Below is a list of questions that can be used to start a discussion about employee stock options.

1. Did you know incentive stock options (ISOs) are not taxed when issued or granted to employees?
2. Did you know you should consider exercising nonvested ISOs early?
3. Do you know how to make a Section 83(b) election?
4. Do you know when you should consider selling exercised ISO shares early?
5. Did you know employees might not have to pay withholding or payroll taxes on ISOs?
6. Did you know you can pay for ISOs by swapping stock you already own?
7. Do you know what a nonqualified stock option is?
8. Do you know how to minimize taxes on nonqualified stock options?

Exhibit 12-1, “Sample Fact Sheet for Employment Compensation Assistance Service—Employee Stock Options,” gives some suggested answers to the questions listed above.

Buyout settlements are also included in this category particularly because there are many tax consequences to these discussions. Clients will have many decisions to make regarding their pension, accelerated vesting, severance pay, exercising options, health insurance, COBRA, fringe benefits, and outsourcing or displacement services and counseling.

FINALIZING THE ENGAGEMENT

This is similar to other consulting engagements—fee for first meeting followed by a fixed fee for the full engagement.

EXHIBIT 12-1 **Sample Fact Sheet for Employment Compensation Assistance Service—Employee Stock Options**

EMPLOYEE STOCK OPTIONS

1. No Tax on Incentive Stock Options (ISOs) When Exercised

ISOs are not taxed when issued or granted to employees as long as certain conditions are met. The option price must equal or exceed the stock's fair market value when the ISO is granted. In addition, the market value of the stock subject to options cannot exceed $100,000 a year at the time of grant for any one employee. Finally, this beneficial deal applies only when you sell the ISO shares more than two years after the option grant date (the date you received the option) and more than one year after you actually bought the shares by exercising your ISO.

2. Exercising Nonvested ISOs

You should consider exercising nonvested ISOs early. If your company plan permits, you should consider exercising nonvested ISOs at least one year before they vest. That way, you establish a holding period for long-term capital gains treatment. You can then sell the shares as soon as they vest and the proceeds will be taxed at rates no higher than 20 percent.

3. Making a Section 83(b) Election

Option holders who exercise nonvested ISOs should consider making an election under Section 83(b) of the Internal Revenue Code within 30 days of the exercise. The election is made by filing a statement containing certain information with your IRS Service Center and attaching a copy to your return. An 83(b) election freezes the amount of preference income subject to alternative minimum tax (AMT) at the amount existing on the date of early exercise. Otherwise, AMT income will be calculated on the date that the shares would have vested, as the difference between the value of the shares at that time and the amount paid for the option.

4. Selling Exercised ISOs Early

When stock acquired by exercising options is sold before the statutory two-year holding period, the AMT does not apply. The downside is that you pay income tax rates at up to 35 percent on the gain, not long-term capital gains rates. To decide whether to exercise early, consider how your after-tax return on the options will fit your personal wealth accumulation plans. Also, consider early exercise and sales to protect against possible price declines in the value of the shares.

5. Withholding and Payroll Taxes on ISOs

Employees do not have to pay withholding or payroll taxes on ISOs when the shares sold are taxed as compensation income. This includes federal and state withholding, and FICA. You will have to pay income tax when you file your return for that year, but the FICA taxes are permanently saved.

6. Paying for ISOs

You may be able to pay for ISOs by swapping stock you already own. Some companies permit employees to swap stock at fair market value for the shares they acquire. The ISO holder does not have any cash outlay and tax is delayed on the increments in value of the swapped stock. No tax is owed on appreciation in the swapped shares. The total basis of the old stock is transferred to an equal number of the new shares. Any remaining shares have a zero basis.

(*continued*)

7. Nonqualified Stock Options

Unlike ISOs, nonqualified options are not limited to employees. Many companies use nonqualified stock options to compensate directors and advisory board members, as well as consultants, professionals, and suppliers. The price of these options can be any value, whereas the price of ISOs cannot be less than the fair market value of the stock when granted. If the nonqualified stock options are granted at the fair market value of the stock there would be no tax consequence upon grant. If the fair market value share is greater than the option price these might be taxed or you might consider a Section 83(b) election.

8. Minimizing Taxes on Nonqualified Stock Options

You can minimize taxes by immediately exercising nonvested nonqualified stock options and making an 83(b) election. The election allows you to establish a low tax basis for your shares, which are taxed at favorable long-term rates when shares are held for at least one year. No two-year-from-date-of-grant holding periods exist as they do with ISOs. Because nonqualified stock options are taxed as compensation income when exercised at the difference between the stock's value and the option price, an early exercise freezes the ordinary income at low amounts. Otherwise, you face high income and FICA tax if the stock greatly increases in value when the option is exercised. ISOs are only taxed when the stock received is sold. The downside to this is that you must lay out cash for the exercise price and you can lose money if the stock declines in value.

CHAPTER 13

RETIREMENT PLANNING AND COUNSELING

This is a specific financial planning service that helps clients plan for their retirement. This involves calculating how much a client will have to retire on and how much he or she will need. This work can take place one to two years before the expected retirement, or fifteen to twenty years earlier. It depends on the client. You may also find yourself doing some quick calculations for a client in his or her early 50s who is being offered early retirement. Whatever the case, it is a matter of paramount importance to the client, and must be treated by the CPA as such.

Clients will also call upon you to help them decide how they should take their pension plan, individual retirement account (IRA), Keogh, simplified employee pension plan (SEP), or 401(k) money.

WHO NEEDS THIS SERVICE

Every client who even remotely mentions future retirement is a candidate for this service.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

Starting work on these engagements requires gathering information—that which is existing, and that which needs to be received—if the client is to have an effective retirement financial plan. Our training as accountants equips us with the best tools to show clients how they can measure where they stand now against where they want to go. Once the present situation is held up against the future goal and if additional assistance is then needed, financial planning specialists can be recommended.

There should be a familiarity with the various pension penalties and excise taxes.

You should know how to calculate the required distribution amount when a client reaches age 70½, and the beneficiary requirements for such plans.

INTRODUCING THE CLIENT TO THE SERVICE

Clients over the age of 50 have to be thinking about this. All you need to do is ask them if they would like to have you review their plans and help determine if they are on track, or what they could expect in the way of retirement cash flow.

You should be able to calculate the tax effect of a lump sum distribution as well as explain how they should do a rollover, and variations in between.

FINALIZING THE ENGAGEMENT

We are strong proponents of fixed fees, so that is how we price most of our engagements including retirement planning.

CHAPTER 14

INDIVIDUAL RETIREMENT ACCOUNT DISTRIBUTION ANALYSIS

This is actually part of the retirement financial planning, but is usually done as a separate self-contained service. Clients are always calling and asking what they should do, or asking us to calculate their required minimum distribution as they get closer to age 70½.

WHO NEEDS THIS SERVICE

Any client getting close to the mandatory beginning date—April 1 of the year following the year they attain age 70½—needs consulting in this regard. Clients who will be inheriting an individual retirement account (IRA) also will need this service. The time for decision making is before they get the first check. Once the first distribution is made, events are set in motion that could cause undesirable consequences that cannot be reversed.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

We are not only trained in taxes but we take considerable continuing education for assisting clients with IRA distributions. Calculating IRA distributions is a tax function.

INTRODUCING THE CLIENT TO THE SERVICE

We have several handouts to promote this service. We have two lists of questions and fact sheets used to generate a discussion. We also have a handout that is a checklist of decisions that need to be made before the client's first IRA distribution.

The first list of questions focuses on the regular IRA versus a Roth IRA.

1. Have you considered converting your regular IRA to a Roth IRA?
2. Did you know there is a downside to converting to a Roth IRA?
3. If your IRA has been reduced by the market, did you know a conversion may be less expensive tax-wise?
4. Did you know that after converting your regular IRA to a Roth IRA, you can still convert it back to a regular IRA if you choose?
5. Did you know you can divide your IRA into mini-IRAs before converting them to Roth IRAs?
6. Do you know how much your tax bill will be as a result of conversion?
7. Have you considered the benefits of converting an IRA to a Roth IRA in stages, as you build up cash reserves?

The second list of questions is for clients who have inherited or will be inheriting IRAs.

1. Do you know how to take distributions if the owner dies on or after the required beginning date?
2. Do you know how to take distributions if the owner dies before the required beginning date?
3. Did you know you can split an account after the owner's death?
4. Did you know you can disclaim (give up) your inheritance and payouts to allow remaining beneficiaries more favorable payout terms?
5. Do you know what occurs if the death of the beneficiary occurs after the required beginning date, but before the death of the account holder?
6. Do you know how to calculate payouts when a trust is named as the beneficiary of an IRA?
7. Did you know you can make an estate the beneficiary of an IRA?

The follow-up fact sheets are included in Exhibit 14-1, "Sample Fact Sheet for IRA Distribution Analysis Service—Regular IRA versus Roth IRA," and Exhibit 14-2, "Sample Fact Sheet for IRA Distribution Analysis Service—Inheriting an IRA." The checklist we use when discussing IRA distributions with clients is included in Exhibit 14-3, "Sample Handout Checklist for IRA Distribution Analysis Service."

Most of our clients' requests are for what seems like simple calculations. However, IRA distribution planning should be carefully integrated with their estate plan. For that reason, we decline to calculate the minimum distribution unless the client comes into our office for an initial consultation that eventually should lead to an estate planning engagement.

FINALIZING THE ENGAGEMENT

We charge our standard initial consultation fee, and after the meeting then discuss what is entailed in going forward with serious estate planning.

EXHIBIT 14-1 **Sample Fact Sheet for IRA Distribution Analysis Service—Regular IRA versus Roth IRA**

REGULAR IRA v. ROTH IRA

1. Converting a Regular IRA to a Roth IRA

A regular IRA can be converted to a Roth IRA. Your modified adjusted gross income must be no greater than $100,000 in the year you convert. Income in subsequent years does not matter. After five years and age 59½, whichever comes later, all Roth IRA withdrawals are tax-free. No lifetime minimum required distribution rules apply.

2. Problem With Conversion

Upon conversion, all of the deferred income tax is due on the regular IRA. If you have a $500,000 IRA and all contributions have been deductible, upon conversion, you'll recognize $500,000 in taxable income.

3. Saving Taxes

If your IRA has been reduced by the market, a conversion to a Roth IRA will be less expensive tax-wise. If your IRA was once worth $500,000 but it is worth only $300,000 now, converting will generate $300,000 of taxable income, not $500,000. After the conversion, if the stock market recovers, and your Roth IRA regains its lost ground, all of that growth can be completely tax-free.

4. Recharacterizing Your IRAs

If you convert an IRA to a Roth IRA in one year, you can convert it back to a regular IRA as late as October 15 of the following year assuming you obtained an extension the last date of filing individual tax returns.

5. Mini-IRAs

You can divide your IRA into mini-IRAs before converting them to Roth IRAs. No tax is due on this arrangement. You can see which mini-IRAs are up since the conversion and reconvert them to smaller IRAs while leaving the other mini-IRAs converted to Roth IRAs.

6. Large Tax Bills

Counting state and local taxes, you might owe 40 percent on a Roth IRA conversion. If you had a $250,000 conversion, you might trigger a $100,000 tax bill and you might not have this money in the bank. If you are under 59½ and take money from the Roth IRA to pay, you will trigger a penalty. The best suggestion for this is to take out loans to pay the tax bill. One source is that you could borrow against the cash value of your life insurance policy.

7. Converting in Stages

To avoid any penalties for huge tax bills that cannot be paid, you can convert your IRA to a Roth IRA in stages, as you build up cash reserves. You can divide your IRA into mini-IRAs. Then you can put some money in the bank so you can afford a tax bill. The more cash reserves you have, the more you can convert the other mini-IRAs, penalty free. Ultimately, all of your IRAs become Roth IRAs, providing you with ample tax-free growth.

EXHIBIT 14-2 **Sample Fact Sheet for IRA Distribution Analysis Service—Inheriting an IRA**

INHERITING AN IRA

1. *Owner Dies After the Required Beginning Date*

If the owner dies on or after the required beginning date, the designated beneficiary can take distributions over his or her life expectancy, based on the IRS's Single Life Expectancy Table. If the designated beneficiary is older than the IRA owner, he or she can elect to use the age of the deceased owner to calculate minimum distributions—which would be lower.

2. *Owner Dies Before the Required Beginning Date*

If the owner dies before the required beginning date, a designated beneficiary must take distributions over his or her single life expectancy. If there is a beneficiary who is not a *designated* beneficiary the funds must be withdrawn using the five-year rule. The five-year rule is to take a complete distribution of all funds in the IRA by the end of the fifth year following the year of death.

3. *Splitting Accounts*

When there are multiple beneficiaries, the account can be split after death so that each account has one beneficiary. Then each beneficiary can take distributions over his or her own life expectancy. Moreover, splitting the account allows a beneficiary to take a full distribution or make his or her own investment decisions for the account.

4. *Disclaimers*

You may think about disclaiming an inheritance and payouts to remove a beneficiary so that remaining beneficiaries have more favorable payout terms. For example, if a child inherits a parent's IRA, the child can disclaim it, allowing the funds to pass to the grandchild. Since the grandchild has a longer life expectancy, required distributions can be spread over a longer time period. Note that the intended beneficiaries after the disclaimer have to be included as contingent beneficiaries.

5. *No Contingent Beneficiary*

Assume an account holder started required minimum distributions and designated her daughter as the designated beneficiary. If the daughter dies before the account holder, and the account holder never named another beneficiary and had no contingent beneficiary listed, and no default designated beneficiary, and then dies, the account must be paid out over the account holder's life expectancy.

6. *Trusts as Beneficiaries*

If a trust is named as the beneficiary of an IRA, all of the trust's beneficiaries are taken into account when determining the beneficiary with the shortest life expectancy, including remaindermen. Remaindermen are those whose interests are postponed until the death of the life interest. If the remainderman is younger than the beneficiary holding the life interest, there will be no shorter payout period; however, if the remainderman ends up being older than the beneficiary holding the life interest, there will be a shorter payout period.

7. Estates as Beneficiaries

If an estate is named as the beneficiary of an IRA—to provide funds for estate taxes and administration expenses—there can be no stretch-out of distributions. Since the estate has no life expectancy, all funds must be distributed from the IRA no later than the end of the fifth year following the year of death if the owner dies before his or her required beginning date. If the owner dies after the required beginning date, then the payments are distributed based on the owner's remaining life expectancy at the time of death. Also, the estate may not disclaim the interest in order to create a designated beneficiary for the IRA.

EXHIBIT 14-3 Sample Handout Checklist for IRA Distribution Analysis Service

EIGHT IRA DECISIONS TO BE MADE

Following is a checklist of some decisions that must be made before deciding on your first IRA distribution. Note: It is not a complete listing, but gives the major decisions that you would have to make. This checklist should not be a substitute for discussing your options with a professional adviser.

1. Determining required beginning date.

Use the following chart and fill in your information:

IRA REQUIRED MINIMUM DISTRIBUTION INFORMATION

	Sample	*Sample*	*Fill in your #*
Date of birth	June 1, 1933	Dec. 1, 1933	
Date attained age 70	June 1, 2003	Dec. 1, 2003	
Date attained age 70½	Dec. 1, 2003	June 1, 2004	
Required beginning date	April 1, 2004	April 1, 2005	
Attained age during the calendar year age 70½ was attained (used for life expectancy purposes)	Age 70	Age 71	
Life expectancy divisor to use (based on Uniform Distribution Table)	27.4	26.5	
IRA valuation date for first payment	Dec. 31, 2002	Dec. 31, 2003	
IRA valuation date for second payment	Dec. 31, 2003	Dec. 31, 2004	

UNIFORM DISTRIBUTION TABLE
(based upon the age of the IRA owner on his or her birthday in the year of the distribution)

(This table is not applicable where a spouse more than 10 years younger is the designated beneficiary.)

Age	*Applicable Divisor*	*Age*	*Applicable Divisor*	*Age*	*Applicable Divisor*
70	27.4	86	14.1	102	5.5
71	26.5	87	13.4	103	5.2
72	25.6	88	12.7	104	4.9
73	24.7	89	12.0	105	4.5
74	23.8	90	11.4	106	4.2
75	22.9	91	10.8	107	3.9
76	22.0	92	10.2	108	3.7
77	21.2	93	9.6	109	3.4
78	20.3	94	9.1	110	3.1
79	19.5	95	8.6	111	2.9
80	18.7	96	8.1	112	2.6
81	17.9	97	7.6	113	2.4
82	17.1	98	7.1	114	2.1
83	16.3	99	6.7	115 and older	1.9
84	15.5	100	6.3		
85	14.8	101	5.9		

2. Deciding if the first payment will be in the year you attain age 70½ or in the year following (on or before April 1 which is the required beginning date).

If payment is taken in the year of the required beginning date a payment for that year must also be taken by December 31 of that year, so two payments will have been received in that year. You should do a tax projection to determine the marginal taxes for that year and compare it to the marginal taxes if one payment was received in the year of attaining age 70½ and one in the next year for the second year's payment.

Also to be considered is the effect of state taxes. Some states have annual exclusions for pension and IRA payments. This should also be factored into the projections before making the decision for the first payment.

The choices are as follows:

- First payment in year attained age 70½ and second payment in next year.

or

- First payment in year of required beginning date and second payment by end of that year.

Keep in mind that the decision only applies to the first payment. After that one payment per year must be taken. *Caution:* Some states exclude a portion of IRA payments from income. Delaying the first year's payout might result in a loss of this state tax benefit.

3. Deciding whether you want to name a beneficiary other than your spouse.

Naming children or individuals other than a spouse might decrease minimum required distributions but it will definitely stretch out payments after the IRA owner's death.

Naming a charity will definitely increase minimum required distributions but it will assure remaining balance will go to a charity and will escape income and estate taxes.

Other decisions involve naming trusts, or your estate. These decisions must be considered very deliberately and carefully.

4. Deciding if you want to use customized designation of beneficiary forms.

This should be discussed with professional financial advisers and an attorney. Many times the standard forms you are given limit your choices of beneficiaries. For instance, you may want to consider naming minors with a custodian or a second spouse in a qualified terminable interest property (QTIP) trust.

