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New IRS rules benefit small taxpayers (building owners).

New tax rules issued by the IRS can reduce your tax bill if you own buildings, and you qualify as a "small taxpayer." The changes are part of final IRS rules issued last year on treatment of repairs and maintenance and the treatment of capital costs which previously were depreciated, not written off. Here is the background:

Old tax rules-

> Repairs & Maintenance costs were allowed to be deducted in the year incurred. The definition of repairs & maintenance were costs that do not extend the life of building such as roof repair, carpet replacement, paint, window replacements, and HVAC repair. These costs were classified as improvements and were required to be capitalized and depreciated over time. Improvement costs were those that extend the life of buildings.

New tax rules-

> RABI rules: Restoration, Additions, Betterment, and Improvements
>
> Costs that are RABI items must be capitalized and depreciated over time.

If the cost is not a RABI item, a building owner can deduct the expense in the year incurred. With the new tax rule, there is an exception, a safe harbor election for small taxpayers. The election allows individuals or entities with average annual gross receipts for the prior three years of less than $10 million and an eligible building property, any building with an unadjusted basis of no more than $1 million. These taxpayers are allowed to write off costs that normally are classified as capitalized RABI costs.

If the property qualifies under the small taxpayer election, the capital costs that normally are depreciated can be written off in full for the year paid or incurred. The write-off is based on a percentage of the unadjusted basis of the property at the beginning of the year up to the lesser of $10,000 or 2% of a building's unadjusted basis per invoice paid.

The building safe harbor election must be included in a timely filed return on an annual basis with a description of each building within the election.

Example:

A building with a cost of $500,000 and accumulated depreciation of $100,000 has an unadjusted basis of $500,000 at the beginning of the year. The small taxpayer election allows the taxpayer to deduct costs (per invoice) up to 2% of the basis, computed as of the beginning of the current tax year. In this example (per invoice), the taxpayer is allowed to deduct up to $5,000. The taxpayer is able to plan costs with its vendors to benefit from the $5,000 write-off threshold. In this case, the owner could request billings on tenant improvements that meet the tax rule and deduct the costs in the current year.

If in the current year the owner plans to replace HVAC units in the current year, the taxpayer could arrange with the vendors to bill him for the units separately, and then bill him for the installation. In this situation, (per invoice) each HVAC unit were $3,850, and the labor was 2,500 to install.

In this example, all costs are deductible in the current year under the new IRS tax rules.

Please contact our office with any questions regarding these new IRS rules and how they may affect your tax planning.

An overlooked value driver – company culture alignment.

Culture is often overlooked when firms are preparing for sale as well as when companies are searching for acquisitions. There is a higher likelihood of success in a sale and in a purchase when both cultures are in alignment as noted in the article below…

Company culture drives value

(Originally published in Value Examiner)

By Scott T. Wait, CPA, AEP, and Mark A. Dayman, CPA, ABV, CVA

What does company culture have to do with value? Valuation professionals have been taught that value is ultimately driven by the level, strength, and predictability of earnings and free cash flow, applied within the context of common valuation approaches.

However, a company's culture—the shared values and practices of a company's *people*—is one of the least understood but most critical value drivers. The Booz & Company annual study, "Why Culture Is Key" (Winter 2011), defined company culture as "the organization's self-sustaining pattern of behaving, feeling, thinking, and believing. It trumps strategy and leadership."

As an example, remember when Steve Jobs returned to Apple Computer? The "white knight" used his commitment to visionary products and design perfection to motivate employees as Apple revolutionized ways of delivering and listening to music and communicating and connecting with others.

Consider as well Louis V. Gerstner, Jr.'s turnaround of IBM, which by 1993 was the corporate equivalent of an ocean liner full of fiefdoms focused on building office machines. And that ocean liner essentially was rudderless and adrift: IBM was running out of cash, Gerstner later wrote in his book *Who Says Elephants Can't Dance?* Over the next 19 years, IBM transformed itself into a more cooperative and highly profitable business, based on renewed leadership in the field of software as a service (SAAS). Once cash flow was stabilized, Gerstner focused on transforming the culture to optimize the long-term value of IBM. In *Who Says Elephants Can't Dance?* Gerstner wrote that IBM's culture reemphasized cooperation, fun, innovation, and results orientation to drive IBM's overall company value to new heights.

The Booz study found critical links between culture and value. We used to think that R&D drove innovation and company value, but the Booz study emphasizes that "there is no statistical relationship between financial performance and innovation spending in terms of either total R&D dollars or R&D as a percentage of revenues." Take Apple, as noted above: it consistently *underspends* its peers on R&D, but its results *outperform* its peers.

Businesses that have aligned cultures to innovation and strategy have a distinct performance advantage. The Booz study found that companies that highly align their cultures to strategic goals achieve higher rates of growth in both gross profit and enterprise value. Companies with highly aligned cultures generate 16.67 percent higher enterprise value based on five-year Compound Annual Growth Rate, CAGR compared with the average of all companies participating in the study.

And where do such companies focus their attention? Belying the belief that customer service died long in ago America, companies with perceived strong cultures focus on three key success factors: superior product performance, superior product quality, and aggressive customization of products to local markets and geographies.

