
Wilson & Orcutt, P.C.

Business Law Newsletter



Wilson & Orcutt, P.C.
201 Great Road
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NEW TAX TRAP FOR SMALL BUSINESS OWNERS

A recently adopted tax bill signed by the President makes a little noticed but very significant change in how the gain from the sale of many a business will be treated.

For over a decade now, lawyers have counseled their small business clients to do business as a corporation, for limited liability reasons, and to elect so called Subchapter S status for tax purposes. That structure insures that any gain realized by the owners upon a sale of the business will be taxed as capital gain (at a lower rate than regular income), and insures that only the owners will be taxed.

In the absence of a Subchapter S election, when a corporation sells a business, both the corporation and the shareholders realize a gain, and there are two levels of taxation. This is because virtually all such sales are done as "asset deals", where the corporation sells its assets to the buyer, and the proceeds are distributed to the seller's stockholders. Buyers rarely are willing to do a "stock deal", where the buyer purchases the stock in the corporation from its stockholders, since this results in a continuity of existence of the old business entity

subject to unknown and contingent liabilities, e.g. lawsuits that only come to light after the sale.

Most asset deals involve a down payment with the remainder of the purchase price paid over time pursuant to a promissory note given to the seller by the buyer. Under the so called "installment sales" rule the seller's tax on the gain isn't due until the payments are made, and the tax burden is spread over the same number of years as the payments are.

BUT BEWARE, under the new tax bill "accrual basis" taxpayers are no longer eligible for installment sales tax treatment, and any gain on the sale of business assets must be realized in the year of the sale, even if the purchase price is paid over a period of years.

Since all businesses which sell from inventory must use the accrual method of accounting, the sale of many small businesses will be dramatically affected by this change.

Sellers will now want to structure sales as stock deals, or may insist upon all of the purchase money up front,

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forcing buyers to use bank financing to provide the purchase funds. The former may entail more risk than the buyer can tolerate, and the latter may cause the price the buyer is willing to

pay to go down, since bank financing is typically much more expensive than seller financing.

Did I hear anyone say the word “repeal”?

Do It Yourself Law – A Primer

Lawyers are fond of quoting the old saying that “he who represents himself has a fool for a client”. While it is usually true that a small business owner attempting to practice law in order to save on legal fees is a bit like do it yourself brain surgery, the truth is that there are **some** things that **sometimes some** people can do on their own.

While you would be foolhardy in the extreme to represent yourself in a complex piece of litigation in federal court, you can (and should) represent yourself in Small Claims Court; you can do some homework on self-help law and draft routine legal documents; and you can (albeit with some risk) find lawyers who are willing to sell their services an hour at a time, to review your work or consult with you on a specific topic.

Small Claims Court

Every State District Court in Massachusetts regularly conducts a small claims session in which disputes of \$2,000 and under are resolved by a Judge in an informal proceeding. Such claims can not justify the services of a lawyer whose fee could quickly exceed the amount in controversy.

A small claim can be made by you (as a “Plaintiff”) by mail or by appearing in person in the Clerk’s office for the District Court for the city or town where either you or the other party (the “Defendant”) live or have a usual place of business or employment. If filing by mail, you should first call the Clerk and inquire about the amount of the filing fee and the form in which the claim must be made. Note that claims regarding landlord-tenant matters must be brought to the District Court for the city or town where the rental property is located; and claims made by businesses against consumers must be brought in the District Court for the city or town where the Defendant lives or has a usual place of business or employment.

The Clerk will provide you with a Complaint and Summons form and instruct you how to give the Defendant notice of a hearing date which will be set at that time.

The average hearing lasts less than 30 minutes, and you should bring with you any evidence that would help the Judge to decide the case, including business records, correspondence, photographs and even witnesses.

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It is best to begin your presentation to the Judge with a brief summary of your case and then make a chronological presentation of your evidence. You should talk to the Judge rather than the other party, and refrain from arguing with your opponent or from becoming emotional.

Routine Documents

If you are “on the net” you have available to you a wide variety of legal forms and the information necessary to complete them.

For example, when presenting a new idea to potential investors, vendors, and customers, you may well want a signed non-disclosure agreement to prevent them from revealing your trade secrets to a competitor. Go to www.rmarkhalligan.com for a free form.

When hiring salespeople or other employees who will be given access to customer lists, pricing strategies and other confidential information, you may want them to sign a Confidentiality Agreement and/or a Non-Competition Agreement. Forms for these and other common business transactions are available at www.toolkit.cch.com and www.techdeals.findlaw.com (click on the small business tab), www.teneron.com and www.nolopress.com.

New Ventures

The first words of advice to the owners of a new business is usually “get a good lawyer”. While always a wise choice, often a realistic budget just doesn’t cover the hefty hourly rates of experienced and skilled business lawyers. The truth is that, with an experienced accountant (a service arguably more essential to a start up) and the free and low cost aids now available, you can do much of the necessary work yourself.

Help with protecting a business name and incorporating can be found on the Web sites of the U.S. Small Business Administration (www.sba.gov) and the National Federation of Independent Business Owners (www.nfibonline.com). Also, check out the sites listed on page four of this issue and the links on the Wilson & Orcutt, P.C. Web site (www.wilsonorcutt.com).

When going it alone, it may make sense, and make the difference between failure and success, to buy an hour or so of an experienced lawyer’s time to guide you and to review your work.

On the Other Hand

There are some tasks which simply can not be done right without a lawyer. Avoid doing business acquisitions, filing patent applications, handling complex litigation or drafting anything other than the simplest of partnership agreements on your own. There just are too many tax and legal implications which are not intuitively obvious.

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When you absolutely, positively have to have a lawyer, the best way to find the right one is by word of mouth recommendations from someone who has “been there before”. Alternative sources of referrals are the bar referral panels for local bar associations (Boston Bar Association, Tel. (617)742-0615, Middlesex Court Bar Association Tel. (617)494-4150 and the Massachusetts Bar Association Tel. (617)338-0500 or the two major national databases of lawyers where you can search for location and areas of expertise (Westlaw at www.lawoffice.com and Martindale Hubbell at www.martindalehubbell.com).

In House News

We are pleased to announce that Todd D. Fenniman has become associated with the firm.

Recommended Websites

Microsoft Business Central - a Web service for new and growing small businesses with lots of information and ideas: <http://www.bcentral.com>

Free Tax Cutting Advice From the IRS. Reduce audit risk by visiting: www.irs.ustreas.gov/gus_infor/mssp/index.html

Solve problems by contacting the IRS Problem Reduction Program at: www.irs.ustreas.gov/ind_info/advocate.html

Read IRS Tax Regulations Written In Plain English at: www.irs.ustreas.gov/tax_regs/index.html

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