5. Deciding if you want to divide your IRA accounts into separate accounts for multiple beneficiaries.

You can divide your IRA into as many separate accounts as you so desire. Each account can have different calculation methods and withdrawal rates. Also, your total annual minimum required distributions can come out of one or more accounts and does not have to come out of each separate account each year. Your choices can change from year to year.

6. Deciding how estate taxes will be paid.

Estate taxes can be paid from assets passing through the probative estate (permitting the IRA beneficiaries to receive the IRA without having to reduce it by paying any estate taxes)

or

Estate taxes can be paid proportionately by each beneficiary that inherits assets, including assets passing outside the probative estate. This would have the IRA beneficiaries paying their share of the estate taxes based on the amount of their inheritance.

(*continued*)

This has no direct tax effect but can greatly affect the legacy you leave behind if they take incorrect actions. This should be discussed with a professional adviser.

7. Naming contingent or alternate beneficiaries.

You have to name beneficiaries who will take the place of a deceased primary beneficiary. *Note*: This will not change the distribution schedule and can include your estate or a charity.

8. Leaving a letter of instruction to your beneficiaries.

EIGHT IRA ERRORS TO AVOID

1. Leaving 401(k), 403(b), and pension funds with employer.

IRAs give you much more flexibility in planning if your intention is to have funds accumulate with distributions made as slowly as possible. With proper planning and circumstances it is possible to spread IRA distributions over 50 or more years. Most employer plans limit distribution periods—some to as little as five years. Also, employer plans must provide for minimum distributions to spouses even in situations where there are prenuptial agreements or second marriages. IRAs do not have these requirements. And employer plans have a 20 percent withholding tax requirement that IRAs do not have.

2. Naming your estate as beneficiary.

This will require your beneficiaries or estate to withdraw the funds no later than by the December 31 of the fifth year following the year of your death, if you die before you reach your required beginning date. If you die after your required beginning date, the distributions can continue based upon your remaining life expectancy when you died. Also, your beneficiaries are not permitted to choose to have your IRA plan distributions spread over their life expectancies or for your spouse to roll it over, in full, into his or her own plan. Additionally, it is possible the IRA accounts would have to be liquidated even sooner so the funds could be used to pay estate taxes, causing accelerations of the income tax payment on the IRA withdrawals.

3. Having the name of the IRA account changed upon the owner's death.

When any IRA owner dies many beneficiaries and trustees change the name of the account to the beneficiary's name. That is devastatingly incorrect. The account name should be kept in the name of the deceased IRA owner and the beneficiary's name should be added as follows:

> John Smith, deceased (date of death, July 29, 2004), for benefit of Susan Brown [designated beneficiary] (soc. sec. # 123-45-6789), beneficiary.

When the name is changed to the beneficiary's name the longest the distribution can be delayed would be until the end of the fifth year following the year of death.

If the name is not changed the distributions for the beneficiaries could be made over the remaining life expectancies of the beneficiaries if the death occurred before the required beginning date, or based upon the withdrawal rate in effect during the owner's lifetime if death occurred after the required beginning date.

Irrespective of what is done, a spouse still has the right to roll over the funds into his or her own IRA. If the name is changed to the surviving spouse's name it is deemed a spousal rollover.

4. Distributions continuing to be made to beneficiary after the IRA owner's death.

In many instances, where the IRA owner has commenced regular or periodic distributions, and the IRA owner dies, the regular distribution check is sent to the beneficiary who deposits it. This is usually done by the IRA trustee based upon preexisting instructions. When this is done and the check is deposited, the beneficiary loses the right to make a qualified disclaimer. Where the IRA account names a beneficiary that can cause additional tax to either the estate or person inheriting the IRA and there are satisfactory contingent beneficiaries named, a qualified disclaimer (made within nine months of death) can be made that could redistribute the IRA and increase family wealth or accomplish other family objectives such as passing the IRA on to a charity.

5. Not properly naming a contingent beneficiary.

Naming the primary beneficiary is usually done carefully. This is not so in many cases with a contingent or secondary beneficiary. The contingent beneficiary is important in redistributing wealth within the family or to a charity. The primary beneficiary determines the distribution rate, but in many situations, it is the contingent beneficiary who ultimately inherits the IRA. If a spouse beneficiary predeceases the IRA owner the contingent beneficiaries (unless the beneficiary is changed) will inherit the IRA when the owner dies. If a charity is to be the ultimate beneficiary, the naming of a charity as primary beneficiary will cause the distribution rate to be based on a single life expectancy and will be accelerated. If a spouse or other beneficiary is named, the distribution rate would be based on a joint life expectancy and will be slower. The strategy to employ would be for the primary beneficiary to disclaim that inheritance and the IRA account will then go to the charity. Of course, you need the understanding and willingness of the primary beneficiary to accomplish that.

6. The will not saying whether estate taxes are to be paid by the estate or apportioned to the IRA accounts.

If an IRA is left to a spouse, there would be no immediate estate tax. However, when the spouse also dies, there would be estate tax if the estate is large enough (over $1,500,000 in 2004 and 2005). There is also estate tax if IRAs are left to beneficiaries other than a spouse and the decedent's assets are over the estate tax exemption threshold ($1,500,000 in 2004 and 2005).

Estate taxes are payable from one of two sources—the estate, or from proportionate shares of each inheritance, including IRA and pension accounts, life insurance, and other estate-tax-subjected assets passing outside of the estate.

An apportionment clause determines which of the beneficiaries will bear the payment of the estate taxes.

One way of providing for the estate taxes is to have the probative estate pay all the estate taxes. In that situation, amounts passing outside the will, such as through an IRA or pension plan or life insurance, will not bear any of the estate taxes. Accordingly, this could substantially reduce bequests made in the will. The other way is to apportion the taxes to all heirs including those receiving assets outside the will such as through the IRA, pension plans, or life insurance. If the taxes are apportioned to the IRA and pension plan beneficiaries, and funds are withdrawn to pay such taxes, this would accelerate the payment of income taxes on those amounts further reducing the amounts left to those beneficiaries. Likewise, beneficiaries of nonmonetary assets such as a car or a painting would have to reach into their own funds in order to pay their share of the estate taxes.

Either way is correct under certain circumstances. The choices should be explained to you and understood by you when you have your will drawn up. You should then choose the method that fits your circumstances.

7. Not keeping copies of the forms you sign.

Copies should be kept of all forms signed regarding your IRA plan. This includes a copy of the actual plan and any amendments; designation of beneficiary forms; any withdrawal or distribution forms or requests; any voluntary nondeductible contribution information; and any correspondence

(*continued*)

between you and the trustee; Many times the trustee is changed because of a merger or acquisition of the trustee which is usually a bank, broker, or insurance company. Papers get misplaced and lost. The burden of proof of what you decided remains on you, or your heirs, which makes it an even harder task. Signed and dated copies provide all the assurance you need.

8. Not getting proper professional advice.

Many times the IRA owner completes the designation forms without professional advice. IRAs, especially when they contain rolled over funds, can be quite substantial. Yet major irrevocable decisions are made without proper counseling.

Our firm will assist clients in IRA decisions only after we have a thorough understanding of the cash flow needs of the client and his or her spouse, the family estate plan, and charitable desires. Unless a client is willing to commit to the process, we decline to help in these decisions.

CHAPTER 15

ELDER CARE ASSURANCE SERVICES

There are two distinct types of Elder Care Assurance services.

One service is the complete financial care and oversight of elderly clients. These could be relatives of the people retaining us, or the elderly person themselves. The other service is consulting on the financial planning and tax needs of the elderly person.

Elder care is a service that we have seen being introduced to the practice by the tax department. That is probably because it is the tax preparer who has the closest relationship with the nonregular business clients.

WHO NEEDS THIS SERVICE

Anyone with an elderly parent or relative they care for, or worry about, is a potential user of this service. Also some elderly clients can be converted to this service if they are simply made aware of its existence.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

People tell us everything, and I mean everything, since they feel there might be a tax benefit lurking somewhere. If we are attentive, we usually develop a database of vast knowledge about clients. Offering to help can be a great service for the client.

We find that most of the skills needed for elder care services are right in line with those regularly being done by CPAs. These skills include basic write-up services, bill paying, and investment tracking. The sample engagement letter at the end of this chapter lists many of the services employed; you could see which ones you feel qualified to do—probably most of them.

Our elder care services even have included arranging for a client's cat to go to the vet.

INTRODUCING THE CLIENT TO THE SERVICE

Clients can be asked very simply if they have considered having someone perform these services for their family member or themselves. We usually provide them a draft of the engagement letter and call them after tax season to ask if they wish to discuss how we could better serve them.

Many older clients get lazy, careless, or impatient with their paper work and bill paying. We can usually spot when the way they provide us with their tax information changes, and declines. When we suggest that this service is available many express interest, and request that we follow up after tax season. With these clients we do not wait; we try to speak to them as soon as we complete their tax returns (which then become a priority). Following is a listing of introductory tax break questions that can be asked of your older clients, or those caring for older family members.

1. Did you know there are exemptions to taxable distributions and penalties on retirement plans depending on your age?
2. Did you know if you take a distribution from your life insurance policy because you are chronically or terminally ill, it may be tax-free?
3. How much do you know about the sources of tax-free income available for older people?
4. Did you know people age 65 and older can claim an "additional standard deduction"?
5. Did you know a portion of fees for continuing care can be deducted each month as a medical expense?
6. How much do you know about the credits available to the elderly?
7. Did you know you may be eligible for a reduction of property taxes based on your age?

Exhibit 15-1, "Sample Fact Sheet for Elder Care Assurance Services," has responses to the questions listed above.

FINALIZING THE ENGAGEMENT

Fees are usually based on an hourly rate. We charge an hourly rate, and a fixed monthly supervisory fee. After we've had the client a while and the work routine can be anticipated, we consider setting a fixed monthly fee. We bill at our standard billing rates for any accounting or other services that might be performed. Services that are billed at standard rates would be anything not specifically stated in the engagement letter.

Exhibit 15-2, "Sample Engagement Letter for Elder Care Assurance Engagement," is a sample engagement letter we have used. In it we clearly define what these services entail.

EXHIBIT 15-1 **Sample Fact Sheet for Elder Care Assurance Services**

TAKING ADVANTAGE OF TAX BREAKS THAT COME WITH AGE

1. Retirement Plan Benefits

Distributions from retirement plans are subject to federal income tax. They may also be subject to penalties; however, there are exceptions to both the tax and the penalties depending on a person's age. Distributions after age 59½ from qualified plans and IRAs are subject to income tax, but are penalty-free. Distributions after age 55 from qualified plans on account of "separation from service" with an employer are penalty-free and distributions that are "annuitized" can be penalty-free if certain conditions are met (that will be explained to you if you are interested in this). In addition, some states may provide exemptions from state income tax for retirement planning distributions.

2. Accelerated Death Benefits

If you take a distribution from a life insurance policy because you are chronically or terminally ill, you may be able to exclude some or all of the distribution. For chronically ill people, distributions to cover the cost of long-term care are tax-free. Up to $200 a day of insurance paid on a per diem basis without regard to the cost of care is excludable from taxable income. This number is adjusted for inflation each year. For the terminally ill, all distributions are tax-free.

3. Tax-Free Income

There are other sources of tax-free income available to older people. Disability payments from the Veterans Administration, life insurance proceeds, inheritances, and reparations are all tax-free. Gain from sales of primary residences up to $250,000 for a single person and $500,000 for joint filing are tax-free regardless of age. Also Roth IRA distributions are tax-free if you qualify.

4. Additional Standard Deduction

People age 65 and older can claim an additional standard deduction on their federal income tax return. For example the deduction for 2003 was $950 for married individuals and those entitled to surviving spouse filing status, and $1,150 for individuals.

5. Continuing Care

People who move to a continuing-care facility that provides housing, meals, and health care can deduct a portion of monthly fees as a medical expense. Entry fees into the facility are a deductible medical expense.

6. Credits for the Elderly

If your spouse cannot care for himself or herself and you work, you can claim a federal tax credit of 30 percent of care expenses up to $2,400. There is also credit available for low-income seniors whose Social Security benefits are very low. These persons age 65 and older may be entitled to a federal income tax credit.

7. Local Property Tax Breaks

If you own a home, you may be eligible for a reduction of property taxes based on your age. Each municipality has its own rules. States also might provide state income tax credits for property taxes.

EXHIBIT 15-2 Sample Engagement Letter for Elder Care Assurance Engagement

Date

Ms. Daughter
Street Address
City, State, and Zip Code

Dear Ms. Daughter,

We are looking forward to working with you to coordinate and oversee the financial care of your mother, Mrs. Mother. We know your mother's financial care is important to you, and our service is designed to provide you with the comfort of knowing that her needs are being met. This letter highlights the steps involved in developing, implementing, and maintaining a financial care program for your mother. It also outlines, in general, our understanding of the terms and objectives of our engagement. The sufficiency of the procedures is solely your responsibility. Consequently, we make no representation regarding the sufficiency of the procedures.

Services to Be Performed

Following is a listing of some of the services we will perform on a regular basis. We will generally perform all financial and "paperwork" type of services your mother would need.

1. We will collect all her bills and ascertain their validity and accuracy.
2. We will write and mail checks for payments due by your mother in a timely manner. Generally we will review all items due on a weekly basis and perform whatever is necessary. Checks for amounts in excess of $1,000 with the exception of the monthly rent, real estate taxes, income taxes, and estimated tax payments will not be signed by us without your written approval.
3. We will review income Mrs. Mother is supposed to receive and ascertain that it is received or deposited timely. This will include the Social Security checks, IRA withdrawals and CD interest income and rollovers, and any other income Mrs. Mother usually receives or should receive.
4. We will review receipts for prescriptions and other medical expenses and prepare the necessary AARP forms for reimbursements and follow up on their payment.
5. We will maintain files of the original invoices and receipts in our office.
6. We will send you monthly a listing of all disbursements and receipts along with copies of all invoices and bills. This will generally be sent during the first week of each month.
7. We will send you copies of all bank reconciliations monthly when they are prepared, usually within one week of receiving the bank statements, along with a copy of the bank statements.
8. We will reconcile all brokerage and fund accounts and send copies to you. We expect that you will receive copies directly from the brokerage firms and mutual funds, if applicable.
9. We will discuss with you the types of investment alternatives as funds become available. We will provide suggestions but will not make any direct decisions, nor will we have signatory power over any investment accounts. We have some ideas on how the accounts could be maintained, particularly CDs, at a secure low-cost, low-maintenance, low-effort basis. We will discuss this with you when the first situation arises.
10. Telephone calls to you or your mother as necessary.

11. We will always have available for your review a year-to-date general ledger. We will print them as you request. Generally, we will only send these to you at six-month intervals.
12. We will prepare whatever information you might need to prepare your mother's tax returns.
13. We will not be responsible to prepare any tax returns, but will pay the estimated taxes if applicable.
14. We expect you to have a checking account where we could sign the checks. This account should have an initial balance equivalent to about two months of expenses. As the balance declines you would replenish it.
15. We will not deposit any income into this account. Rather, all income will be deposited into accounts that you control and where we are not signatories. The only exception might be the automatic deposit of your mother's Social Security checks.
16. Initially, we will write the checks on existing accounts and send them to you or bring them to your mother to sign.
17. We will use QuickBooks and Quicken software for these services. The versions we will use will be owned by us and will not be billed to you, unless the software providers change their policy and require us to purchase separate software packages for use in our servicing your mother's work. We intend to order preprinted checks and these will be billed to you. Initially, we will print a limited number of checks in our office for you so that there is no delay in getting started.

All disbursements we make will be subject to the approval and other controls we have established. However, in making those disbursements, we will be relying on the accuracy and reliability of information provided. We will not audit, examine, or review the information.

Please also note that our services cannot be relied on to disclose errors, fraud, or other illegal acts that may exist. Our firm's maximum liability to you for any reason relating to our services under this letter shall be limited to fees paid to our firm for our services under this letter. In addition, you will indemnify and hold harmless our firm and its personnel from any claims, liabilities, costs, and expenses relating to our services under this letter, except to the extent finally determined to have resulted from the gross negligence or willful misconduct of our firm.

Professional standards preclude us from disclosing client information without your specific consent. However, as CPAs in good standing with the states of New Jersey and New York, and as members of the AICPA, we have a routine triennial peer review of our procedures, policies, and standards. By your retaining us it is recognized that your files might be selected for such review.

Fees

Our fee will be on an hourly basis at $xx per hour, plus a fixed supervisory fee of $xxx per month, for all routine work as described above, and $xxx per hour for the type of work that involves discussions with a partner or accounting staff regarding decisions that need to be made such as where the CDs will be rolled over to, or the term of the CDs, or other investing decisions. We will record our time in half-hour segments. We will also bill you for out-of-pocket disbursements such as postage and excessive copying charges. If you wish, we could discuss a monthly fixed fee after we establish a routine; that usually takes about two months.

(*continued*)

Financial and estate planning services are available. The rates for this are $xxx per hour and will be performed by a partner. We may occasionally have preliminary discussions with you regarding these types of services or the need for them, which will be billed at the $xxx per hour rate. However, if you wish to proceed we will then bill you at the $xxx rate. Please note that the $xxx rate will not be billed unless there is a specific engagement for such services, and there is an appropriate engagement letter agreed to by you. Until then, you will not be liable for that rate.

Our invoices for these fees will be rendered monthly and are payable on presentation. We will prepare the checks and will include copies along with the other bills we paid. We will always be available to discuss our charges, should you have any questions.

You or we may terminate this engagement at any time, upon written notice. During the course of our providing services, disagreements may arise between you and Mrs. Mother. It is our understanding that you and Mrs. Mother will resolve such disagreements, and that the resolution will be communicated to us.

Cordially,

CHAPTER 16

SECOND OPINIONS

Second opinions are just that—an outside look at a client's business or personal situation. We used to call them second opinions and promoted them as such. We no longer do that, but offer this as a separate and distinct service or product such as we do for performance measurement services. We feel that the difference is how the service is marketed, not how it is performed for the client.

