



# 2016 Business Update

Regions PCCS Conference

Chicago

May 23, 2016

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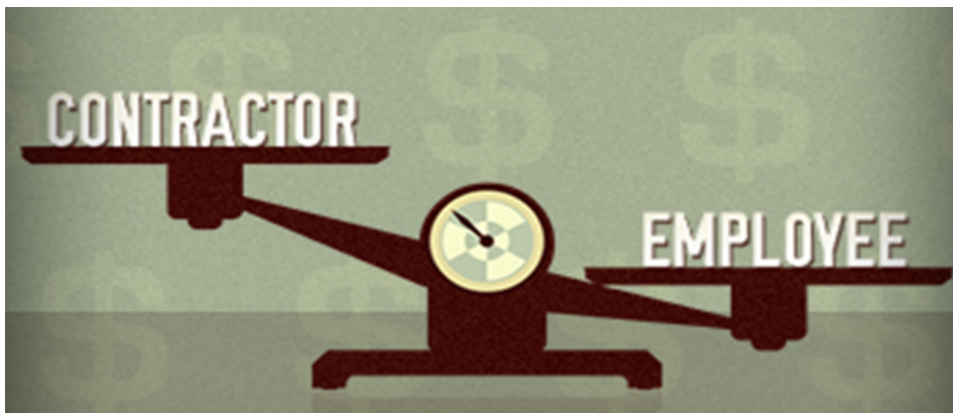
# Agenda

- 1099s
- Self-Employment Earnings
- Annual Financial Statements
- Tax Law & Other Compliance Updates
- Succession Thoughts



# Employee Vs. Independent Contractor

- What's the difference?
  - IRS gave us 20 factors
    - ◇ Control – 3 categories
      - Behavioral
      - Financial
      - Relationship of parties



Employees	Independent Contractors
Works the hours set by the employer	Works for more than one company
Receives employment benefits	Sets own hours
Works under the control and direction of the employer	Works independently - Has authority to decide how to go about accomplishing tasks and does so without input
Tends not to incur costs or make investments in the work	Incurs the costs associated with performing the job
Likely to be eligible for unemployment compensation	Not eligible for unemployment benefits
Is covered by federal and state wage and hour laws (minimum wage and overtime)	Paid according to terms of contract – no overtime compensation
Covered by workplace safety, employment and anti-discrimination laws	Not protected by employment anti-discrimination and workplace safety laws
Pays Social Security and Medicare	Pays self-employment taxes
Covered by worker's compensation benefits	Not eligible for worker's compensation benefits



# Employee Vs. Independent Contractor

- Why does it matter?
  - Payroll liability
  - 1099 responsibility
  - HUGE issue in buy/sell transactions