Companies whose management teams have aligned their cultures to their company strategies also are employers of choice (and valued at a premium), because they have optimized product design, delivery, and customer services. Informed investors prefer to buy companies that strongly align their cultures to innovation, which routinely delivers higher profitability while also serving as a long-term "growth engine."

In our business valuation and M&A consulting practices, we have seen a direct connection between a company culture of "engaged" employees and value. When working with potential buyers of company clients, such as private equity groups and strategic buyers, we seek to identify cultural factors that drive value.

Here are some questions that we typically use to identify the existence and scope of a strong corporate culture and its impact on a company's value:

1. Continual communication with customers drives customer loyalty, innovation, revenues, profits, and thereby value (higher economic benefits). Does the company regularly survey customers on the utility and quality of its products and services, especially in relation to alternative products and services and the customer's emerging needs? Does the company have a history of taking action based on its customer surveys?

2. A company that depends on a single owner for market, product, and operational success is headed for trouble and has limited value. Management depth builds value (higher economic benefits, lower specific company risk). Has the owner developed at least one layer of executive management sufficient to ensure that the owner can step away from the business?

3. A company with a history of well-conceived and well executed business plans tends to realize lower business risk and better economic results. Does the company annually complete a strategic business planning session that involves input from all staff?

4. Employee empowerment increases product and service performance and customer satisfaction in turn. Making every employee part of the "team" is critical. Some issues to consider:

   - Does the company have an established program to hire the best candidates?
   - Is there an effective plan for new employee orientation, and procedures with reality checks (the happy and sober realities of work environment) Does the company maintain a mentoring system to orient new employees with appropriately matched, seasoned employees?
   - Do all employees have clearly explained job responsibilities and rewards? Are employees trained and empowered to make decisions involving their work processes? For example, at most auto manufactures today, any single employee can stop a manufacturing line if he or she finds a defect in an auto on the line: that's empowerment.

The message is clear: company culture drives value. Valuation, M&A, and exit strategy professionals must seek to understand company cultures, whether the assignment relates to a company's general purposes, or for transition-related positioning.

Ideas to trim your IT budget.

Information Technology is an important investment for most businesses. There are ways though to manage your IT budget without sacrificing your security and communication via your IT system. Since cash can be tight small and medium-sized enterprises (SME), owners are looking for ways to cut outlays. IT could look like an easy target. The trouble is that your IT is one of those things with the potential to fuel real efficiency increases in many areas of operation thus ultimately being a dollar saver. Besides, sooner or later you will be forced to refresh old technology, either because it’s stopped working or is so slow that it’s cramping your productivity. Here are some suggestions for how you can rein in the IT budget.

- 1. Postpone non-essential purchases – then bargain shop. Let the lifetime of hardware extend out a little past the recommended upgrade date and stick with the current version of your software programs. If you do need to buy, don’t just settle for the first price you’re offered. A number of websites specialize in price comparing IT products. They often include details about discounts and other offers that can reduce the price of a product substantially.
- 2. Use open source software. Not only does Open Source software enable you to create more customized solutions to better fit your needs but it’s way cheaper than proprietary products (often free) so you can spend your budget on upgrading hardware infrastructure. You and your team will need training to make it work and there’s a migration process involved but it is definitely a money saver.
- 3. Set up a client/server system to run your computers. Invest in a robust server (to do all the processing on behalf of all the individual terminals you have) and hang even your obsolete computers off it as thin clients (they don’t require their own hard drive now).
- 4. Virtualize applications. Virtualization enables you to run multiple operating systems and applications on a single server rather than several. It can dramatically reduce costs for IT management, hardware, power consumption and maintenance.
- 5. Compare your internet service provider costs against the offerings of other providers.
- 6. Get the best deal on communications. Consider amalgamating your business, mobile/s and internet services with the one provider – amalgamating accounts usually means better pricing. Compare provider’s plans – there are great plans available out there in the market that could save you a lot of money.
- 7. Voice over Internet Protocol (VoIP) hardware costs are dropping and quality is improving making it a fast growing resource for small businesses intent on cutting communication costs.
- 8. Investigate moving to software as a service solutions (SaaS). Outsourcing via SaaS can provide savings on software and maintenance as well as other benefits such as automatic backups and data security.
- 9. Assess alternatives to new computer purchase. Consider upgrading e.g. adding memory and removing unwanted software and files to improve performance; buying refurbished hardware; in the case of most PCs, the hardware, packaging and even warranty coverage are literally identical to those you would buy new, only with a lower price tag.

- 10. Turn your computers and monitors off at night. Make sure everyone in the office does this as well. It will save you money, your equipment will last longer and it is much better for the environment.

Most SME owners aren't IT wizards and the learning curve necessary to make a smart IT decision often leaves them with less than the best setup. That can mean a lot of unnecessary expenditure in the longer term. So, invest your time first up in finding a vendor able to understand your business and tailor their recommendations to particular needs – it will be time very well spent.

Regular Pieces

How To Make The Most Of Your Newsletter

Be sure to read each article with the mindset 'How could this apply to our business.' Thinking of it that way will guarantee that you get value. Better yet, take notes as you read and commit to having the ideas implemented by the time the next edition arrives. Also, make copies for each team member. To really make sure something positive happens, work with your business development specialist to talk your team through the ideas and how to set a schedule for getting them implemented. We're here to help you get started.

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