WHO NEEDS THIS SERVICE

Every client who has a business or complicated personal financial situation would need this service.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

This is doing what we always do with a different name to it. Rather than make the push to become someone's "permanent" CPA we sell this as a single assignment engagement.

INTRODUCING THE CLIENT TO THE SERVICE

Suggestions of your availability to review complicated business and tax situations can be made when a tax client mentions problems at his or her company with current issues, or a general unclearness of a business' financial affairs.

We call the business "second opinion" our performance measurement service, and refer you to further discussion in Chapter 20.

The engagement letter in Exhibit 16-1 shows how the service can be introduced to a nonbusiness client.

FINALIZING THE ENGAGEMENT

We try to quote fixed fees for these engagements and we expect to complete them within three months. The fees are payable one-third upon acceptance by the client, one-third a month later, and the balance a month after that.

Exhibit 16-1, "Sample Engagement Letter for Second Opinion Service," is an engagement letter we use.

EXHIBIT 16-1 **Sample Engagement Letter for Second Opinion Service**

Date

Mr. Patrick Boyle
Sreet Address
City, State, and Zip Code

Dear Pat,

This letter sets forth a proposal of the terms and objectives of our being engaged by you to provide financial, tax, planning, conceptualization, and general consulting services.

Consultation Services

The scope and nature of the services to be provided will include all consulting services, discussions, and exploratory work on any of the items we discussed at our meeting, and any other issues you wish to raise. It will not include any detailed written memos, letters, or analyses that are intended for third parties.

Some of the items we will cover are as follows:

We will help you articulate your broad goals and objectives, understanding that these will continuously change based on your activities.

We will discuss your individual financial statement, your significant assets, an overview of your company, and cash flow. We will also review all agreements you have with people in the business.

We will review your life insurance policies, their ownership, and payment arrangements for them.

We will prepare or review your detailed income tax projection for the current year, and discuss it with you.

We will review the wills, trusts, and estate plans for you and your wife. We will make suggestions of things that should be considered or followed through on. We will also review all designation of beneficiary forms for your retirement accounts and coordinate them with your estate plan.

We will discuss the advisability, benefit, and cost, if any, of rolling over your IRA into a Roth IRA.

We will meet with you, your wife, your attorney or other advisers, and your staff as necessary to accomplish what is necessary for us to effectively and appropriately advise you.

We will use our full efforts and resources to obtain an overall familiarity and thorough understanding of your complete financial affairs.

Fee

The fee for the consulting services will be billed as incurred according to our standard billing rates, which range from $xx per hour to $xxx per hour for staff accountants and $xxx per hour for partners. The work will be completed by our personnel at the appropriate level for the task being performed. In order to begin, we will require a retainer payment in the amount of $x,xxx. Bills will be submitted to you periodically. The retainer will be applied against the final billing for this engagement.

(*continued*)

Fees are payable as billed. There will be an additional charge of 1.5 percent per month for past due amounts. Additionally, we will bill you for out-of-pocket disbursements, if any. Also, should you hire any of our personnel it is acknowledged that we would be entitled to a $xx,xxx "search" fee.

Limitation on Scope of Services

These services are not designed, and should not be relied upon, as a substitute for your own business judgment nor are they meant to mitigate the necessity of an ongoing review. These are not investment advisory services. These services are designed to supplement your own planning and analysis and aid you in fulfilling your financial, business, and estate planning objectives. In addition, these services are not designed to discover fraud, irregularities, or misrepresentations made in materials provided to us.

The services described in this letter do not include other services that may also be provided by us, upon your request, including but not limited to:

Tax compliance services, including income tax and gift tax return preparation;

Accounting and auditing services;

Appraisals and business valuations; and

Any other services not specifically outlined herein.

We will bill separately for any such additional services provided, based on a predetermined agreed-upon fee.

Right to Terminate

Either party may terminate the relationship at any time, for any reason, within 10 days of written notice to the other party. It is understood that any unpaid services that are outstanding at the date of termination are to be paid in full within 10 days from the date of termination.

Conclusion

If this letter correctly sets forth your understanding of the terms and objectives of the engagement, please so indicate by signing in the space provided below and returning a copy to us.

Cordially,

CHAPTER 17

CONFLICT RESOLUTION

This service puts the CPA in the role of a mediator attempting to resolve conflicts and to serve as a facilitator to move things along to accomplish stated goals regarding financial issues.

WHO NEEDS THIS SERVICE

We can mediate in divorces, partnership disputes and differences, parent-child financial squabbles, and a myriad of other situations.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

CPAs have the training, experience, and trust to be effective mediators and facilitators.

INTRODUCING THE CLIENT TO THE SERVICE

Clients can be asked if there are any unresolved conflicts in their lives. This can lead to some interesting engagements.

There are a lot of tax and financial issues in prenuptial and marital separation discussions. Most of the fighting is over money—not children's custody or visitation.

FINALIZING THE ENGAGEMENT

We charge individuals who are not regular clients for initial consultations. Existing clients usually are not billed for initial exploratory meetings. At the point that it appears they will move forward, we then set a fixed price.

When we charge hourly fees in an adversarial engagement, we have a four-hour minimum for meetings or appearances outside of our office. If preparation work is needed beforehand, and we are able to have a staff associate perform any of it, the billing will be at the associate's rate which is much lower.

SECTION III

CROSS-SELLING TO BUSINESS TAX CLIENTS

CHAPTER 18

QUICKBOOKS® TRAINING AND CONSULTING

QuickBooks® and other low-end accounting system consulting is a great door opener for new business. The service consists of helping businesses straighten out their system and some reconfiguration of the way they enter and output the data. This has become a great discussion area, but as itself it is not a big money maker since the software is so user-friendly that it only needs a few hours to get most businesses back on track.

QuickBooks® consulting has nothing to do with taxes, but we generate extensive additional business when we mention it during a tax return interview. We have also found it to be a great door opener for other services totally unrelated to QuickBooks® or taxes.

This opening has led us to outsourced bookkeeping, accounting, and administrative services for many types of organizations. The purpose of the outsourced services is to provide the client with an immediately functioning back office and bookkeeping system without having to hire anyone. The nature of such services is planned to be temporary until the client is able to ease into establishing their own in-house functions.

WHO NEEDS THIS SERVICE

Every business that uses low-end accounting software, or those that might still be doing it without a computer, can use this service.

If our tax client recently started a business, or if they work for an organization (many nonprofits can get great benefits from this service) where they have heard the bookkeeper or owner complain about the system, they could be in a position to recommend us to take a look at the system.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

Who is better able to fix up accounting system problems? We find that most problems are not with the software but with the way the software was set up—and these are really accounting, not software, issues.

INTRODUCING THE CLIENT TO THE SERVICE

It is a simple issue of making your tax clients aware of the services your firm offers. A little probing can have the tax client reveal a lot about the company he or she works for. Exhibit 18-1, "Sample Handout for QuickBooks® Training and Consulting Service," is the ad we give to clients who are possible candidates for our QuickBooks® consulting services.

FINALIZING THE ENGAGEMENT

We have a price schedule for various numbers of hours a client could purchase. The packages are based on hours purchased. We do not offer free consultations for QuickBooks® clients. A minimum sale is three hours. The rate is a uniform amount regardless of the level of the person in our firm who performs the service.

EXHIBIT 18-1 Sample Handout for QuickBooks® Training and Consulting Service

QuickBooks® Service Packages

by **QB:asap**sm*...a service of Mendlowitz Weitsen, LLP, CPAs*

QuickBooks & QuickBooks Pro are registered trademarks of Intuit Inc.
Mendlowitz Weitsen, LLP, CPAs is not affiliated with Intuit Inc.

THE BASIC PACKAGE—$xxx

- We will train your staff on the following QuickBooks® Procedures
  - ❑ Running your business
  - ❑ Check writing
  - ❑ Sales, accounts receivable, and income received
  - ❑ Purchases and accounts payable
- 5 hours on-site setup and training
- Payment due at end of first session (payment by check or MasterCard and Visa)

THE GOLD PACKAGE—$xxx

- Basic *plus* 3 additional hours of on-site training
- Telephone support between our visits
- Three on-site visits within a two-week period
- 8 total hours
- Payment due at end of first session

THE PLATINUM PACKAGE—$x,xxx

- Gold *plus* job costing *plus* inventory control *plus* advanced transactions (8 additional hours on-site training and 1 hour phone support)
- 17 total hours
- Payment due in two installments—at end of first and second sessions

THE PAYROLL PACKAGE—$xxx

- Payroll processing set up and training
- Three on-site hours (two hours when you learn how to set up and do your first payroll and one hour when you do your first payroll tax returns)
- 30 minutes of telephone support through the second payroll you do on your own
- Includes salaried, hourly, and commission workers and overtime pay
- Fee surcharges as follows:
  - ❑ $xxx for every 10 extra employees over the first 10 employees
  - ❑ Restaurant payrolls are $xxx extra
  - ❑ Apartment building payroll is $xxx extra
  - ❑ 401(k) plans are $xxx extra
  - ❑ Section 125 cafeteria plans are $xxx extra
- Payment due at first payroll session

POST INSTALLATION OR EXISTING USER SUPPORT PACKAGES

- 3 hours for $xxx
- 6 hours for $xxx
- 20 hours for $x,xxx
- Includes telephone or on-site support or remote support with **pcANYWHERE™** (software not included)
- Telephone and remote support billed in 1/4 hour units
- On-site support billed in 1 hour units
- Includes backing up your staff if they are ill or on vacation
- Priority service treatment for all calls
  - ❑ Telephone support within one hour of your call during 9–5
  - ❑ Remote support within three hours of your call during 9–5
  - ❑ On-site support within one day of your call (Mon–Fri)
- Expires six months after purchase

OTHER SERVICES

- Other computer services are available, please let us know your needs.
- We also support and train Peachtree® and One Write Plus®.
- We offer a full range of accounting services. Let us know your needs.

QB:asapsm*...a service of Mendlowitz Weitsen, LLP, CPAs*
K2 Brier Hill Court, East Brunswick, NJ 08816-3341
(732) 613-9700 Fax (732) 613-9705
E-mail QBasap@aol.com http://www.MWLLP.com

(*continued*)

EXHIBIT 18-1 Sample Handout for QuickBooks® Training and Consulting Service *(cont'd)*

QUICKBOOKS® PROCEDURES YOU WILL LEARN

Running Your Business
- Setting up your company
- Initial chart of accounts set up
- Preparing income statements and balance sheets
- Preparing profit-and-loss (P&L) trend analysis
- General ledger account detail reports
- Filtering transactions
- Generating graphs
- Data backup

Check Writing
- Issuing checks
- Setting up vendors
- Setting up recurring checks
- Borrowing money and loan payments
- Bank reconciliations
- Using credit card and bank subaccounts
- Check issuance history

Sales, Accounts Receivable, and Income Received
- Setting up customer files
- Entering opening balances
- Entering statement changes
- Issuing standard invoices
- Entering invoiced amounts
- Receiving customer down payments
- Assessing finance charges
- Making deposits
- Credit card payments
- Cash payments
- Sales tax tracking and paying
- Preparing aged schedules
- Handling bounced checks
- Correcting misapplied payments
- Customer transaction data base

Purchases and Accounts Payable
- Setting up vendor files
- Entering opening balances
- Preparing schedules
- Handling vendors who are also customers
- Vendor purchases data base
- Entering after-the-fact payroll
- Recording fixed asset purchases

Payroll Processing
- Payroll taxes
- Medical insurance
- Fringe benefits
- Bonuses
- Employee reimbursements
- Employee advances
- Garnishments
- 401(k)
- W-2, 940, and 941 forms
- Adjusting payroll items
- State Unemployment and Disability taxes
- Electronic tax payments
- Setting up and creating 1099-MISC

Job Costing
- Invoicing
- Subcontractors
- Jobs-in-process records
- Accounting for reimbursable expenses
- Time tracking

Inventory Control
(If you need manufacturing inventory you will be taught and trained on Peachtree® instead of QuickBooks®)
- Setting up inventory
- Tracking inventory through purchases and sales
- Adjusting inventory price, quantity, or value
- Inventory reports
- Back tracking to vendors or customers

Advanced Transactions
- Custom invoices
- Entering barter transactions
- Hiding items and reimbursable expenses on invoices
- Online bill paying
- Reconciling incorrect bank account balances
- Changing beginning balances
- Creating packing slips
- Condensing data
- Exporting to spreadsheets
- Tracking fixed asset costs and depreciation
- Recording sales of fixed assets
- Adjusting for sales tax credits or penalties
- Customizing forms and graphs
- Cleaning up your chart of accounts, items, and other lists
- Using "To Dos" and the Notepad
- Setting reminders
- Customizing customer and vendor information fields
- Entering state sick and disability payments to employees
- Setting up and entering transactions for money market and sweeps accounts

We can train a bookkeeping novice to perform 85 percent of the QuickBooks® *tasks you need for your business after eight hours of training. What we do works!*

QB:asap℠*...a service of Mendlowitz Weitsen, LLP, CPAs*
K2 Brier Hill Court, East Brunswick, NJ 08816-3341
(732) 613-9700 Fax (732) 613-9705
E-mail QBasap@aol.com http://www.MWLLP.com

CHAPTER 19

OUTSOURCED ACCOUNTING, CHIEF FINANCIAL OFFICER, AND OTHER SERVICES

Outsourced administrative, bookkeeping, controllership, and chief financial officer (CFO) services is an answer to many newly formed businesses, companies with work overloads and shorthanded staffing, those with large short-term seasonal needs, and those that are frustrated by the difficulty of being able to find and keep competent internal accounting staff.

The service is as limited or as complete as a business requires with regard to its bookkeeping, accounting, tax compliance, controllership, and treasury functions.

WHO NEEDS THIS SERVICE

Every organization needs internal accounting help. This is not limited to businesses—it also includes nonprofits and governmental agencies. Many very small organizations cannot afford full-time help, and many are not able to assess the ability of those applying for the position. Others are newly formed and need to be functioning on a moment's basis—they need a turnkey back office. And still others occasionally get backlogged and need temporary support. Another group gets caught short with people leaving suddenly, quitting in anger, or suddenly out because of a medical emergency or accident.

There is a widespread need for these services, and in some cases the business just has to be made available.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

Very few of the services of this type are outside of the ability of most CPAs. The hardest part is learning about the peculiarities of the organization and its system needs. Knowing how to do the work is second nature to most CPAs.

INTRODUCING THE CLIENT TO THE SERVICE

We have specific handouts for potential outsourcing clients based on their needs. Exhibit 19-1, "Sample Handout for Outsourcing Service—Directed at Newly Formed Companies," and Exhibit 19-2, "Sample Handout for Outsourcing Service—Directed at High-Level Internal Accounting Staff," are two examples.

FINALIZING THE ENGAGEMENT

We generally start with a fixed monthly retainer that is adjusted to actual time charges on a periodic basis. Once the work is caught up and a routine is established we try to set fixed fees. We usually bill at lower rates for these services with an extra monthly supervisory fee. A sample engagement letter for complete outsourced internal accounting is included in Exhibit 19-3, "Sample Engagement Letter for Outsourcing Engagement."

EXHIBIT 19-1 **Sample Handout for Outsourcing Service—Directed at Newly Formed Companies**

Outsourced Administrative, Bookkeeping, Controllership, and CFO Services for Newly Formed, dot.com, and Pre-IPO Companies

➔ **New Age companies need New Age services. We handle all the nonproductive work your company *must* do.**

➔ **We take charge of your administration so you don't get bogged down with what you don't have to do.**

One of our clients, an e-commerce company, told us he engaged us because he worked for a company where the CEO got so bogged down with the administrative stuff he couldn't get the company off the ground—and he didn't want that to happen to him.

➔ We will

- Set up your accounting system including billing and receivables, purchases and payables, payroll, cost accounting, activity based costing, inventory planning and control, budgeting, cash flow and working capital projection and analysis, ongoing system needs analyses and product search, and serving as your internal project manager working with VARs (value added resellers).
- Actually perform all bookkeeping and administrative functions
- Set up a contact management system
- Provide secretarial services as needed
- Arrange for temporarily investing excess cash
- Work with insurance agents to obtain complete business and health insurance
- Arrange for acquisition and financing of office and communications equipment
- Work with realtors to preliminarily search for office space
- Coordinate with attorneys employment incentive packages including ISO, NQSO, 401(k), pension or profit sharing plans, signing bonuses, restricted stock, and Section 83(b) elections
- Help you in preorganizational planning such as choosing an entity, shareholders or members agreements, tax elections, helping decide how your ownership interests should be structured, and choice of state of organization and operation
- Provide individualized tax planning for principals and key staff
- Prepare all tax registrations and regular filings as well as develop and maintain tax and compliance calendars
- Function as your back office to meet front office and management needs
- Assist you in negotiating with investment bankers and venture capitalists
- Give you access to outside advisers with specialized knowledge
- Prepare business projections, do strategic modeling, and help you articulate your long-range plans
- Make available the multiple disciplines needed to start up, organize, and operate a business
- Prepare your business for the independent audit the underwriters will need. We can also assist you in obtaining the services of a national CPA firm.

(*continued*)

EXHIBIT 19-1 **Sample Handout for Outsourcing Service— Directed at Newly Formed Companies** (*cont'd*)

Full-time availability at part-time prices

✔ You are not hiring a person; you are engaging a firm with the levels of the expertise you will need.

✔ We run the traditional side of your business so you can develop the unique thing you do.

✔ No matter how great your idea, and no matter how great you are, if the numbers don't add up, you won't matter.

✔ We not only take a burden from you, we give you time—time to do what you do best and time that accelerates your business plan.

✔ We give you an immediate turnkey operation with no waiting to get you operating.

Make us your outsource source

Mendlowitz Weitsen, LLP, CPAs

K2 Brier Hill Court, East Brunswick, NJ 08816-3341

Tel: 732.613.9700 Fax: 732.613.9705 E-mail: mw@MWLLP.com

www.mwllp.com

Our clients also include conventional businesses such as manufacturers, distributors, retailers, direct marketers, contractors, stock brokerage firms, publishers, real estate brokers, managers and developers, condominium associations, trade associations, and professional firms.