# New Overtime Rules – Effective 12/1/16

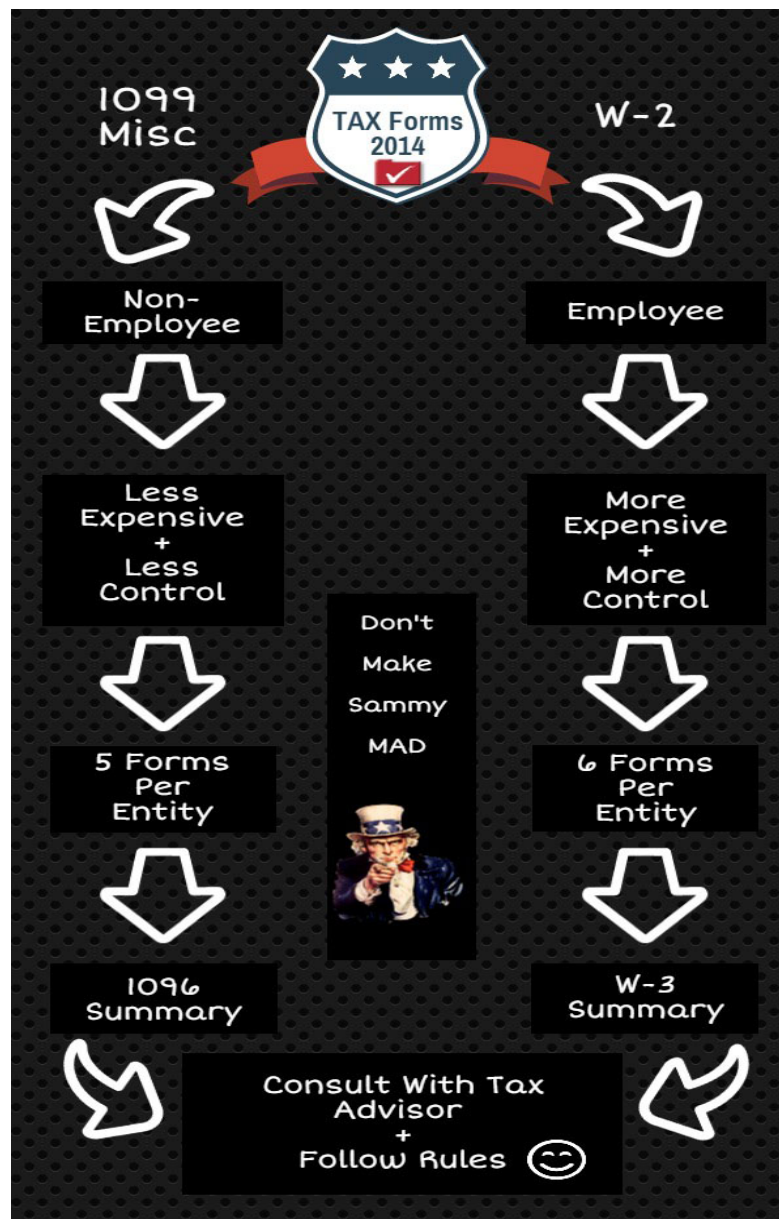
## New

- Earn \$47,476 (\$913/week) or less
- No “managerial” duties (i.e. not classified as administrators, executives or professionals)
- OT at >40 hrs/week

## Previous

- Earn \$23,660 or less (\$455/week)
- No “managerial” duties (i.e. not classified as administrators, executives or professionals)
- OT at > 40 hrs/week







# 1099 Reporting

☐ W2

☒ 1099





9595

☐ VOID☐ CORRECTED

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.				1 Rents	OMB No. 1545-0115  <b>2015</b>  Form <b>1099-MISC</b>	<b>Miscellaneous Income</b>
				\$		
				2 Royalties		
				\$		
				3 Other Income	4 Federal income tax withheld	<b>Copy A</b> <b>For</b> <b>Internal Revenue</b> <b>Service Center</b>  <b>File with Form 1096.</b>  <b>For Privacy Act and Paperwork Reduction Act Notice, see the 2015 General Instructions for Certain Information Returns.</b>
				\$	\$	
PAYER'S federal identification number	RECIPIENT'S identification number	5 Fishing boat proceeds	6 Medical and health care payments			
		\$	\$			
RECIPIENT'S name				7 Nonemployee compensation	8 Substitute payments in lieu of dividends or interest	
Street address (including apt. no.)				\$	\$	
City or town, state or province, country, and ZIP or foreign postal code				9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/>	10 Crop insurance proceeds	
				\$	\$	
Account number (see instructions)		FATCA filing requirement <input type="checkbox"/>	2nd TIN not <input type="checkbox"/>	11	12	
				13 Excess golden parachute payments	14 Gross proceeds paid to an attorney	
				\$	\$	
15a Section 409A deferrals	15b Section 409A income			16 State tax withheld	17 State/Payer's state no.	18 State income
\$	\$			\$		\$
				\$		\$

Form **1099-MISC**

Cat. No. 14425J

[www.irs.gov/form1099misc](http://www.irs.gov/form1099misc)

Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**

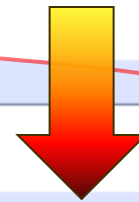
# Self-Employment Earnings

<b>SCHEDULE C</b> <b>(Form 1040)</b> <small>Department of the Treasury Internal Revenue Service (99)</small>		<b>Profit or Loss From Business</b> <b>(Sole Proprietorship)</b> <b>► Information about Schedule C and its separate instructions is at <a href="http://www.irs.gov/schedulec">www.irs.gov/schedulec</a>.</b> <b>► Attach to Form 1040, 1040NR, or 1041; partnerships generally must file Form 1065.</b>		<small>OMB No. 1545-0074</small> <b>2014</b> <small>Attachment Sequence No. 09</small>	
Name of proprietor				Social security number (SSN)	
A Principal business or profession, including product or service (see instructions)				B Enter code from instructions	
C Business name. If no separate business name, leave blank.				D Employer ID number (EIN), (see instr.)	
E Business address (including suite or room no.)					
City, town or post office, state, and ZIP code					
F Accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify)					
G Did you "materially participate" in the operation of this business during 2014? If "No," see instructions for limit on losses				<input type="checkbox"/> Yes <input type="checkbox"/> No	
H If you started or acquired this business during 2014, check here				<input type="checkbox"/>	
I Did you make any payments in 2014 that would require you to file Form(s) 1099? (see instructions)				<input type="checkbox"/> Yes <input type="checkbox"/> No	
J If "Yes," did you or will you file required Forms 1099?				<input type="checkbox"/> Yes <input type="checkbox"/> No	
<b>Part I Income</b>					
1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked	1			
2	Returns and allowances	2			
3	Subtract line 2 from line 1	3			
4	Cost of goods sold (from line 42)	4			
5	<b>Gross profit.</b> Subtract line 4 from line 3	5			
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	6			
7	<b>Gross income.</b> Add lines 5 and 6	7			



**Part II Expenses.** Enter expenses for business use of your home **only** on line 30.

8	Advertising . . . . .	8		18	Office expense (see instructions)	18	
9	Car and truck expenses (see instructions). . . . .	9		19	Pension and profit-sharing plans . . . . .	19	
10	Commissions and fees . . . . .	10		20	Rent or lease (see instructions):		
11	Contract labor (see instructions)	11		a	Vehicles, machinery, and equipment	20a	
12	Depletion . . . . .	12		b	Other business property . . . . .	20b	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions). . . . .	13		21	Repairs and maintenance . . . . .	21	
14	Employee benefit programs (other than on line 19). . . . .	14		22	Supplies (not included in Part III) . . . . .	22	
15	Insurance (other than health)	15		23	Taxes and licenses . . . . .	23	
16	Interest:			24	Travel, meals, and entertainment:		
a	Mortgage (paid to banks, etc.)	16a		a	Travel . . . . .	24a	
b	Other . . . . .	16b		b	Deductible meals and entertainment (see instructions) . . . . .	24b	
17	Legal and professional services	17		25	Utilities . . . . .	25	
				26	Wages (less employment credits) . . . . .	26	
				27a	Other expenses (from line 48) . . . . .	27a	
				b	Reserved for future use . . . . .	27b	
28	<b>Total expenses</b> before expenses for business use of home. Add lines 8 through 27a . . . . . ▶					28	
29	Tentative profit or (loss). Subtract line 28 from line 7 . . . . .					29	
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method (see instructions). <b>Simplified method filers only:</b> enter the total square footage of: (a) your home: <input type="text"/> and (b) the part of your home used for business: <input type="text"/> . Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30 . . . . .					30	
31	<b>Net profit or (loss).</b> Subtract line 30 from line 29. • If a profit, enter on both <b>Form 1040, line 12</b> (or <b>Form 1040NR, line 13</b> ) and on <b>Schedule SE, line 2</b> . (If you checked the box on line 1, see instructions). Estates and trusts, enter on <b>Form 1041, line 3</b> .					31	





# Miscellaneous Individual Tax Developments

- Net Investment Income Tax – 3.8%
  - Reminder to group passive activities
  - Must be done in first tax year after 2013 in which Net Investment Income exists and income exceeds the threshold
  - New – “Significant Participation Activity” - >100 hours in the activity in a year - excluded



# State Tax Laws and Other Compliance

- Unclaimed Property
  - Must escheat to the State
  - Note any credit balances refunded caused by federal funds must be returned within 240 days to the Department of Ed
- States are hungry
  - Economic Nexus
  - 6 States currently
- Affordable Care Act Reporting