Our services cover the full range of CPA services including audits, prospective financial statements, tax, financial, estate and succession planning, shareholder counseling, establishing systems and internal control procedures, and entrepreneurial training.

Let us help you. Call us today and tell us what you want to do. We can help you make it happen.

EXHIBIT 19-2 **Sample Handout for Outsourcing Service—Directed at High-Level Internal Accounting Staff**

Complete Services to CFOs, VPs of Finance, and Controllers

Auditing
Publicly traded companies
SEC compliance
GAAP compliance
GAAP to tax adjustments
Attestation services
Forensic auditing
Internal auditing

Accounting Services
Prospective financial statements
Budgets
Business plans

Business Succession Planning
Estate planning
Family limited partnerships
Intentionally defective irrevocable trusts
Charity remainder trusts
Private foundations
Business valuation
Succession planning
Family transition mediation/counseling/resolution/coaching
Buy-sell agreement design
Merger and acquisition planning
Due diligence for mergers and acquisitions
Strategic planning/coaching

Tax Planning and Compliance
Tax planning
Tax return preparation
Tax audits
State tax planning
Full tax reporting and compliance services
Foreign entity U.S. qualifications
Tax questions

Production Services
ABC/ABM/TOC/Kaizen

Outsourced Services
Accounting
Bookkeeping
Human resources
Insurance
Turnkey accounting systems
Full back-office operation
Reports to investors
Management reports

Credit Service Consulting
Letter of credit financing
Alternative financing
Long-term asset acquisition financing

Employee Benefits
Incentive stock option planning
Nonstatutory stock options and restricted stock
Stock option plan modeling and formulation
Employee benefit plans
Pension plans
Golden parachute taxation
401(k)/investing education
Section 162 plans
Split dollar life insurance plan analyses
Creative executive benefit plan conceptualization
Phantom stock plans

Other Services
Board of Director due diligence advising
Yourport® shareholder reports

Member: AICPA SEC Practice Section

Call us and tell us your needs. We can help you!

Mendlowitz Weitsen, LLP, CPAs
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EXHIBIT 19-3 Sample Engagement Letter for Outsourcing Engagement

Date

Owner Name
Your Business, LLC
Street Address
City, State, and Zip Code

Dear __________:

It was a pleasure meeting with you on Thursday of last week. We are pleased to provide you with this proposal of services that we will provide for Your Business, LLC.

Outsourced Bookkeeping Services

We will serve as the internal bookkeeper for Your Business, LLC including the following:

1. Establishing a computerized accounting and bookkeeping system suitable for your business.
   This will include a review of your accounting needs and configuration of an accounting system for your company using QuickBooks® software. We will set up the chart of accounts, prepare recurring entries and memorized transactions, and configure the program to provide the management information that would best serve your needs. Included in the initial set-up services will be billing and payment systems.
2. Periodically, you will send us your bills for checks to be prepared and sent out.
3. Recording sales receipts
   Note: Collection and depositing of sales receipts will be done by you at your office.
4. Generating monthly accounts receivable schedules, if required
5. Entering all expenses and bills after they have been approved
6. Entering the payroll information on your books from the payroll prepared by the payroll service including recording the tax payments
7. Reviewing the quarterly payroll tax returns that will be prepared by the payroll service
8. Bank reconciliations of all accounts with transactions
9. Monthly schedules of accounts payable, if appropriate
10. Monthly balance sheets and income statements in the form of a trend analysis to be discussed with you via telephone, every month
11. Review of the annual payroll taxes prepared by the payroll service
12. Preparing sales and use tax returns (if applicable)
13. Preparing annual Forms 1096 and 1099 information returns for submission to the taxing authorities and distributing them to independent contractors, if any
14. Properly filing all correspondence, invoices, bills, and worksheets in files to be maintained in our office; these records will always be available to you immediately upon your request
15. All other bookkeeping services that are considered normal for an endeavor such as yours

The work will be done on our premises using the latest version of the QuickBooks® software.

We will use our personnel and be fully responsible for their work, and the timeliness of their performance. We anticipate using the same person; however, on occasion we will vary the personnel so we could be assured of sufficiently trained backup personnel, should it be necessary to use someone else. There will be at least two other people in our firm familiar with your system and offices. We will be employing personnel trained by us to work on your systems and your company on the QuickBooks® software.

We anticipate that someone from our firm will be working on your bookkeeping at least every two weeks. The number of hours will vary based upon the services required.

Please note that outsourced bookkeeping services specified in this letter will not include the audit or review of your financial statements.

Please also note that our outsourced bookkeeping engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any material errors that come to our attention and any irregularities or illegal acts that come to our attention, unless they are inconsequential.

Accounting and Tax Services

We will serve as your accountant and provide the following services:

1. If requested, we will generate an annual compilation report from QuickBooks® and prepare the supporting workpapers to facilitate the preparation of financial statements.
   Note: Should financial statements by an independent accounting firm be requested, we may not be sufficiently independent to issue such statements. In such case another accounting firm would have to be engaged for that purpose.
2. Tax preparation and tax planning including year-end tax planning
3. Identification of special accounting issues and assistance in their interpretation
4. Preparation of your federal and state individual income tax returns
5. Preparation of federal and state income tax returns for Your Business, LLC (if and when a return for an entity, such as an LLC, is required)

Fees for Our Services

There is a one time set-up fee for QuickBooks® of $x,xxx.

For the first three months the fee will be $xx per hour for outsourced bookkeeping services plus a $xxx per month supervisory fee. After three months, when we have a better idea of the scope of the work, we will quote a fixed fee with you, including ongoing outsourced bookkeeping, accounting, and tax services.

For the preparation of your individual 2003 income tax return, the fee is estimated to be $x,xxx (subject to our review of your 2002 returns and any unusual or new circumstances for 2003).

The fee for writing up your 2003 accounting records and closing the books for the same year, assuming that all the transactions including cancelled checks and bank statements are provided to us, will be $x,xxx.

In order to begin, we will require a retainer of $x,xxx to be applied against the QuickBooks® set-up fee and the initial outsourced bookkeeping services. Fees are payable as billed. There will be an additional charge of 1.5 percent per month for past due amounts. Additionally, we will bill you for out-of-pocket disbursements, if any. Also, should you hire any of our personnel it is acknowledged that we would be entitled to a $xx,xxx "search" fee.

You may discontinue your services from us at any time. Should this occur, you will be issued a final bill for unbilled work within a reasonable time, thereafter. In that event our services to you would cease immediately, or continue until such time as mutually agreed-upon including the appropriate fee.

(*continued*)

Privacy Policy

Attached is our privacy policy as required by the Federal Trade Commission.

Unanticipated Services

Furthermore, the parties agree that if an unanticipated need arises (such as, but not limited to, an audit by a taxing agency, or any other exogenous service not anticipated in this agreement by the parties), Mendlowitz Weitsen, LLP, CPAs hereby agrees to perform this additional work at a price mutually agreed-upon before the service is provided.

Conclusion

We are most pleased that you are considering our firm. We know that this will be the beginning of a long and successful relationship. Please call me to discuss this proposal and any additional questions you may have. If the above meets with your approval, please sign a copy and return it to us.

Cordially,

CHAPTER 20

BUSINESS PERFORMANCE MEASUREMENT

Business performance measurement services help clients run their businesses better by providing real time information about the things they need to know to do a better job.

WHO NEEDS THIS SERVICE

Every person in business needs and should have this service.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

We believe that CPAs are the best qualified business advisers. Unfortunately many do not see the value of offering these additional services when they feel they are locked into a fee arrangement that could not be expanded to include the benefits and value of these extra services.

Our training as accountants has provided us with the best tools to help a client identify where they are strong and what areas they are weak in, and then use that information to assist them. In situations where the high impact areas need specialized assistance, the CPA is usually the best suited to recommend specialists to further expand the value of these services to the client.

INTRODUCING THE CLIENT TO THE SERVICE

For existing business clients we usually do a preliminary review of crucial business areas to identify weaknesses as well as areas of growth potential. We also try to identify four or five key performance indicators—the information that will provide the greatest relevance to the client. After a brief (about one hour) meeting we leave with the client bursting with ideas and things they can do to better operate their business. We follow up a few weeks later to offer to evaluate the results of the just started actions. If the client really did not get started, or the results were not what was expected, we then explain how we could get further involved and what benefits they could expect from our participation.

If we are meeting an employer of a tax client for the first time, there is no charge. We explain our service and separate it from traditional accounting services. This is very important for us. By unlinking it to a decision of switching accountants we have found that the client has an easier decision—to hire us for a one-shot assignment that might greatly benefit them, or to pass on it. The decision to switch accountants is usually a major decision, even for those generally unhappy with their current accountant. We try to separate it and get our foot in the door. Occasionally we cannot come to a fee quote or handle on the business at one meeting, so we have two or three until we are confident with making a proposal.

Our firm has developed performance measurement into a specific service that we work hard at expanding. Many of the things we do are similar to the questions we will throw at a "potential client" when we are told of their dissatisfaction with either their present business accountant, or the accountant used by a friend or their employer. Included in Exhibit 20-1, "Sample Checklist for Business Performance Measurement Service," is a checklist that is a guide of the types of "performance measurement" we do or offer.

FINALIZING THE ENGAGEMENT

Our fees are fixed for each assignment. Because of this you have to be careful when describing the services in the engagement letter so you don't end up doing work that you were not engaged to do. A sample engagement letter for a law firm is included in Exhibit 20-2, "Sample Engagement Letter for Performance Measurement Engagement."

EXHIBIT 20-1 **Sample Checklist for Business Performance Measurement Service**

ACCOUNTANT'S CHECKLIST FOR EVALUATING A CLIENT'S BUSINESS PERFORMANCE

Goal of performance measurement: The identification of critical success factors that lead to measures that can be tracked over time to assess progress made in achieving specific targets linked to an entity's vision.

The following checklist is only a guide to the ways you can help a client evaluate their business' performance. Its purpose is to help you start thinking about ways you can add value to your client's business.

[*This listing is limited to nontax items*]

General

- Timely financial statements
- A review of the financial statements with the client, to make sure the client actually looks at them and understands them
- An analysis of why some of the "numbers" are not so good
- A quick ratio analysis
- A discussion of the client's financial controls
- A discussion of the client's cash flow
- A break-even analysis
- A discussion of the quality of the internal controls on the client's business
- An analysis of how up-to-date the bookkeeping is

Sales

- A review of the client's five or ten largest customers and their buying and payment patterns
- A review of the cost to get sales from some of the client's largest customers and clusters, or groups of some of the smaller clients
- An 80/20 review of the client's customers
- A review of sales returns, allowances, markdowns, and debits to determine if there is a pattern from any customer, or any salesperson's customers
- A review of the amount of time from shipment that a sale is returned
- A discussion with the client on their pricing policies, strategies, methods, and formulas
- A discussion with the client on why, when, and how to raise prices
- A review of the prices the client charges for the same items to different customers, or groups of customers
- A review of the average size of an invoice and how it may have changed during the last five years, and then questioning why
- A review of the potential of a client's customers to buy more, or increase the size, or frequency, of their orders
- A review of the customer reorder pattern
- A review of how much the client loses, or makes, on shipping charges
- A review of the time it takes the client to ship an order, and questioning whether this time is more or less for different types or groups of customers
- A review of the client's different types or groups of customers
- A discussion of how the client distinguishes between types or groups of customers
- A discussion of whether the client consciously knows that they have different types or groups of customers, and why they should know

(*continued*)

- A suggestion that the client periodically review credit reports of their largest customers and largest suppliers

Production

- How does client dispose of stale inventory?
- Have you ever reviewed the time from when an order is received until it is shipped?
- What is the backlog situation? Is it more or less than a few years ago?
- Why are there backlogs?
- Is production the cause of the problem? Is it lack of proper raw materials? Or is it because a key employee or key machine or department is having problems?
- Speaking about production, when was the last time you took a walk through the factory, shipping area, and other essential areas? Have you ever done that?
- Does the client have a small number of essential suppliers, or a wide range?
- How important to the business are the top five suppliers?
- How long after an order are the materials received?
- Have you recently compared the prices a client pays for raw materials with competitive suppliers prices?
- Have you reviewed the prices paid for consistency with the supplier. How often do the prices change?
- How often does the client reorder supplies and raw materials?
- How has the client's sales grown throughout the years—in dollars and units
- Do you measure raw materials to sales?
- Have you reviewed purchase returns, credits, and allowances to determine the reason and the effect on production, if any?
- Have you ever looked at production reports? Do you know what the client measures?
- What does the client do with manufacturing scrap?
- During the production process, are setups an issue?
- If setups are important, how does the client schedule setups?
- What quality control procedures does the client employ?

Payroll

- How stable is the labor force? Is there much turnover?
- What type of people is the client hiring now compared to five years ago?
- Is there a labor union? How are relations with the union?
- If the client is not unionized, what is the client doing to keep it that way?
- How has production per employee changed over the last five years?

Client's Future

- What are the long-term prospects for the client's industry?
- How is the client preparing for the future?
- Is the client making investments in equipment and technology?
- Is the client's business particularly sensitive to interest rate changes and shifts in the economy?
- Is the client dependent on certain commodities?
- What type of "new" competitors does the client have?
- If the client started a new business or product line, did you help them by assisting them in their business plan? How can you help them now?
- Are there alternative competitive products?
- Have you ever discussed with the client how much their business is worth?
- Have you ever discussed with the client what their goals are?
- Have you ever discussed with the client why they are in business?
- Have you ever discussed with the client their exit strategy?

- Have you ever discussed with the client their transition plans?
- Have you ever discussed with the client what would happen to the business if he or she got sick, or died?
- Have you ever discussed with the client what would happen if his or her partner got sick, or died?
- Does the client have a "brand"?
- How well is the client adapting to change?
- Are the client's management techniques still applicable?

The above listing is not complete. You can add any items you want to the list.

EXHIBIT 20-2 Sample Engagement Letter for Performance Measurement Engagement

Date

Mr. John Smith
Managing Partner
Company Name
Street Address
City, State, and Zip Code

Dear Mr. Smith:

This letter sets forth a proposal of the terms and objectives of our being engaged by you to provide your firm with a **Yourport**® Partners' Report.

The **Yourport**® partners' report is a catalogue of a business' essential information organized in a manner where the owners or primary managers could focus on the areas that will help them achieve greater profitability, wealth, growth, enjoyment, excitement, security, and peace of mind.

Scope and Nature of Services

The scope and nature of the services to be provided cannot be clearly defined, but will include a thorough analysis of your firm in a way that you can use the information presented by us to generate additional revenue, provide better service to your clients, increase profitability of your practice, improve attorney and staff realization, develop a strategic direction for your firm, and better evaluate and allocate your firm's resources.

The finished product will be a confidential written report that will be presented to the partners in a meeting that will take approximately three hours. A follow-up meeting will be scheduled, if necessary, in the month following the presentation.

Information Requested

In order to perform our services, it will be necessary for us to have complete access to your financial, accounting, and bookkeeping records, including your time and billing system, and client files. There will be a number of visits of our staff to your office to work on gathering the information needed and analyzing it in the appropriate manner for inclusion in the **Yourport**® Partners' Report. We will also need to interview partners and some of the associates and other personnel.

Please note that all information provided to us or which we review will be held in the strictest confidence and will not be used for any purpose other than to provide you with the **Yourport**® Partners' Report.

Fees

These services will take place over the next three months. Our fee will be fixed at $xx,xxx, payable $x,xxx upon acceptance, and $x,xxx monthly for the following two months.

Guarantee: If you are not satisfied in any manner with our work, we will refund any portion of the fee you request. You will not have to provide any reason for your dissatisfaction.

We will also be entitled to a $xx,xxx "search fee" for any of our staff people that you hire or engage to perform services for you.

Limitation on Scope of Services

These services are not designed, and should not be relied upon, as a substitute for your own business judgment nor are they meant to mitigate the necessity of an ongoing review. These services are designed to supplement your own planning and analysis and aid you in fulfilling your financial, business, and strategic planning objectives. In addition, these services are not designed to discover fraud, irregularities, or misrepresentations made in materials provided to us.

The services described in this letter do not include any continuing or ongoing service; appraisals and business valuations; letters or analyses that are intended for third parties; tax compliance services; or any attestation, accounting, or auditing services.

Right to Terminate

Either party may terminate the relationship at any time, for any reason, within 10 days of written notice to the other party. It is understood that any unpaid services that are outstanding at the date of termination are to be paid in full within 10 days from the date of termination. The guarantee will not apply if you terminate our services prior to the presentation of our final report.

Conclusion

If this letter correctly sets forth your understanding of the terms and objectives of the engagement, please so indicate by signing in the space provided below and returning a copy to us.

Sincerely,

Yourport® is a registered trademark of Mendlowitz Weitsen LLP CPAs.

CHAPTER 21

BUYING AND SELLING A BUSINESS

This service includes assisting clients in deciding whether to buy or sell a business; determining the proper price; helping in the due diligence process; and structuring the price financially in terms of cash flow and tax considerations.

This area involves a lot of tax and financial issues.

The client will need help in the sales process; mechanics of the sale; deciding to buy or sell; articulating their thoughts about why they are buying or selling; determining how much they want to pay for the business, or sell the business for; getting started; assembling the team; preparing a "book" if they are selling; assembling and keeping track of a checklist of items needed or to be available for buyers; determining what will be bought or sold; valuing the business; structuring the transaction including the terms; assisting in the letter of intent; due diligence investigation; and reviewing the contract and tax effect of the sale or purchase price allocation.

WHO NEEDS THIS SERVICE

This service is for every client that wants to buy or sell a business, as well as their family or friends.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

CPAs are always advising clients in these areas. Even if a CPA has no experience in assisting in the price and term negotiations, the CPA can certainly help in structuring the price for best tax advantage.