Click Here to  
Search Your  
State





# Large Employers: Begin Reporting 2016 for 2015 benefit year

Large Employers required to annually submit an:

1. Information return to the IRS by either March 1, 2016 (typically, Feb. 28) or March 31, if filing electronically – **Now May 31 or June 30, 2016 for efilng**
2. Information to employees on or by January 31 (Feb 1, 2016 ) – **Now March 31, 2016**
  - Can be provided electronically like W-2s

**Forms:** 1094-C (transmittal) and 1095-C (employee statement)

- Applies to employers with 50 or more FT + FTE employees
- No filing required if employer has no full-time employees

**DEADLINE  
EXTENDED**



**Sec. 6056  
Reporting**





# Ever Feel Like This?



# Annual Financial Statements

- How do you use them?
- How do others use them?



**"Our books are balanced. 50% of our numbers are real and 50% are made up."**



# The Balance Sheet

Assets	
Cash and Cash Equivalents	\$2,500
Tuition Receivables, Net	4,500
Other Current Assets	<u>250</u>
Total Current Assets	7,250
Property and Equipment	7,000
Total Assets	<u>\$14,250</u>
Liabilities and Stockholders' Equity	
Current Liabilities	
Current Maturities of Notes Payable	\$250
Accounts Payable	250
Accrued Expenses	350
Unearned Tuition	<u>5,700</u>
Total Current Liabilities	6,550
Notes Payable	<u>1,000</u>
Total Liabilities	<u>7,550</u>
Stockholders' Equity	
Common Stock	1
Additional Paid-in Capital	250
Retained Earnings	<u>6,449</u>
Total Stockholders' Equity	<u>6,700</u>
Total Liabilities and Stockholders' Equity	<u>\$14,250</u>

- Current Ratio (WC) – 1.11:1.00 (7,250/6,550)
- Acid Test – 1.07:1.00 ((2,500+4,500)/6,550)
- Debt Service Coverage Ratio – 5.94:1.00 (1,646/277)
- Net Worth - \$6,700,000 – (Tangible)
- Debt to Equity – 1.13:1.00 (7,550/6,700)
- Composite Score – 2.27



# Income Statement

Revenues	
Tuition and Fees, Net	\$25,000
Salon Services, Net	<u>450</u>
Total Revenues	<u>25,450</u>
Expenses	
Direct Costs of Courses and Products Sold	\$7,302
Selling, General & Administration	15,402
Depreciation	1,073
Interest	<u>27</u>
Total Expenses	<u>23,804</u>
Net Income	<u>\$1,646</u>

- EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) – \$2,746  
(1,646+1,073+27)
- Profit Margin – 6.47%  
(1,646/25,450)
- Gross Profit – 71.31%  
((25,450-7,302)/25450)



# Cash Flow Statement

## Direct

### Cash Flows from Operating Activities

Cash Received from Students and Customers	\$ 23,600,000
Cash Paid to Suppliers and Employees	(21,955,281)
Interest Paid	<u>(27,324)</u>
Net Cash Provided by Operating Activities	<u>1,617,395</u>

### Cash Flows from Investing Activities

Purchases of Property and Equipment	<u>(2,500,000)</u>
Cash Flows Used by Investing Activities	<u>(2,500,000)</u>

### Cash Flows from Financing Activities

Proceeds from Borrowings on Notes Payable	<u>1,250,000</u>
Cash Flows Used by Financing Activities	<u>1,250,000</u>

**Net Change in Cash and Cash Equivalents** 367,395

Cash and Cash Equivalents - BOY 2,132,605

**Cash and Cash Equivalents - EOY** \$ 2,500,000

## Indirect

### Reconciliation of Net Income to Net Cash

#### Provided By Operating Activities

Net Income \$ 1,643,848

Adjustments to Reconcile Net Income to Net Cash

#### Provided By Operating Activities

Depreciation	1,073,547
Bad Debt Expense	300,000
Change in Tuition Receivables	(1,500,000)
Change in Other Current Assets	(25,000)
Change in Accounts Payable	(25,000)
Change in Accrued Expenses	50,000
Change in Unearned Tuition	<u>100,000</u>