INTRODUCING THE SERVICE TO THE CLIENT

Clients can be asked if they have ever thought about buying a business and told that if they should ever do so, the CPA can assist them. We have a handout in Exhibit 21-1, "Sample Handout for Buying and Selling a Business Services," that describes our services in helping clients buy or sell a business. The client may keep this handout or possibly pass it along. We also have reprints of articles to hand out. One reprint tells a client the major tax issues in buying a business. This reprint is included in Exhibit 21-2, "Sample Handout for Buying and Selling a Business Services—Reprint Article on Buying a Business." The second reprint tells a client the major tax issues in selling a business. We give copies to clients to establish credibility and to show them the range of tax issues that we could help them with. This reprint is included in Exhibit 21-3, "Sample Handout for Buying and Selling a Business Services—Reprint Article on Selling a Business."

FINALIZING THE ENGAGEMENT

Pricing this service is a tough one. Charging by the hour would make the fees too high should the deal fall through. It also gets the client holding back from calling with all their questions, putting a crimp on the relationship. We usually charge a retainer against time, and then we don't bill the balance if the deal is not completed. This allows the client to come back for the next deal, or the one after that.

When we help clients sell a business we also get a retainer against time. Sometimes we have minimum fees regardless of time, and sometimes we tell the client we will request a "bonus" based upon value added.

However we charge, and for as long as we have been doing this, we still haven't found a fully satisfactory method, that is, one that recognizes the true value we bring to the transaction

EXHIBIT 21-1 Sample Handout for Buying and Selling a Business Services

THE **CPA's** [AND MW's] **ROLE** IN **INVESTMENT** BANKING

Investment banking has remained a mystery to many people outside of a small inner circle. This is not so for many of our clients!

Most people only become aware of investment banking when they want to buy or sell a business. Our role has been—and is—to walk our clients through the maze of events that lead to the culmination of the deal. And then to be there afterwards to financially ease them into their new situation or status.

If you are buying or selling a business you will need an **investment banker** to identify and find the buyer or seller. Their role includes the presentation of your company in its best and most favorable position and to assist in the negotiation process. They are a necessary part of your team, just as is your attorney and your CPA.

The **lawyer** is necessary to prepare and/or review the contracts and assist in the negotiations and to put you in the best legal posture with the most protection.

The **CPA** is probably the least understood role and yet the most important. (Did you think we would say anything different?) Our role in such deals has been to actually represent our clients with their own lawyer and investment banker. We say this with complete respect for those other professionals—but nevertheless we have a most unique role.

As accountants we most likely have been the closest financial advisers to our clients over an extended period of time under varying business climates and conditions. We have learned how our clients think, what is important to them, and what values they have. We feel that we understand best [as much as any adviser can] what our clients *actually* want out of the deal—not just closing the deal—but why they are doing it in the first place!

For new clients it is our talent and role to help them actually decide what they want and to discuss if it is realistic and practical, and to chart a course that keeps them and everyone else on the team focused on those goals. Sometimes clients simply want far more than is sensible for a buyer; other times business owners sell themselves and their businesses short and underestimate their real value in the marketplace.

We start by helping the client articulate his or her thoughts and project them into an effective course of action. We then monitor the negotiations and contracts to see that they are on target with the projections. We are also there to help the client, team, and buyer or seller immediately adapt to changing situations.

Our role is to also develop the tax plan that determines the nature of the income if our client is selling or the allocation of the costs (with appropriate appraisals) if our client is buying. Estate tax aspects

(*continued*)

EXHIBIT 21-1 Sample Handout for Buying and Selling a Business Services (*cont'd*)

are also considered as well as the method for insuring the succession of the entity if our client is the buyer. Additionally, we help construct the earnout provisions, and parameters and safeguards for monitoring the company.

Whether you are a buyer or seller it is very important to have realistic financial projections with assumptions that are reasonable and that recognize the true situation. Our role is to review the projections or to prepare or assist in their preparation, as the case may be. We also will review the financial books and records of target if our client is the acquirer. When due diligence needs to be done, we are also involved.

Where a business plan or offering memorandum has to be prepared we will work with the client's staff to develop raw data in the financial area. We will assist in the recasting of the financial statements, if necessary. We will also see that the investment banker has the materials needed to effectively represent you.

Some of the things we have been able to do for our clients have been to arrange for earnout and/or compensation payments irrespective of whether our client remained in the employ of the buyer; early buyouts of earnout provisions; noncompete clauses; restructuring of the deal after the closing; binding provisions in the letter of intent where a client is selling and nonbinding provisions where a client is buying; bank and performance guarantees of earnout and consulting fees; continued medical, life, and disability insurance premium payments and continued use of company offices, secretaries, autos, and credit cards; and the closing taking place simultaneously with the signing of the contract.

Our experience is quite broad. We have been involved in the purchase or sale of advertising representatives, agencies, and production studios, magazines and newsletters, book publishers, television stations (we were even involved in three different changes of ownership of a single T.V. station over a 10-year period), restaurants, computer consulting firms, insurance agencies and brokerages, medical, dental, legal, and accounting practices, retail chains, hotels, construction contractors, real estate developers, mail order, and many manufacturing and service companies. Our experience is vast both across industry lines as well as type of deals.

We hope this memo answered some of your questions and alerted you to the general process. We also hope you will turn to us first when thinking about a sale, merger, or acquisition transaction.

Other areas we are active in include workouts, Chapter 11s, leveraged buyouts, ESOPs, restructurings, recapitalizations, start-ups, business plans, financial evaluations and appraisals, initial public offerings, private placements, corporate shells, due diligence and investigative auditing, golden parachutes, and outplacement services.

Call today to arrange for a consultation...before you start!

Mendlowitz Weitsen, LLP, CPAs
K2 Brier Hill Court, East Brunswick, NJ 08816-3341
Tel: 732.613.9700 Fax: 732.613.9705 E-mail: mw@MWLLP.com
www.mwllp.com

EXHIBIT 21-2 **Sample Handout for Buying and Selling a Business Services—Reprint Article on Buying a Business***

Buying A Business Tax Loopholes

by Edward Mendlowitz, CPA
Published in *Tax HotLine* May 2003 issue
Mr. Mendlowitz can be reached at em@mwllp.com

You can save a lot of money when you buy a business by structuring the transaction in tax favorable ways. *Consider these opportunities…*

Loophole: Buy the individual assets of the business rather than its corporate stock.

Reason: Buying the assets lets you allocate the purchase price among them. This maximizes the benefits of the tax deductions you take. (Any amount you pay beyond the price of the assets is considered goodwill, which can be amortized over time.) By contrast, the price you pay for a business' shares, including any amount over the value of the assets, is not deductible.

Flip side: Sellers of businesses typically prefer selling the corporate stock, because the gain is taxed as a capital gain and there is no additional tax on the profits from any separate assets. The sale of assets generates a combination of ordinary income (including the recapture of previously taken tax breaks)—with a top tax rate of 35 percent—and capital gains. For C corporations, the asset sale is taxed at the corporate level and again when the sales proceeds are distributed to shareholders.

Loophole: Carefully label payments for continuing assistance and advice from the sellers. Former business owners who will be paid to continue working for the company following the sale should have those payments characterized as "covenants not to compete" in the sales contract.

Reason: When such payments are characterized as compensation—for example, consulting fees—the payments are subject to Social Security and Medicare tax of 15.3 percent and state unemployment and disability insurance. However, payments for covenants not to compete are exempt from those taxes.

Loophole: Factor in tax costs to the seller of the business when you calculate your purchase price. Buyers want to structure acquisitions so that they gain as many tax write-offs as quickly as possible. Figure in your tax breaks when you make your offer...

- Goodwill, covenants not to compete, trade names and trademarks, copyrights and contract acquisitions are amortized over 15 years for tax purposes.
- Equipment and software can be depreciated and amortized according to IRS guidelines (generally, over three to seven years).

Loophole: Value the business based on "earnouts," so that any gain on sale qualifies as a capital gain for the seller and not as "compensation" income.

How it works: Earnouts allow you to pay a lower up-front price and to incur lower interest costs. Earnouts make sense when the price of a rapidly growing business is based on future increases in profitability. They call for additional payments, typically over three years after the sale of the business, when certain targets are met. Targets are usually based on profits, but they can also be based on sales or new client growth, key employee retention, etc. Interest does not have to be imputed in the earnout price.

(*continued*)

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EXHIBIT 21-2 **Sample Handout for Buying and Selling a Business Services—Reprint Article on Buying a Business*** (*cont'd*)

Loophole: Structure the sale of the business as an installment sale.

Reason: Doing so will reduce your upfront cash payment. The benefit to the seller is that tax is not generally due until each installment payment is received. Interest costs paid will be deductible.

Loophole: Reduce the purchase price for selling the business on an installment sale and raise the component of the payments that is considered interest.

Reason: Interest will be deductible as paid while the tax benefits associated with the part of the purchase price allocated to hard assets (equipment) and soft assets (goodwill) will accrue slowly over time.

Benefit to seller: A lower allocation to depreciable assets will reduce the immediate tax on depreciation recapture on an installment sale. Example: Equipment that cost $400,000 has a book value of $100,000. When the equipment is sold for $300,000, the $200,000 gain is attributable entirely to depreciation recapture. A special tax rule says that the gain attributed to depreciation recapture is fully taxable in the year of sale. This is true even though there is an installment payout.

Loophole: Use the Applicable Federal Rate as your interest rate. The Applicable Federal Rate is the minimum interest rate that must be charged on deferred payments. If you use a lower rate, the IRS can recharacterize a portion of the payments as interest payments. New rates are published monthly in Internal Revenue Bulletins (www.irs.gov/individuals/lists/0,,id=98200,00.html).

Reason: This will usually result in lower payments than bank based rates.

Loophole: Use payment terms as a negotiating strategy.

Reason: Payment terms are an essential part of a business' value but are usually negotiated separately from the value. Buyers therefore should be aware of this and not fall into a trap of thinking that they have made a deal until all the terms of the purchase have been agreed upon. When deferred prices are negotiated without a stated interest rate, the IRS will impute interest, changing the characterization of the purchase price. On the other hand, excessively high interest will result in a lower purchase price.

Loophole: After your acquisition, elect to use the previous owner's Social Security and unemployment wage base amounts (for employees that stay on) instead of starting over.

Reason: This will reduce your employment taxes because you won't have to start over for the year. This is done using IRS Revenue Procedure 56-60.

Loophole: When a deal is structured, allocate assets based on relative current value. Buyers of businesses typically structure their acquisitions to create as many current tax write-offs as possible. Maximize the deductions by allocating assets based on their relative current values. The asset allocation is also critical to determine the taxes owed by the buyer and seller. For example, when a buyer acquires the stock in a corporation, none of the purchase price can be deducted for tax purposes. For accounting or financial statement purposes, however, it might have to be deducted over a very short period. Buyers and sellers each must file IRS Form 8594, *Asset Acquisition Statement Under Section 1060*, when the transfer of the business includes an allocation of goodwill or going concern value.

EXHIBIT 21-3 **Sample Handout for Buying and Selling a Business Services—Reprint Article on Selling a Business***

Selling A Business Tax Loopholes

by Edward Mendlowitz
Published in *Tax HotLine* June 2001 issue
Mr. Mendlowitz can be reached at em@mwllp.com

Are you thinking of selling your business? How you structure the sale will have a big impact on your tax bill. To maximize your profit, consider these strategies...

Loophole: Sell the C corporation stock, not the individual assets of the business. A sale of corporate stock is the simplest transaction and minimizes taxes for the seller.

Reason: A stock sale generates capital gains, taxed at top rate of 15 percent. A sale of assets generates a combination of ordinary income—with a top tax rate of 35 percent—and recapture of previously taken tax breaks. Furthermore, the asset sale is taxed at the corporate level and again when the sales proceeds are distributed to shareholders.

Caution: Buyers prefer purchasing assets, because any excess paid is considered goodwill and can be amortized. By contrast, the premium paid for shares over the value of the assets is not deductible.

Loophole: Keep the corporate entity intact in the form of a personal holding company when you must sell corporate assets rather than stock.

Reason: Setting up a personal holding company for the proceeds of the sale of the company lets you avoid immediate double taxation. The tax is deferred until the time when the personal holding company is liquidated.

Even better: When a seller still owns a personal holding company at death, no capital gains tax is owed on the liquidation of the corporation.

Loophole: Elect S-corporation status before selling the business to eliminate double taxation of the proceeds. Income from S corporations flows through and is taxed on the individual shareholder's tax returns.

Caution: Businesses that convert from C corporations to S corporations must value the business' assets on the date of the conversion. When assets are sold within ten years, profits are realized to the extent of any built-in gains as of that date. Taxes are figured as if the company was still a C corporation—the company pays its own capital gains tax on the built-in gains and distributes the after-tax balance to corporate shareholders in the form of a dividend.

Loophole: Carefully characterize payments you will receive to offer advice to your business's new owners. Specifically, former business owners who will be paid to stay on a little bit following the sale should have those payments characterized as "covenants not to compete" in the sales contract.

Reason: When such payments are characterized as compensation—for example, consulting fees—the payments will be subject to Social Security and Medicare tax of 15.3 percent. However, payments for covenants not to compete are exempt from those taxes.

(*continued*)

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EXHIBIT 21-3 Sample Handout for Buying and Selling a Business Services— Reprint Article on Selling a Business* (*cont'd*)

Loophole: Factor in tax benefits to the buyer when you calculate your sale price. Buyers want to structure acquisitions to gain as many tax write-offs as quickly as possible. Figure in these tax breaks when you value your business...

- Goodwill, covenants not to compete, trade names and trademarks, copyrights and contract acquisitions are amortized over 15 years for tax purposes.
- Equipment and software can be depreciated and amortized according to IRS guidelines, generally, over three to seven years.

Loophole: Value your business based on "earnouts," so it qualifies as a capital gain and not "compensation" income.

How it works: Earnouts make sense when the price of a rapidly growing business is based on future increases in profitability. They call for additional payments, typically over three years after the sale of the business, when certain targets are met. Targets are usually based on profits, but they can also be based on such things as sales or new client growth or key employee retention.

Loophole: Structure the sale of your business as an installment sale. When the business is sold for cash, the seller pays tax on the gain in the year of the sale. With installment sales, the tax is not due until each installment payment is received over time.

Loophole: Allocate a small part of the purchase price to equipment where "depreciation recapture" is an issue. Certain items are taxed in the year of sale even when payments are deferred in an installment sale. The major item is depreciation recapture; this means you must include in taxable income all or part of the amount of depreciation deducted on an asset.

Example: Equipment that costs $400,000 has a book value of $100,000. When you sell the equipment for $300,000, the $200,000 gain is attributable entirely to depreciation recapture. A special tax rule says that the gain attributed to depreciation recapture is fully taxable in the year of sale.

What to do: Reduce the tax by allocating as little as possible of the business' purchase price to depreciated assets.

Loophole: Keep the accounts receivable when you sell the business to reduce taxes in the year of sale.

How it works: When a buyer acquires the accounts receivable of a cash-basis business, the entire amount of the accounts receivable is taxed as income to the seller in the year the business is sold...even if the sale is structured as an installment sale. When the seller keeps the accounts receivable rather than transferring them to the buyer, taxes are due only as the money in the accounts is collected.

Loophole: Defer tax by selling company stock to an employee stock ownership plan (ESOP). When business owners sell at least 30 percent of their company's stock to an ESOP, the proceeds are not currently taxable as long as they are invested in common stock of U.S. corporations. The tax is deferred until the replacement shares are sold. Structure the sale so the third party buyer acquires their shares from the ESOP.

Loophole: Sell a cash-rich company in two stages to minimize taxes.

How it works: The current stockholders redeem a portion of their stock immediately before or simultaneously with the sale of the company to the buyer. This way, the cash is stripped from the company and received immediately by the seller. All proceeds received in this manner are taxed to the seller at favorable capital gains rates.

CHAPTER 22

STARTING A BUSINESS

Many clients start small businesses and some grow into big businesses. Anyone starting a business needs assistance at the beginning from an accountant on choosing an entity, determining the initial capitalization, getting an identification number, and setting up the books.

Services also related in this area are buying a franchise, entering into a partnership, and structuring investments. All proposed transactions by clients should be reviewed by a CPA for the tax consequences of such activities.

WHO NEEDS THIS SERVICE

This service is for every client considering starting a business.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

We are the best qualified to offer these services, and can do a fine service helping the client get started.

INTRODUCING THE CLIENT TO THE SERVICE

You must constantly let your clients know that you do new business analysis and consulting.

We publish a biannual *New Business Kit—NJ edition*; we are up to our 6th edition. We give it to clients considering starting or buying a business.

We also have a list of questions to generate discussions.

1. Have you considered what legal entity you should choose?
2. Do you know how to register with the tax authorities?

3. Do you know how to set up proper accounting and bookkeeping procedures?
4. Do you know which of the different payroll taxes your business will incur?
5. Do you know how to choose your year end?
6. Do you know how to pay your income taxes?
7. Have you thought about how you'll obtain credit and financing for your business?
8. Are you aware of the different required and optional insurance policies available to you?

The fact sheet with answers to these questions is included in Exhibit 22-1, "Sample Fact Sheet for Starting a Business Services."

Always offer to do a C corporation versus S corporation analysis, and you should also be able to compare an S corporation with a partnership and limited liability company.

Advising a client when they are making an investment on the tax ramifications as well as whether the investment meets with their financial goals takes care, knowledge of the financial markets, and sensitivity of the client's risk tolerance. Unless these attributes are present, the tax preparer will never bridge the gap to financial adviser or confidant to the client.

FINALIZING THE ENGAGEMENT

We charge for initial consultations—we don't like to give this information away for free. There is definite value to the client and we deserve to be compensated for it.

Included are two sample engagement letters for clients starting a business. The first sample is shown in Exhibit 22-2, "Sample Engagement Letter for Starting a Business—Initial and Ongoing Services Engagement." The second sample, shown in Exhibit 22-3, "Sample Engagement Letter for Starting a Business—Preparing a Business Plan Engagement," covers prospective financial statements and a business plan.

EXHIBIT 22-1 **Sample Fact Sheet for Starting a Business Services**

SETTING UP A NEW BUSINESS

1. Selecting a Legal Entity

One of the first major decisions you will have to make as you start a new business is the form of legal entity it will take. There are three basic forms of business organizations, each with its own benefits and drawbacks. Each is treated differently for legal and tax purposes. The first form, a sole proprietorship, is typically a business owned and operated by one individual, or very often by a husband and wife. The second form, a partnership, can take two legal forms, general or limited. In a general partnership, two or more individuals join together to run the enterprise. A limited partnership is composed of one or more general partners who are personally liable for partnership debts and one or more limited partners who contribute capital and share in the profits and losses of the business. The third form of business organization is a corporation, a separate legal entity that exists under the authority granted by state law. There are also newly created entities for licensed professionals, limited liability companies (LLCs), and limited liability partnerships (LLPs). These permit a business to operate with much of the legal protection of corporations but to have the tax attributes of partnerships.

2. Registering With Tax Authorities

A significant task for the new business owner is assuring that the business is properly complying with the extensive tax and information filing requirements imposed by various governmental agencies. Stiff penalties are commonly assessed if the required forms and returns are not properly prepared and timely filed. All tax forms filed with the IRS require the use of a federal employer identification number (EIN). You might also be required to obtain a business license.

3. Accounting and Bookkeeping

Most operators of a new and growing business have a flair for the environment in which the business operates. They may be a great salesperson, an outstanding mechanic, carpenter, lawyer, or inventor. Unfortunately, most people do not like to keep the books. The necessity for good, well-organized financial records cannot be overemphasized. Questions you should ask in developing an accounting and financial reporting system are: Who will be the users of the financial information? What questions do I need answered to manage the business? What questions should be answered for government or regulatory taxing authorities? As your business grows, you should work closely with your accountant to ensure that your accounting system is providing you with appropriate information.

4. Payroll Taxes

Irrespective of the form of business in which you operate, if you are going to have employees then you will have to contend with payroll taxes. IRS Circular E, Publication 15, "Employer's Tax Guide," covers the payroll tax reporting and deposit requirements and can be obtained through the local office of the IRS.

5. Selecting a Year End

If the new business is a sole proprietorship, a partnership, an S corporation, or personal service corporation, the company will usually be required to use a calendar year end. Regular corporations are free to select a fiscal year end using a month other than December. The election of a year end is made on the first tax return of the corporation.

(*continued*)

6. Income Taxes

Eventually you will have to deal with income taxes. The income tax laws are extensive and can be confusing for an individual starting a business. Each type of legal entity is required to file a different type of income tax form. Corporations must file Federal Form 1120; partnerships, LLCs, and LLPs must file Federal Form 1065; S corporations must file Federal Form 1120S; and sole proprietors must file Federal Form 1040 and fill out Schedule C.

7. Obtaining Credit and Financing for Your Business

If you are not independently wealthy—and perhaps even if you are—eventually you will probably need to obtain some outside capital for your business. In some instances, you may need to obtain capital for the initial expenses prior to opening your business or, for instance, the funds you require may be for expansion or working capital during the off season. Generally, business financing can take two forms, debt or equity. Debt means borrowing money. The loans may come from family, friends, banks, other financial institutions, or professional investors. Equity relates to selling an ownership interest in your business. Such a sale can be the admitting of a partner, or, if you are in a corporation, issuing of additional common stock, options, or warrants to investors.

8. Required and Optional Insurance Policies

Business insurance, like many types of expenditures, is one of those items which business owners typically do not like to pay. Sufficient insurance can be as critical to the success of your business as a good product or service. Without proper insurance, you could lose all of the money, time, and effort you put into your company. Very little insurance coverage is mandatory. Workers' compensation is the only insurance coverage typically required by law. You might want to consider business interruption coverage, employee fidelity bond coverage, or umbrella coverage. Other optional policies include life insurance, disability insurance, and disability buyout insurance.

EXHIBIT 22-2 **Sample Engagement Letter for Starting a Business— Initial and Ongoing Services Engagement**

Date

Owner's Name
Working Company
Street Address
City, State, and Zip Code

Dear John:

It was a pleasure meeting with you earlier today. We are pleased to provide you with this proposal of services that we will provide for Working Company.

Accounting Services

We will prepare the quarterly payroll tax returns, as required, for the years 20X2 and 20X3.

We will prepare the W-2 forms and year-end reports for the years 20X2 and 20X3, as required.

We will represent Working Company with the tax agencies regarding resolving payroll tax notices for the company and related entities that filed payroll forms in error.

We will also prepare the application for the employer identification number for John Doe T/A Working Company.

We will provide accounting and tax consulting regarding the choice of entity, if necessary.

Fee

The fee for the accounting services will be billed as incurred according to our standard billing rates, which range from $xx per hour to $xxx per hour for staff accountants and $xxx per hour for partners. The work will be completed by our personnel at the appropriate level for the task being performed (for example, staff-level individuals will prepare payroll tax forms and partners will be involved with consulting and decision making). In order to begin, we will require a retainer payment in the amount of $x,xxx. Bills will be submitted to you periodically. The retainer will be applied against the final billing for this engagement.

Fees are payable as billed. There will be an additional charge of 1.5 percent per month for past due amounts. Additionally, we will bill you for out-of-pocket disbursements, if any. Also, should you hire any of our personnel it is acknowledged that we would be entitled to a $xx,xxx "search" fee.

Unanticipated Services

Furthermore, the parties agree that if an unanticipated need arises (such as, but not limited to, an audit by a taxing agency, or any other exogenous service not anticipated in this agreement by the parties), we will be pleased to discuss our fee arrangements for these assignments with you.

Privacy Policy

Attached is our privacy policy as required by the Federal Trade Commission.

Conclusion

Thank you for this opportunity to be of service to you. If the foregoing fairly sets forth your understanding, please sign the enclosed copy of this letter and return it to us, with the retainer.

Sincerely,

EXHIBIT 22-3 Sample Engagement Letter for Starting a Business—Preparing a Business Plan Engagement

Date

Name
Company
Street Address
City, State, and Zip Code

Dear George:

It was a pleasure meeting you this morning. This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

Forecasting Services

We will compile, in accordance with attestation standards established by the American Institute of Certified Public Accountants, from information management provides, the forecasted balance sheet and related statements of income, retained earnings, cash flows, and summaries of significant assumptions and accounting policies of the Company, Inc. for a full five-year period. We will not express any form of assurance on the achievability of the forecast or reasonableness of the underlying assumptions.

A compilation of a financial forecast involves assembling the forecast based on management's assumptions and performing certain other procedures with respect to the forecast without evaluating the support for, or expressing an opinion or any form of assurance on, the assumptions underlying it.

If for any reason we are unable to complete our compilation of your financial forecast, we will not submit the forecast or issue a report on it as a result of this engagement.

A financial forecast presents, to the best of management's knowledge and belief, the Company's expected financial position, results of operations, and cash flows for the forecast period. It is based on management's assumptions, reflecting conditions it expects to exist and the course of action it expects to take during the forecast period.

Management is responsible for representation about its plan and expectations and for disclosure of significant information that might affect the ultimate realization of the forecasted results.

There will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. Our report will contain a statement to that effect.

We have no responsibility to update our report for events and circumstances occurring after the date of our report.

At the conclusion of the engagement, management agrees to supply us with a representation letter, which, among other things, will confirm management's responsibility for the underlying assumptions and the appropriateness of the financial forecast and its presentation.

In order for us to complete the engagement, management must provide assumptions that are appropriate for the forecast. If the assumptions provided are inappropriate and have not been revised to our satisfaction, we will be unable to complete the engagement, and, accordingly, we will not submit the forecast or issue a report on it.

If management intends to reproduce and publish the forecast and our report thereon, they must be reproduced in their entirety, and both the first and subsequent corrected drafts of the document containing the forecast and any accompanying material must be submitted to us for approval.

The scope of this service does not include preparation of financial statements or any kind of work on existing transactions. It is strictly limited to forecasting services.

Business Plan Services

We will prepare a business plan for you that encompasses the needs and goals of the Company, Inc.

Based on discussions with you and a review of the information provided to us, we will prepare a business plan that will set forth the purpose of the business, the financial needs of the business as determined by the prospective financial statements, background information on key personnel involved in the formation and operations of the company, funding requirements both initially and on a recurring basis, indications of possible exit strategies, market information, marketing methods, the company concept and objectives, capital structure of the company, and the characteristics that distinguish this company from others that might be in the same business.

Fees

Our fee for the compilation of the forecast will be $xx,xxx.

Our fee for the business plan will be $x,xxx.

We will require a $x,xxx retainer upon acceptance of this engagement. Payments of $x,xxx will be due two weeks after acceptance of this engagement and two weeks after that. The final payment of $x,xxx will be due upon delivery of our final report or 30 days after the delivery of a completed draft, if sooner.

Reimbursement for the out-of-pocket expenses will be due upon presenting the bill. In the event you hire any of our personnel it is acknowledged that we would be entitled to a $xx,xxx "search fee." Additionally, bills that are more than 30 days past due will be subject to a 1 1/2 percent per month late charge.

Conclusion

We appreciate the opportunity to be of service to you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign a copy to confirm your understanding, and return it to us.

Sincerely,

CHAPTER 23

BUSINESS VALUATIONS

Business valuation is performing appraisals of businesses for many uses and reasons.

WHO NEEDS THIS SERVICE

This service is for anyone engaged in litigation where the value of a business is an issue, such as partnership and marital dissolutions. Also, there are many instances where there are tax-motivated transactions, particularly in the gift and estate tax arena.

Annual valuations can also be prepared for the personal knowledge of a business' owners serving as a measure of the growth of the business, and perhaps to be used as a guide to uncover hidden or underutilized value triggers.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

In order to perform credible valuations the CPA needs an accreditation from a reliable source. This would entail demonstration of the ability to perform these services and involves extensive continuing education.

Many, if not most, nonlitigious business valuation assignments are tax motivated. Most of the CPAs we know who specialize in business valuations were originally tax people.

INTRODUCING THE CLIENT TO THE SERVICE

After you receive your accreditation, the service should be promoted to all your clients.

Present wealthy clients should be told about the benefits of making lifetime gifts of discounted assets. This can further lead to estate and succession planning engagements. Exhibit 23-1, “Sample Handout for Business Valuation Service,” is a brief discussion of valuation discounts. This is discussed and illustrated with clients who are considering making gifts to reduce eventual estate taxes.

FINALIZING THE ENGAGEMENT

We try to quote fixed fees for the engagement. Experience usually enables you to come up with pretty reliable fees. A sample engagement letter is included in Exhibit 23-2, “Sample Engagement Letter for Business Valuation Engagement.”

EXHIBIT 23-1 Sample Handout for Business Valuation Service

BUSINESS VALUATION DISCOUNTS

Valuation discounts or adjustments are an important part of the valuation process. If only part of the business is being sold or transferred there might be a discount to the pro rata value for a minority interest, the reasoning being that the person with the minority interest has less say, and less, or no, control, of the affairs of the business. A minority partner or shareholder also has little or no say in whether dividends are declared or cash flow is distributed, or whether the company can be sold or liquidated. Minority interest discounts could range up to 40 percent depending on the type of business, number of stockholders, and a myriad of factors that could limit the control of the minority stockholder.

Another discount that might be appropriate is for the lack of marketability of the stock or partnership interest. Lack of marketability adjustments reflects the reality that stock in a closely held business is not portable or easy to sell. These discounts could be around 25 percent depending on circumstances. This discount could be in addition to the minority interest discount.

Following is a model to illustrate how these adjustments work. Note that the percents are only for illustrative purposes and do not reflect an opinion of what the discounts should be, or usually are.

	Discount	***$***
Value of assets before fragmentation in minority interests		$10,000,000
Discount for minority interest	25.0%	2,500,000
Marketable minority value		7,500,000
Discount for lack of marketability	30.0%	2,250,000
Minority, nonmarketable value		5,250,000
Cumulative percent	47.5%	

EXHIBIT 23-2 Sample Engagement Letter for Business Valuation Engagement

Date

Mr. James Franklin
Liberty Inc.
Street Address
City, State, and Zip Code

Dear Mr. Franklin,

This letter outlines our proposal to prepare valuation services for Liberty Inc.

Business Valuation Services

We will perform a valuation of Liberty Inc. as of December 31, 200X.

The objective of our valuation will be to estimate the fair market value of a 100 percent common equity interest in Liberty Inc. The term *fair market value* is defined as follows:

> The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property.

Although our valuation is intended to estimate fair market value, we assume no responsibility for a seller's or buyer's inability to obtain a purchase contract at that price.

In performing our valuation, we will be relying on the accuracy and reliability of the historical financial statements, copies of tax returns, and other financial data of the company. We will not audit, compile, or review the financial statements, forecasts, or other data, and we will not express an opinion or any form of assurance on them. At the conclusion of the engagement we will ask you to sign a representation letter on the accuracy and reliability of the financial information used in the engagement. Our engagement cannot be relied on to disclose errors, fraud, or other illegal acts that may exist.

Our valuation will be subject to the following assumptions and limiting conditions, which will be included as an appendix to our valuation report:

- Information, estimates, and opinions contained in this report are obtained from sources considered to be reliable. However, we assume no liability for such sources.
- Liberty Inc. and its representatives warrant to us that the information they supply is complete and accurate to the best of their knowledge and that the financial statement information reflects the company's results of operations and financial condition in accordance with generally accepted accounting principles, unless otherwise noted. Information supplied by management will be accepted as correct without further verification, and we express no opinion on that information.

Possession of this report, or a copy thereof, does not carry with it the right of publication of all or part of it, nor may it be used for any purpose by anyone but the client without the previous written consent of the client or us and, in any event, only with proper attribution.

We are not required to give testimony in court, or be in attendance during any hearings or depositions, with reference to the company being valued, unless previous arrangements have been made.

The various estimates of value that will be presented in this report apply to this valuation only and may not be used out of the context presented herein. This valuation is valid only for the purpose or purposes specified herein. This report is valid only for the effective date specified herein.

This valuation will contemplate facts and conditions existing as of the valuation date. Events and conditions occurring after that date will not be considered, and we have no obligation to update our report for such events and conditions.

We assume that there is full compliance with all applicable federal, state, and local regulations and laws unless otherwise specified in this report.

This report will be prepared under the direction of Edward Mendlowitz, CPA, ABV. Neither the professionals who will work on this engagement nor the partners of Mendlowitz Weitsen, LLP have any present or contemplated future interest in Liberty Inc., or any personal interest with respect to the parties involved, or any other interest that might prevent us from performing an unbiased valuation. Our compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.

At our sole discretion, we may include additional assumptions and limiting conditions in our report as a result of performing the valuation.

We will document the results of the engagement in a formal report. We understand that the distribution of the valuation report is restricted to the management of Liberty Inc. and, accordingly, will not be distributed to outside parties to obtain credit or for any other purposes. If for any reason we are unable to complete the valuation engagement, we will not issue a report as a result of the engagement. We have no responsibility to update our valuation report for events and circumstances that occur after the date of its issuance.

Fees

We estimate that our fee for these services will be $x,xxx. We will require a retainer of $x,xxx with the balance of $x,xxx payable when we submit a draft of the report. If we encounter unusual circumstances that would require us to expand the scope of the engagement, we will discuss this with you before doing the additional work. Our valuation report will state that our fee is not contingent on the value determined by this engagement.

The fee estimate is for the valuation and valuation report, and does not include any services that may be required defending our valuation report in litigation, including conferences, depositions, court appearances, and testimony. Fees for such services, if required, will be billed at our then standard hourly rates.

Should our presence be required at court hearings or depositions, our fee shall be billed in half-day increments. Our firm's current billing rate for such services is $xxx per hour.

Fees are payable as billed. There will be an additional charge of 1.5 percent per month for past due amounts. Additionally, we will bill you for out-of-pocket disbursements, if any.

Conclusion

We sincerely appreciate this opportunity to be of service to you. If you agree with the foregoing terms, please sign the copy of this letter in the space provided and return the letter to us.

Sincerely,

CHAPTER 24

SUCCESSION PLANNING

Clients who own businesses should have a plan of succession. One plan should be for when and how they will retire, and another for if they should die while they are in full control of the business. Things happen and will happen and can be devastating to the family—financially and mentally.

Helping a client develop a succession plan can be a valuable good deed for the family as well as providing a great feeling of comfort for the business owner.

Advising on how to transfer stock to successors or the next generation always represents additional services. We've identified over 25 ways, in terms of taxes, that the transfer can be done. Once we explain two or three methods to the client it becomes evident that we have to get seriously involved. If they want to have a sound succession plan, it is also clear that it should be done taking advantage of the best tax laws, and be as uncomplicated as possible.

Additionally, advising in succession planning also includes:

- Lifetime financial planning for the main owner
- Identifying succession candidates and qualifying them
- Valuing the business
- Estate taxes
- Structuring the transfer
- Discussing problems within the family
- How the succession planning process works, how it is done, and the timing of it

The range of these services is also widespread, and encompasses the highest levels of our skills.

WHO NEEDS THIS SERVICE

When tax clients own their own businesses we generally are also the accountants for the business. The ones who are minor or minority owners are usually the younger members of the business. This then becomes a service that helps them after the senior owners retire, or plan for their retirement.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

Of all outside professionals the CPA is usually the most informed about the business and family dynamics. Additionally, the CPA has access to the financial data of the business and the primary owner-operators. The techniques used employ skills the CPA best has—such as income and estate tax planning, financial projection, and budgeting skills, and cash flow management. The CPA also enjoys a high degree of independence, which brings an element of trust and objectivity to the process, especially in getting the parties to sit down together to discuss the ramifications of different courses of action.

INTRODUCING THE CLIENT TO THE SERVICE

We contact clients who we feel need succession planning services by phone, discuss the situation with them, and suggest a meeting. Probing questions we use are listed below.

1. Have you considered shifting company shares and income to family members with a qualified Subchapter S trust?
2. Have you considered reducing eventual estate taxes by giving shares of an S corporation to a defective grantor trust?
3. Have you considered using stock options, either nonqualified options or incentive stock options, to transfer company shares?
4. Do you know you could transfer stock to family members with a preferred stock recapitalization?
5. Have you ever considered combining a business transfer with a stock redemption so you could capture personally the cash in the business?
6. Do you know you could issue phantom stock to employees?
7. Do you know there are different ways to make an installment sale of business stock?
8. Are you aware you could transfer stock to the successor or employee tax-cost-free by also giving cash as additional compensation?