**Net Cash Provided by Operating Activities** \$ 1,617,395



# Common Loan Covenants

## Debt Service Coverage Ratio (DSCR)

- EBITDA/Current Debt & Interest
- Indication of company's ability to meet its debt obligations from current earnings
- Less than 1 indicates a troubled company

## Tangible Net Worth

- Capital Accounts and/or Retained Earnings
- Measure of physical worth
- Want this to be a positive number

## Debt to Equity (D/E)

- Total Liabilities/ Stockholder's Equity
- How much a company is using debt to finance its assets relative to stock
- High = more aggressive leveraging (financing growth); volatility related to interest expense



# Composite Score

- Now's the time
  - Know where you are right now and project where you think you will be – big and small can and should do this
- What can help?
  - Debt?
  - Equity Funding?
  - Related Party Loans?
  - Structure?







“What if we don’t change at all ...  
and something magical just happens?”

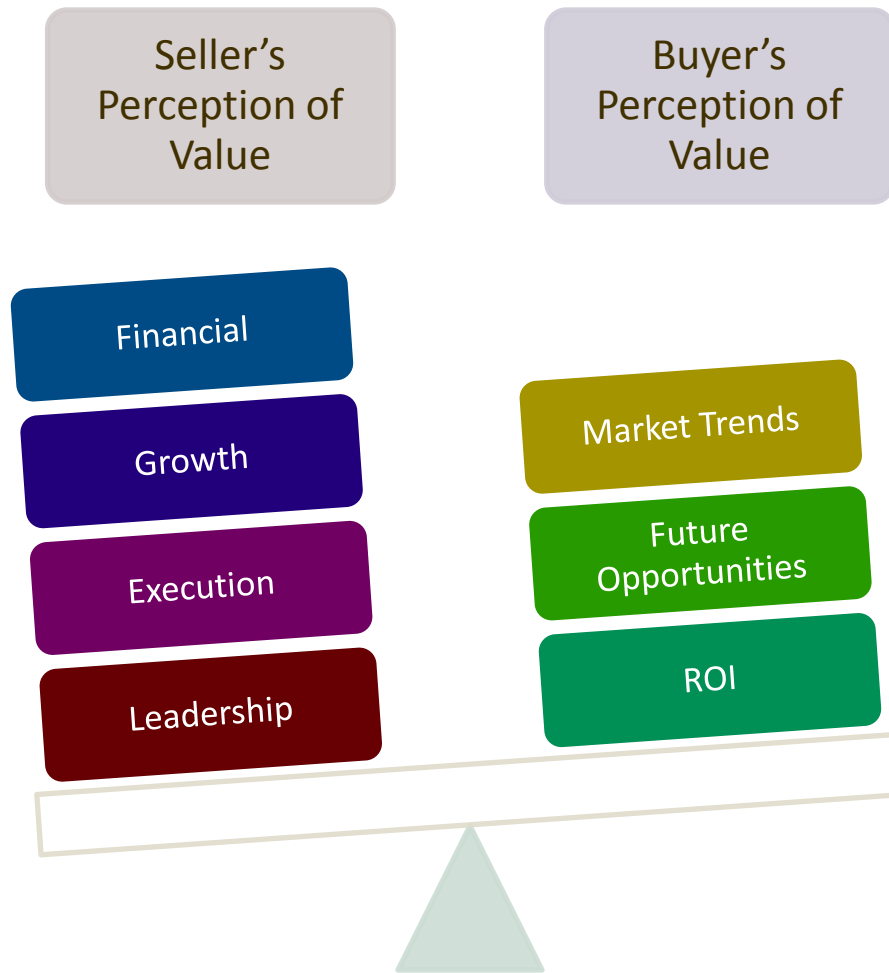


# Thought About Succession?

- Why
  - Retirement/Moving on
  - Monetize investment
  - QFRDD
  - Regulatory
- How
  - Sell
  - Give to family
  - Convert to nonprofit



# Selling Your Business



# Merger or Sale

- What's your Company worth?
  - Valuation and some commonly used pricing models
    - ◇ Asset Based Approach – generally where companies have little value beyond tangible assets (e.g. holding companies)
    - ◇ Market Approach – comparable sales
    - ◇ Income Approach – estimate of future ownership benefits discounted to present value
      - Formula based approach – includes percentage of revenue, multiples of EBITDA, etc.