The fact sheet with responses to these questions is included in Exhibit 24-1, "Sample Fact Sheet for Succession Planning Service." We follow up that call with an introductory letter, which is included in Exhibit 24-2, "Sample Introductory Letter for Succession Planning Service." Succession planning suggestions that pique their interest can get you a meeting with the main owner. If there is no succession plan in place, this is a grand opportunity to get involved in the business and perhaps get a special engagement to develop the plan. This could lead to becoming the accountants for the business.

When you get the tax information, inquire about the business, ask how things are going, and offer to meet with the primary owners for a free consultation to determine if a succession plan is in order. We never charge for those initial meetings unless the client asks if we do that type of work, and then we tell them about our initial consultation fee.

FINALIZING THE ENGAGEMENT

Like any other service we perform, fees have to be set. The methods of billing are by the hour, by the project, or based on the value of the service. Also, the best time to set fees and collect them is before the service is performed. Succession planning is a highly skilled service needing the senior level associates and partners. Because of this it is not subject to the greater leverage less skilled services permit. Charging by the hour, at top rates, in no way reflects the value of the service and benefit to the client. Also, we have found that it inhibits a free flow of ideas because every telephone call has a dollar sign attached to it. Succession planning, like other high-level services, needs a lot of questioning, and sessions where the clients express what's on their mind, what insecurities and concerns they have, and what they really would like to do. Frequent meetings also facilitate the process and move it along.

We undertake these engagements with fixed fees for certain measured (based upon our experience) multiple stages of the process. We specifically exclude items that may not be present in every engagement such as a detailed outline of a transfer to a family limited partnership followed by a sale to an intentionally defective grantor trust. We will work out the numbers and show how the cash flow works, and many attorneys will know what to do if that plan is decided upon. However, putting it in a memo with all the i's dotted and t's crossed will take us some time and require some research to make sure we describe it properly and fully. That is extra and is discussed at the time that it will have to be done.

Occasionally, succession planning engagements take unexpected turns such as ending up with an uncomplicated buy-sell agreement funded with life insurance. That is why we recommend starting the engagement with an exploratory period with a fixed fee for that, to be followed by additional fixed fee assignments based on the needs uncovered.

A sample engagement letter is included in Exhibit 24-3, "Sample Engagement Letter for Succession Planning Engagement."

EXHIBIT 24-1 Sample Fact Sheet for Succession Planning Service

SUCCESSION PLANNING

1. Shifting Company Shares and Income

You should consider shifting company shares and income to family members with a qualified Subchapter S trust (QSST). QSSTs can own stock in S corporations. You, the owner, can transfer nonvoting S corporation stock to a QSST while retaining voting stock and control of the company. The QSST also shifts income from the shares to lower-bracket family members. Note that QSSTs can only have one income beneficiary at a time, so multiple trusts may be necessary.

2. Reducing Estate Taxes

You can reduce estate taxes by giving shares of an S corporation to a defective grantor trust. What you do is establish an intentionally defective trust (under Tax Code Sections 671-679) to hold shares of the S corporation. For income tax purposes, the person who sets up the trust—the grantor—is considered the owner of the company stock held in trust. The company's income is taxed with the grantor's other income on his or her individual tax return. Using a trust takes the stock out of the grantor's taxable estate and provides income to the trust beneficiaries. The grantor pays tax on the trust income, creating a tax-free gift from the grantor to the trust beneficiaries.

3. Stock Options

You could use stock options, either nonqualified options or incentive stock options, to transfer company shares. Generally options are not taxed when issued. Nonqualified options are taxed when exercised to the extent that the value upon exercise exceeds the option price. ISOs are not taxed until the stock is sold. However, the difference in value over the option price at the time of the exercise is subject to the AMT. The successor gets all the upside growth potential in company shares with no current cost and no current tax. The seller gets today's value, but is paid in the future.

4. Recapitalization

You should consider transferring stock to family members with a preferred stock recapitalization. The owner transfers some common stock to his or her successor/children and has the balance exchanged for newly issued preferred stock with a face value equivalent to the fair market value of the balance of the stock. The recapitalization creates no gift or income taxes when the following conditions are met: The preferred stock is entitled to a cumulative market rate dividend—a dividend that is not paid when due, but accumulates and is eventually paid. The shares must be valued at the fair market value. The value assigned to the common stock must be at least 10 percent of the total value of the corporation.

5. Transfer and Redeem

You should transfer before redeeming shares. The designated successors acquire a small number of shares valued at a minority shareholder's discounted price. After the shares are transferred in an unrelated transaction, the majority shareholder/owner redeems all the outstanding shares. The purchase price must equal the shares' fair market value. If the redemption meets the requirements of Code Section 302, the gain will be taxed as capital gain to the seller.

6. Phantom Stock

You should consider transferring phantom stock to employees. This has the same effect as if stock or options were issued, except that real shares do not change hands until corresponding shares of stock are assigned to certain employees. The employees get the same benefits they would get if those "phantom" shares were actual shares. The major difference from a tax point of view is that income taxes are not paid until cash changes hands.

7. Selling Business Stock in Installments

You should consider installment sales of business stock. This will result in a capital gains tax paid by the seller. If a related party sells such stock within two years, there will be an acceleration of the tax on the gain attributable to the unpaid portion of the installment notes to the extent the related party received proceeds on the sale. To make a self-canceling installment note effective, offset the value of the self-cancellation feature with a higher payment amount. Also, the term of the note must not exceed the life expectancy of the seller.

8. Additional Compensation

You could transfer stock to the successor/employee, but give cash as additional compensation. The cash will neutralize the extra cost of the transfer to the successor. The corporation gets a deduction for the full value of the stock (because something with fair market value was given away) and the cash. This should save the corporation enough taxes to cover the cash outlay.

EXHIBIT 24-2 Sample Introductory Letter for Succession Planning Service

Date

Name
Company Name
Street Address
City, State, and Zip Code

Dear ___________:

This letter is to initiate discussions between us regarding a succession plan for you and your business. The discussion will center on trying to formulate a direction for the company in the future and what your roll in it will be. The succession plan can perhaps more appropriately be called a life plan. Eventually you will end up with a new will and perhaps shareholders agreements and trusts.

Nothing in this letter at this time should be taken as definitive; rather its purpose is to prod you into thinking about your future and that of your business and your family. At the appropriate time, specific recommendations will be made and a plan will be set up with certain established procedures.

In order to start we must establish certain assumptions or parameters with which we will be working. The way we see it, you have a number of choices:

1. You will live forever and continue doing whatever you are doing now forever.
2. You will die tomorrow.
3. You will work 10 more years and then retire.

None of these alternatives is certain. Even if you pick a plan, things can happen that could thwart it. What must be done is to establish some semblance of a plan so that it can serve as a road map to take you where you want to go. If you change your mind during the way, or see forks in the road, they can be dealt with at that time.

We should look to see if there are any situations that we can eliminate. Two come to mind as candidates for elimination. I think it is clear that you will not live forever, nor might you want to continue doing what you are doing for as long as you live. If this is not the case then let's recognize it and go forward on that basis.

Another situation that can be eliminated is you dying tomorrow. There is no guarantee that you won't, but on the other hand it can be provided for quite easily. Life insurance is a great equalizer. What we have to do is determine how much money your family should have so that they are not dependent on the value that will be received from the business. Once that is determined you can insure against it; in effect that alternative is completely eliminated.

With respect to any plans you may or may not make, if the living and sustenance for your family will come from the life insurance completely then it is not necessary to dwell on what happens to the company. This appears to be quite an easy thing to do and because of your age it is still possible for you to buy term insurance at relatively low prices. I would suggest without further ado you make arrangements to purchase more insurance—for purposes of discussion we can assume $2,000,000 of life insurance. The total premium for the first year will amount to approximately $12,000 and everybody is provided for.

There are some mechanical things that must be done before you can buy the insurance such as setting up an irrevocable life insurance trust. Instructions on what this is and how it can be done are appended to this letter. I can feel safe in recommending that you go ahead with this immediately. At the same time we can discuss the pros and cons if you wish. If you decide that it is not necessary, we can stop at any point prior to you actually writing out the check for the life insurance. However, if you decide that it is important and necessary to have then you will have it in the works and will not have wasted or lost any more time.

Now that we have eliminated our first two alternatives we have the third one, which leads to quite a few more questions. For instance, will you work for 10 years and then sell or liquidate the business; or do you want to turn it over to the children within a reasonable time (10 years can be defined as that reasonable interval); or do you want to bring someone else in to help run it? We would have plenty of time to formulate a plan and set in the works any implementation of that plan.

Along the lines of trying to narrow down our choices let's consider sale and liquidation at the end of 10 years. Why does it have to be 10 years—why not sooner or longer? Is 10 years considered to be an adequate amount of time for you to evaluate whether your children can continue to run the business, and if so to get them up to snuff or decide to sell if they couldn't handle it? If you think it is the proper time to start bringing your children into the "fold" then maybe you should treat your children effective immediately as if they were going to take over and run this company. It also gives adequate time for you to determine if they could run the company and, if it is necessary, to bring someone else in to help them.

If your plan is that the children will take over the company then you should decide which one will have the controlling interest over the other. Also we would have to work out how they would acquire ownership in the company and a compensation pattern. At this point it might be a little premature but there has to be an ultimate goal that you have to work towards so that things can flow smoothly without crisis or emotions dictating how things are to be done.

We would like you to consider this letter and then meet with us to discuss your feelings and ideas. Any plan will take time and will need much thought by you. You don't commit yourself to anything by starting a process of exploration into your alternatives. Please call me to arrange for the next (first) step.

Sincerely,

Exhibit 24-3 Sample Engagement Letter for Succession Planning Engagement

Date

Names of Couple
Company Name
Street Address
City, State, and Zip Code

Dear John and Jane,

This letter sets forth a proposal of the terms and objectives of our being engaged by you to provide financial, tax, planning, conceptualization, and general consulting services.

Scope and Nature of Services

The scope and nature of the services to be provided are not clearly defined, but will include all consulting services, discussions, and exploratory work on any of the items we discussed at our meetings, and that was included in the meeting agenda, and any other issues you wish to raise. It will not include any detailed written memos, letters, or analyses that are intended for third parties.

Some of the items we will cover are as follows:

- What your financial arrangements are with your children, what they should be, and how they should be administered
- The types of documentation, ground rules, and oversight that should be established
- Whether your children have wills, and what should be in them regarding you and your businesses
- A clear articulation of your broad goals and objectives, understanding that these will continuously change based on your many activities
- Any other such issues that might arise during our discussions

We will discuss your individual financial statement, your significant assets, an overview of each company you are involved in, and cash flow from each activity. We will also review all agreements you have with each person running the businesses.

We will review your buy-sell and shareholders' agreements for all your business interests, and discuss what should be in such agreements should there not be any.

We will review your life insurance policies, their ownership, and payment arrangements for them.

We will prepare or review your detailed income tax projection for the current year, and discuss it with you. We will particularly review the status of any tax losses and credit carry forwards, and help you in planning for their utilization.

We will review both of your wills, trusts, and estate plans. We will make suggestions of things that should be considered or followed through on. We will also review all designation of beneficiary forms for your retirement accounts and coordinate them with your estate plans.

We will discuss the advisability, benefit, and cost, if any, of rolling over your IRAs into Roth IRAs.

We will meet with you, your attorney or other advisers, and your staff as necessary to accomplish what is necessary for us to effectively and appropriately advise you.

Included will be responses to all enquires by you or your staff whether in person, by telephone, or e-mail, and will include the preparation of any necessary memos and calculations to explain the answers or issues internally, as long as extensive research does not have to be performed (defined as questions or issues that will take more than two hours to research). If we come across such issues we will tell you in advance of performing the service what our fee will be for the completion of that issue. Our services described in this letter will not include anything of any sort that will be given to anyone other than your immediate staff. Attendance at meetings of up to two hours per issue with your other advisers is included.

We will use our full efforts and resources to obtain an overall familiarity and thorough understanding of your complete financial affairs.

Continuing Services

This engagement is not for continuing services and will terminate at the conclusion of the stated period. If you wish us to continue, we will discuss the nature and scope of the services to be provided and the fee arrangement.

Fees

The services will take place over the next three months. Our fee will be fixed at $xx,xxx, payable $x,xxx upon acceptance, and $x,xxx each at the beginning of the next two months. We will bill you for out-of-town travel disbursements, if any. We do not bill for telephone, delivery, or copying charges, unless they are extraordinary in nature. We will inform you in advance of any such charges.

Guarantee: If you are not satisfied in any manner with our service, you do not have to pay the final $x,xxx payment and our relationship will be terminated.

We will also be entitled to a “search” fee of $xx,xxx for any of our staff people that you hire or engage to perform services for you.

Limitation on Scope of Services

These services are not designed, and should not be relied upon, as a substitute for your own business judgment nor are they meant to mitigate the necessity of an ongoing review. These are not investment advisory services. These services are designed to supplement your own planning and analysis and aid you in fulfilling your financial, business, and estate planning objectives. In addition, these services are not designed to discover fraud, irregularities, or misrepresentations made in materials provided to us.

The services described in this letter do not include other services that may also be provided by us, upon your request, including but not limited to:

- Tax (income, trust and gift returns) preparation, compliance, and planning
- Accounting and auditing services
- Appraisals and business valuations
- Any other services not specifically outlined herein

We will bill separately for any such additional services requested by you, and provided by us, based on a predetermined agreed-upon fee.

Right to Terminate

Either party may terminate the relationship at any time, for any reason, within 10 days of written notice to the other party. It is understood that any unpaid services that are outstanding at the date of termination are to be paid in full within 10 days from the date of termination.

Conclusion

If this letter correctly sets forth your understanding of the terms and objectives of the engagement, please so indicate by signing in the space provided below and returning a copy to us.

Cordially,

CHAPTER 25

STRUCTURING PARTNERSHIP AND BUY-SELL AGREEMENTS

This service puts the CPA in the role of a mediator attempting to resolve conflicts and a facilitator to move things along to accomplish stated goals.

WHO NEEDS THIS SERVICE

Many businesses do not have shareholders' or buy-sell agreements. The best time to execute these agreements is when everything is going well, and when either party could anticipate being on either end.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

CPAs have the training, experience, and trust to be effective mediators and facilitators.

INTRODUCING THE CLIENT TO THE SERVICE

Remind every business client they should have effective and reasonable buy-sell agreements that should be reviewed periodically; and that you can offer to assist in any manner. Bringing the clients to the table to discuss the issues and consequences of not doing anything usually results in an added service for the client.

To get them to think about the issues we ask the following questions.

1. Do you know what a buy-sell agreement is?
2. Did you know there are different types of buy-sell agreements, one being a redemption agreement?
3. Are you familiar with the cross-purchase agreement?
4. Do you know what valuation to use to set a purchase price?

5. Do you know the advantages of using a redemption agreement for a C corporation?
6. Are you aware of the disadvantages of using a redemption agreement for a C corporation?
7. Did you know most buy-sell agreements are funded with life insurance?
8. Do you know you should avoid the alternative minimum tax (AMT) trap from funding with life insurance?
9. Did you know installment payment interest is deductible?

The answer sheet in Exhibit 25-1, “Sample Fact Sheet for Structuring Buy-Sell Agreements Service,” is sent a few days later.

FINALIZING THE ENGAGEMENT

We charge individuals and businesses that are not regular clients for initial consultations. Existing business clients usually are not billed for initial exploratory meetings. At the point that it appears they will move forward, we then set a fixed price.

When we charge hourly fees in an adversarial engagement, we have a four-hour minimum for meetings or appearances outside of our office. If preparation work is needed beforehand, and we are able to have a staff associate perform any of it, the billing will be at that lower rate.

EXHIBIT 25-1 Sample Fact Sheet for Structuring Buy-Sell Agreements Service

BUY-SELL AGREEMENTS

1. Buy-Sell Agreements Defined

A buy-sell agreement is a contract that puts limitations on the ability of shareholders of a corporation or partners of a partnership to transfer their ownership interests freely. An owner's interest in the business is sold at a particular price to other owners, to the business entity itself, or to both, when certain events in the stated contract occur.

2. Redemption Agreements

In a redemption agreement, the owner of a business entity and the entity itself enter into a contract. The owner sells his or her ownership interest to the entity according to the price, terms, and circumstances specified in the contract. Such transactions are referred to as redemptions.

3. Cross-Purchase Buy-Sell Agreement

A cross-purchase agreement is a contract between the owners of a corporation, partnership, or limited liability company (LLC). In this agreement, owners offer their ownership interests for sale to other owners at the price and terms decided in the contract. In the event of an owner's death, the estate offers the decedent's ownership interest for sale to the other owners at the agreed-upon price and terms. If there is no third-party buyer, the other owners are obligated to buy the interest. A cross-purchase agreement is basically a right of first refusal combined with a purchase obligation or option.

4. Valuation Methods

In buy-sell agreements, there are four common methods used to value a partial ownership interest. The fixed-price method provides assurance by establishing the purchase price in the agreement. If a fixed price is used, the owners should periodically review the price and restate it if necessary. Under the book value method, the purchase price is based on the entity's book value, determined at the end of the year. This method is simple and inexpensive because the financial data needed is readily available in the regular financial statements of the company. The independent appraisal method involves an independent appraiser establishing the purchase price as of an appropriate date. The final method is a formula method. The formula may be based on income, sales, cash flow, or any other measure agreed upon by all parties. Usually the formula method is a much better estimation of the true value than the other methods.

5. Redemption Agreement Advantages

One of the main advantages of using a redemption agreement is the simplicity of having a single agreement that covers all shareholders. Another huge advantage is the ability to use relatively low corporate rates on the first $50,000 of taxable income to accumulate the necessary funds for a nondeductible stock purchase that is nontaxable to the recipient shareholders. Using compensation to draw funds from the corporation to fulfill a shareholder's cross-purchase obligation is usually subject to higher individual income tax rates and payroll taxes.

(*continued*)

6. Redemption Agreement Disadvantages

A primary disadvantage of using a redemption agreement is the influence on the corporate balance sheet. The redemption transaction causes a large debit to the equity section and can leave the corporation with "negative" stockholder equity. Another disadvantage is the lack of a step-up in tax basis. The redemption does not increase the corporation's tax basis in its assets so no tax benefit is received for the appreciation or premium associated with the redeemed stock.

7. Funding Buy-Sell Agreements With Life Insurance

Most buy-sell agreements are funded with life insurance because of the low cost, the certainty it provides, and its favorable tax treatment. All proceeds are usually income-tax-free. In a redemption agreement, the entity is the owner, and the beneficiary of the insurance policies on the lives of the owners. In cross-purchase agreements, the owners own the life insurance policies on each other.

8. Alternative Minimum Tax (AMT) Trap

The buildup in the cash value of corporate-owned life insurance is included in the adjusted current earnings section used to compute the AMT for a C corporation. Life insurance proceeds are excludable from regular taxable income, but they are still included in the adjustment. If you believe the proceeds will create AMT, you should consider additional insurance to cover the tax or you should consider converting to an S corporation.

9. Deductibility

Installment payment interest is deductible. In a cross-purchase agreement, the investment interest limitation rules may apply. In a redemption agreement, the interest should be fully deductible. If you are a shareholder, it is deductible as investment interest.

CHAPTER 26

CORPORATE MANAGEMENT AND FINANCIAL PLANNING TRAINING

This service is doing what you do with your clients, but doing it in front of 30 people. Setting yourself up as a corporate financial planner means you can make one sale and get 30 (or more) "individual" clients.

WHO NEEDS THIS SERVICE

Many companies provide personal financial planning education and services to employees of all levels. The most senior people get full-range financial and tax services. Lower-level staff might get two-hour courses. The range is these two extremes and everything in between.

WHY THE CPA IS SUITED TO OFFER THIS SERVICE

This is what we do best. All that is needed is some confidence to speak in front of a crowd.

INTRODUCING THE SERVICE TO THE CLIENT

Ask your tax clients to introduce you to the right people at the company where they work. We also have a proposal letter we send introducing our services. Examples of proposal letters are included in Exhibit 26-1, "Sample Proposal Letter for Training Engagement—Example One," and Exhibit 26-2, "Sample Proposal Letter for Training Engagement—Example Two."

FINALIZING THE ENGAGEMENT

We charge fixed fees for everything. Training courses run from a two-hour program to an all-day course.

We quote fixed fees for financial planning for groups of employees regardless of how many in the group use all or part of the services.

EXHIBIT 26-1 Sample Proposal Letter for Training Engagement—Example One

Date

Name
ABC Company
Street Address
City, State, and Zip Code

Dear ___________:

Your employees keep calling us for advice about their stock options.

Many ABC employees have come to our firm seeking guidance about their ABC options because they do not know how to manage them for maximum benefit.

Knowing how much emphasis you put on the satisfaction of your employees, we ask you to consider using us for a financial literacy program so your employees can receive the full benefit from you and the right guidance for their financial needs.

This letter sets forth a summary of the types and objectives of our financial literacy program. We would be pleased to present it at any time convenient to you.

Scope and Nature of Services

Our financial literacy program can teach employees of ABC how to understand the financial information they receive from you and use it for improving their wealth. Our programs will make your personnel financially smarter with a greater awareness and with a more confident and secure feeling.

Our program can be one-on-one or for a group of people, depending on your specifications. We will modify the program based on the needs of your organization. We will give illustrations that can be generic, or organization-specific.

We will tailor the program based upon the size of the audience and their financial experience level. We will revise the program specifically for your organization based on information you submit to us.

Fees

The fee for our financial literacy program will depend on your corporation's needs. There are seven options for you to consider:

1. Program on stock options, including everything one must know about exercising the options and the taxes involved. Two-hour (100 minute) speech program at $x,xxx with a thorough handout.
2. Personal Financial Planning Program for employees that will cover risk and understanding what can be done to reduce it, investing basics and different methods of investing, ways of investing to match stated goals, constructing a portfolio that provides growth consistent with confidence and security, managing debt, and basic tax planning techniques. Two-hour (100 minute) speech program at $x,xxx with a 70+ page handout.
3. All-day financial literacy courses for $x,xxx with a 150-page handbook that includes industry-specific financial statements and information. This program shows nonfinancial employees how to read and analyze a financial statement and other financial data received from companies they invest in or organizations they are involved in, including a description of the six elements of every financial statement; how to follow the cash; the type of information they should be getting; how to relate in dollars to what the company does to make money; an explanation of GAAP and GAAS; and how to detect "off the balance sheet" debt.

(*continued*)

4. All day courses with *company*-specific financial data. Fees start at $xx,xxx, and we will need a minimum of two months preparation time after we receive the requested information. We also may have to visit the premises of the organization. This is an excellent program for board members and senior nonfinancial executives.
5. One-on-one personalized financial planning which may or may not include tax preparation. These fees range from $x,xxx to $x,xxx per person in groups of at least 50.
6. Executive financial planning and tax preparation. This is for top executives and fees start at $x,xxx.
7. How to read the *Wall Street Journal* in only 20 minutes a day. Included will be tips on what every person should read, and what can be skimmed over. The program is designed to enable you to scan through the journal and recognize the pertinent information. This is a three-hour program presented in a classroom format that includes the reading of that day's *Wall Street Journal*. Everyone attending the program will be given a handbook that will also serve as a permanent reference source. This course also serves as a "mini MBA" financial skills introduction. The fee is $x,xxx.

All our fees are fixed and are quoted in advance.

We supply camera-ready copies for the handbook. If you so desire, we can also print them. Travel fees, if necessary, are additional and would be discussed at a later time.

Payment is due 50 percent upon acceptance, and the balance four weeks prior to the program.

Limitation on Scope of Services

We will not perform any services that have not been agreed upon by both parties. Any information requested will not be used for any purpose other than to perform the agreed-upon work. If an unanticipated need arises, we will be pleased to discuss our fee arrangements for these assignments with you.

Our Background

We are a regional CPA firm specializing in the financial planning needs of middle and upper range executives. We DO NOT sell any investment products; DO NOT manage money: DO NOT recommend brokers and other sales people: but DO provide completely independent, unbiased, objective advice and guidance to our clients. Our clients include many ABC people, ranging from CEOs and officers of listed companies, to up-and-comers in many of the Fortune 100 companies. Our partners' backgrounds include teaching for many years on the ABC premises for the Fairleigh Dickinson MBA program; award winning articles in the *Journal of Accountancy*; extensive speaking engagements for groups up to 1500; certification as personal financial specialists; being quoted in almost every major publication and newspaper in the United States; and a consistent track record of steady responsible concerned knowledgeable guidance and advice to our clients.

Conclusion

After you have had a chance to review this proposal, please contact me to discuss your needs further.

Cordially,

EXHIBIT 26-2 Sample Proposal Letter for Training Engagement—Example Two

Date

Name
Widget Enterprises
Street Address
City, State, and Zip Code

Dear Chris,

This letter sets forth a proposal of the terms and objectives of our financial literacy program. We would be pleased to present it for Widget Enterprises at any time convenient to you.

Scope and Nature of Services

Our financial literacy program was developed to teach members of boards of directors of public, private, and nonprofit organizations how to understand the financial information they receive from their organizations. Our financial literacy program can include some or all of the following:

- Showing board members and nonfinancial executives how to read and analyze a financial statement and all financial data received from companies and organizations
- Describing the six elements of every financial statement
- Showing members of your organization how to follow the cash and the type of information they should be getting
- Explaining how to relate dollars to what the company does to make money
- Showing ways the books can be "cooked" and how to spot them
- Explaining GAAP and GAAS
- Explaining "off the balance sheet" debt and showing how to uncover it
- Describing the responsibilities of board members
- Showing how board members do not have to be bored by financial information

Our program can be one-on-one or for a group of people, depending on your specifications. We will modify the program based on the needs of your organization. We can give generic illustrations, or make them organization-specific.

We will tailor the program based upon the size of the audience and their financial experience level. Not every program will include all of the items listed above. We will revise the program specifically for your organization based on information you submit to us.

Fees

Our fee will depend on your organization's needs. There are three options for you to consider:

1. We have a two-hour speech program at $x,xxx with a 70-page handbook that includes industry-specific financial statements and information.
2. We have all-day courses for $x,xxx with a 70-page handbook that includes industry-specific financial statements and information.
3. We have all-day courses with company-specific financial data. Fees start at $xx,xxx, and we need a minimum of two months preparation time after we receive the requested information. We also may have to visit the premises of the organization. Included in this option is a complete Yourport® analysis of the business.

(*continued*)

We will supply camera-ready copies for the handbook. If we are to print it, the cost is $xx per handbook. Travel fees, if necessary, are additional and would be discussed at a later time.

Payment is due 50 percent upon acceptance, and the balance four weeks prior to the program.

Guarantee: If you are not satisfied in any manner with our financial literacy program, your organization is entitled to a 50 percent refund.

Limitation on Scope of Services

The services described in this letter are for a single meeting session or program, and will end at the conclusion of that session, and do not include any other services. Any information requested will be solely to facilitate that meeting, and will not be used for any other purpose.

Conclusion

After you have had a chance to review this proposal, please contact me to discuss needs further.

Cordially,

APPENDIX

INDUSTRY-SPECIFIC TAX AND BUSINESS ADVISORY SERVICES

Almost any industry has special tax and financial characteristics that can be developed into additional service. Here are some of the different industries and professionals you can talk about.

Advertising
Architects
Art galleries
ASI members
Attorneys
Bankers and brokers
Broadcasters
Collectible publishers
Construction contractors
Consultants
Day traders
Designers
Distributors
Dot.com companies
Engineering
Entertainment
Foundations and trusts
Health care and professional practices
Hospitality
Importers and exporters
Insurance agents and brokers

Investment advisers

Mail order

Manufacturers

Physicians and dentists

Printers

Professional service companies

Proprietary stock traders

Public relations

Publishers

Real estate management and holding companies

Restaurants

Retail

Stockbrokers

Warehousing

Almost every tax client can recommend you to a trade or professional association they are members of for you to speak to the group. We do not charge for these speeches, and they are great opportunities to establish expertise in an industry and meet potential clients.

Exhibits A-1 through A-4 are reproductions of some advertisements we prepared for specialized industries. Notice that the ads indicate the range of services the specialty encompasses. Examples include ads for physicians (Exhibit A-1), construction contractors (Exhibit A-2), realtors (Exhibit A-3), and the investment community (Exhibit A-4).

EXHIBIT A-1 Sample Advertisement for Industry-Specific Service—Physicians

Complete Tax and Financial Planning Services to Physicians, Residents, and Surgeons

- Individual tax planning
- Business tax planning
- Entity selection planning
- Negotiating insurance adjustments
- Personal financial planning
- Preparing prospective financial statements and budgets
- Revenue management
- Accounting advice
- Cost sharing arrangements
- Practice management
- Practice valuation
- Setting up accounting systems
- Succession planning
- Updating fee schedules
- Estate planning
- Retirement plans and pension planning
- Profit enhancement
- Risk management and insurance
- Tax return preparation
- New partner admission agreements
- Forensic investigation in divorce

We are a regional CPA firm specializing in the financial planning needs of middle and upper range professionals. We DO NOT sell any investment products; DO NOT manage money; DO NOT recommend brokers and other sales people; but DO provide completely independent, unbiased, objective advice and guidance to our clients. Our partners' backgrounds include teaching for many years for the Fairleigh Dickinson MBA program; award winning articles in the *Journal of Accountancy*; extensive speaking engagements for groups up to 1500; certification as personal financial specialists; being quoted in almost every major publication and newspaper in the United States; and a consistent track record of steady, responsible, concerned, knowledgeable guidance and advice to our clients.

Member: AICPA SEC Practice Section

Call us and tell us your needs. We can help you!

Mendlowitz Weitsen, LLP, CPAs

K2 Brier Hill Court, East Brunswick, NJ 08816-3341

Tel: 732.613.9700 Fax: 732.613.9705 E-mail: mw@mwllp.com

www.mwllp.com

EXHIBIT A-2 Sample Advertisement for Industry-Specific Service—Construction Contractors

Complete Services to Construction Contractors

Auditing
GAAP compliance
GAAP to tax adjustments
Financial statements

Accounting services
Prospective financial statements
Budgets
Business plans

Business succession planning
Estate planning
Family limited partnerships
Intentionally defective irrevocable trusts
Charity remainder trusts
Private foundations
Business valuation
Succession planning
Family transition mediation/counseling/resolution/coaching
Buy-sell agreement design
Merger and acquisition planning and due diligence
Strategic planning/coaching
Asset retirement obligations

Consulting services
Segmenting construction contracts
Combining construction contracts
Determining basic contract prices
Recognizing revenue on construction contracts
Percentage-of-completion method
Completed-contract method

Tax planning and compliance
Tax planning
Tax return preparation
Tax audits
Collection issues
State tax planning
Tax questions

Construction services
Developing field reporting systems
Organizing job recordkeeping methods
Compilation of interim or annual financial statements to be reviewed by: Surety bond underwriters, state contract licensing agencies, governmental agencies, banks providing construction financing, suppliers and subcontractors, and project owners
Letter of credit financing
Allocating overhead
Equipment cost pools
Capitalization of environmental costs

Outsourced services
Accounting
Bookkeeping
Turnkey accounting systems
Full back office operation
Reports to investors
Management reports

Credit service consulting
Long-term asset acquisition financing
Investments in construction ventures

Other services
Board of Director due diligence advising
Yourport® shareholder reports

Member: AICPA SEC Practice Section

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www.mwllp.com

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Exhibit A-3 Sample Advertisement for Industry-Specific Service—Realtors

Complete Services to Realtors

Tax Advice
Ways to save on taxes
Tax deductions
Tax advantages of homeownership
Mortgage vs. rent

Accounting Services
Prospective financial statements
Budgets
Business plans

Business Succession Planning
Estate planning
Family limited partnerships
Business valuation
Succession planning
Family transition mediation/counseling/resolution/coaching
Buy-sell agreement design
Merger and acquisition planning
Due diligence for mergers and acquisitions
Strategic planning/coaching

Tax Planning and Compliance
Tax return preparation
Tax audits
Federal and state tax planning
Full tax reporting and compliance services
Tax questions
Entity selection

QuickBooks® Services
Training
Set-up and support
Check writing
Payroll processing
Invoicing
Budgeting

Financial Planning Services
Incentive stock option planning
Stock option plan modeling and formulation
Employee benefit plans
Pension plans
Golden parachute taxation
401(k)/investing education
Section 162 plans
Split dollar life insurance plan analyses
Creative executive benefit plan conceptualization
Phantom stock plans

Outsourced Services
Accounting
Bookkeeping
Human resources
Insurance
Turnkey accounting systems
Full back office operation
Reports to investors
Management reports

Performance Measurement Services
Yourport® shareholder report

Member: AICPA SEC Practice Section

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www.mwllp.com

EXHIBIT A-4 Sample Advertisement for Industry-Specific Service—Investment Community

Complete Services to the Investment Community

Auditing
Broker/dealers
Hedge funds
Mutual funds
Publicly traded companies
SEC and NASD compliance

Developmental Stage Companies
Prospective financial statements
Budgets
Cash flow analyses
Entity selection
Stock option plan modeling and formulation
Employee benefit plans
Business plans
Buy-sell and partnership agreement negotiations
Merger and acquisition planning

Investors in Securities
Mark-to-market tax elections
Day traders
Proprietary traders
Tax planning
Tax return preparation
Tax audits
State tax planning

Tax Planning and Compliance
Individual tax return preparation
Tax projections and estimated tax calculations
Business and individual tax planning
Full tax reporting and compliance services

Outsourced Services
Accounting
Bookkeeping
Human resources
Insurance
Turnkey accounting systems
Full back office operation
Reports to investors
Management reports
Letter of credit financing
Cash management accounts

Financial Planning
Asset allocation
Estate planning
Family limited partnerships
Intentionally defective irrevocable trusts
Charity remainder trusts
Private foundations
Incentive stock option planning
Nonstatutory stock options and restricted stock
Full range of personal financial planning services

Other Services
Business valuation
Attestation services
Complete consulting services
Succession planning

Member: AICPA SEC Practice Section

Call us and tell us your needs. We can help you!

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www.mwllp.com

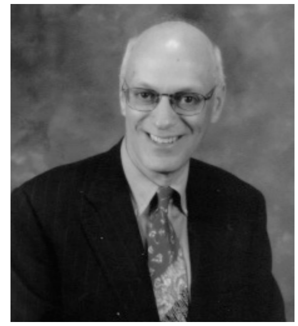
AFTERWORD

Part of growing a practice is to have existing clients use more of your services. A major goal of every meeting with a client is to make sure they know every way you can help them on issues relevant to them.

These opportunities can come from anyone in the firm. Therefore, it is important for everyone in the firm to understand what the firm can do, and how they can offer it to the client. This requires careful, directed, and focused training.

The materials and checklists in this book are a great, thorough, and easy way to get started. Go to it!

ABOUT THE AUTHOR



Edward Mendlowitz, CPA, PFS, ABV, is a partner in the CPA firm of Mendlowitz Weitsen, LLP located in East Brunswick, NJ, and New York City. He is a member of the American Institute of CPAs, the New Jersey Society of CPAs, and the New York State Society of CPAs. Currently he is on the NYSSCPA Estate Planning Committee, and was the Chairman of the committee that planned the NYSSCPA's 100th Anniversary.

Mr. Mendlowitz has authored eight books and edited six others, and has written hundreds of articles for business and professional journals and newsletters. He is a contributing editor to PPC's 1998/1999 *706/709 Deskbook* and is on the editorial board of many financial newsletters including *Bottom Line/Personal* and *Tax HotLine*. He appears regularly on television news programs and has been quoted in almost every major newspaper and periodical in the United States. He is the winner of the Lawler Award for the best article published during 2001 in the *Journal of Accountancy*. He has also taught in the MBA graduate program at Fairleigh Dickinson University, and is admitted to practice before the U.S. Tax Court. He is qualified as a team captain and performs peer and quality reviews of CPA firms.

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