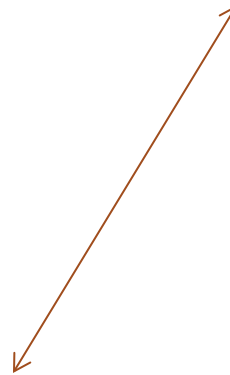


# Income Approach

- EBITDA Multiple is where most end up
  - EBITDA – general standard for pricing

EBITDA (LTM, TTM)
Net Earnings
+ Interest
+ Taxes
+ Depreciation
+ Amortization
= EBITDA

Recast EBITDA for Unusual Items
EBITDA
+ Owner Personal Expenses
+/- Owner Compensation
+/- Adjustments for Market Rent
+/- Any Other Unusual Items
= Adjusted EBITDA



- What are things that drive down EBITDA

# What does the seller receive?

## Base considerations

Cash

Cash + note

Cash + carryover equity

Cash + buyer equity

## Other considerations

Lease on seller-owned real estate

Employment agreements

Non-compete agreement

# Preparation – Sell Side

- A few things to consider...



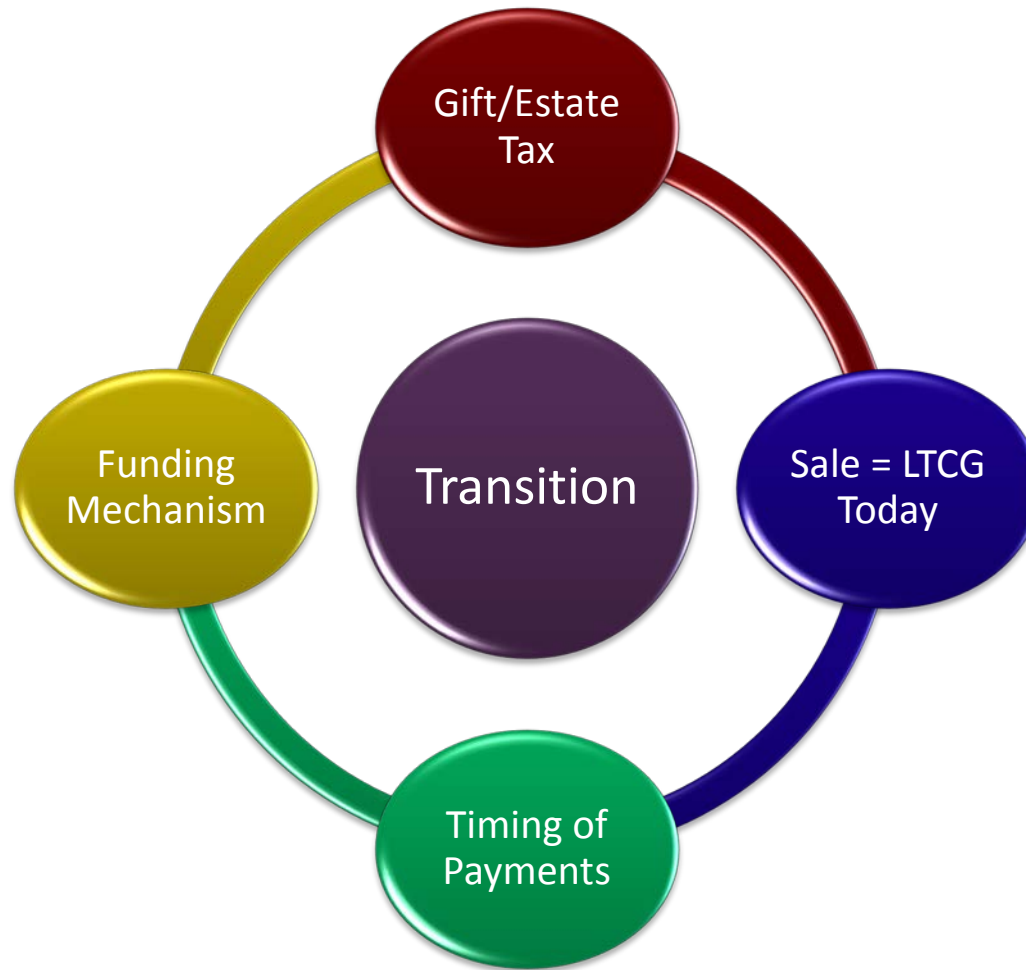


# Family Succession

- Is the next generation ready?
- Some statistics....
  - 65% of 2<sup>nd</sup> generation businesses fail
  - 90% of 3<sup>rd</sup> generation fail
  - 88% of family business owners believe the same family or families will control the business in five years
  - 68% do not have a succession plan
  - 55% do not have a business transfer plan
  - Family owned companies comprise more than 75% of total businesses in the U.S.



# Family Succession Considerations



**I'm  
Retired**

**Not Expired**



# Taking Your Business Nonprofit

- Not a quick and easy process
- Acquisition by unrelated nonprofit is rare
- Transparency required of nonprofits
- Giving up control
- Strict compensation rules



**Part VII Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors**Check if Schedule O contains a response or note to any line in this Part VII . . . . . ☐**Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees****1a** Complete this table for all persons required to be listed. Report compensation for the calendar year ending with or within the organization's tax year.

- List all of the organization's **current** officers, directors, trustees (whether individuals or organizations), regardless of amount of compensation. Enter -0- in columns (D), (E), and (F) if no compensation was paid.
- List all of the organization's **current** key employees, if any. See instructions for definition of "key employee."
- List the organization's five **current** highest compensated employees (other than an officer, director, trustee or key employee) who received reportable compensation (Box 5 of Form W-2 and/or Box 7 of Form 1099-MISC) of more than \$100,000 from the organization and any related organizations.
- List all of the organization's **former** officers, key employees, or highest compensated employees who received more than \$100,000 of reportable compensation from the organization and any related organizations.
- List all of the organization's **former directors or trustees** that received, in the capacity as a former director or trustee of the organization, more than \$10,000 of reportable compensation from the organization and any related organizations.

List persons in the following order: individual trustees or directors; institutional trustees; officers; key employees; highest compensated employees; and former such persons.

☐ Check this box if neither the organization nor any related organization compensated any current officer, director, or trustee

(A) Name and Title	(B) Average hours per week (list any hours for related organizations below dotted line)	(C) Position (do not check more than one box, unless person is both an officer and a director/trustee)						(D) Reportable compensation from the organization (W-2/1099-MISC)	(E) Reportable compensation from related organizations (W-2/1099-MISC)	(F) Estimated amount of other compensation from the organization and related organizations
		Individual trustee or director	Institutional Trustee	Officer	Key employee	Highest compensated employee	Former			

# Top 10 Succession Planning Mistakes

10. Letting the plan grow stale
9. Failing to finance the plan
8. Ignoring concerns of key employees
7. Creating red flags for the IRS
6. Using the same level of ownership for intra-family transfers
5. Missing important valuation factors
4. Using an inappropriate valuation method
3. Planning for only a few contingencies
2. Choosing the wrong type of plan
- 1. Failure to develop a plan**



Q&A

You have

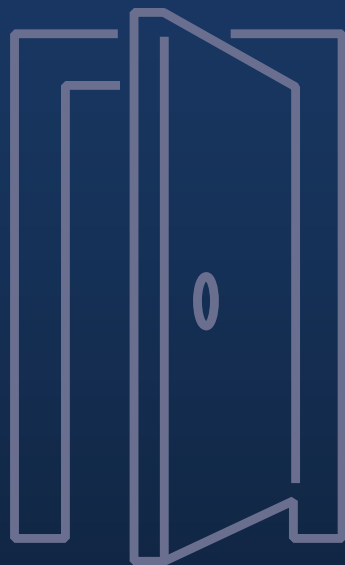
Questions

We have

Answers







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