

## COMMENTS FROM

# THE CHALFIN GROUP INC.

Volume 3, Issue 2

## INSIGHTS FOR INFORMATION TECHNOLOGY FIRMS

### Inside This Issue...

<b>The Due Diligence Process</b>	<b>1</b>
<b>Tax Aspects of Corporate Directorships</b>	<b>1</b>
<b>Speeches and Seminars</b>	<b>2</b>
<b>1999 Financial Benchmark Survey Questionnaires Mailed</b>	<b>3</b>
<b>How The Chalfin Group Can Help You</b>	<b>4</b>

**THE CHALFIN GROUP INC.**  
45 Bridge Street  
P.O. Box 4519  
Metuchen, NJ 08840-4519  
732-321-1099  
732-321-1066 (facsimile)  
www.chalfin.com

### The Due Diligence Process

By Robert J. Chalfin CPA, JD

Due diligence refers to the process through which the buyer collects and verifies information about the business. This includes items like the company's manner of doing business, its financial health, and its customer base, among many others. The purpose of due diligence is to enable the acquirer to understand and quantify the risks that it is assuming in purchasing the company. Since all businesses assume ongoing risks every day, it is virtually impossible for an acquisition to occur where there is no risk. However, a buyer can significantly reduce its risk through the due diligence process; due diligence is thus a vital part of the acquisition process.

While due diligence serves primarily the interests of the buyer, it is important for the continued on page 3

### Tax Aspects of Corporate Directorships

If you serve on the board of directors of one or more corporations, there are a number of tax rules that affect you. In your role as a corporate director, you are considered to be an independent contractor, not an employee of the corporation. This fact has several important tax consequences including the following:

*Directors' income and deductions.* The fees that are received as a corporate director are subject to current income taxation. However, because you are considered to be in the "business" of serving as a corporate director, you can deduct your ordinary and necessary expenses of carrying on this business. For example, you can deduct away-from-home travel expenses that relate to your duties as a director.  
continued on page 2

This information is designed to be accurate and authoritative; however, this publication is distributed with the understanding that it does not render legal, accounting or other professional advice, and no liability is assumed in connection with its use.

## Tax Aspects of Corporate Directorships

continued from page 1

These are business expenses and not itemized deductions, so they are not subject to any limitations based on your income. However, if you are also an investor in the corporation, your expenses may be treated as investment expenses rather than business expenses. In that case, they will be miscellaneous itemized deductions and will only be deductible to the extent that they exceed 2% of your adjusted gross income.

*Keogh retirement plans.* You may be able to postpone paying tax on your directors' fee income by making deductible contributions to a pension or profit-sharing plan for self-employed individuals known as a Keogh plan. Deductible contributions of up to 20% of this income – subject to a maximum of \$30,000 – may be made to one type of Keogh plan.

Your participation in a Keogh plan would be in *addition* to any qualified pension and profit-sharing plan in which you already participate as an employee. Participation in an employee plan would not limit the amount you could contribute and deduct under a Keogh plan.

*Self-employment tax.* As an independent contractor, you will be subject to self-employment tax on your directors' fee income. Self-

employment tax is imposed in addition to income tax, but you can deduct half of your self-employment tax as an adjustment to income.

Self-employment tax consists of a Social Security portion and a Medicare portion. The Social Security tax is imposed at 12.4% but only on self-employment income up to a certain amount. For 1999 this tax applies to the first \$72,600 of self-employment income. The dollar figure was \$68,400 for 1998. However, if you have salary income that exceeds \$72,600 in 1999, or \$68,400 in 1998, there will not be Social Security tax on your directors' fees. The Medicare tax is imposed at 2.9% on all self-employment income. There is no maximum on the amount of self-employment income that is subject to Medicare tax.

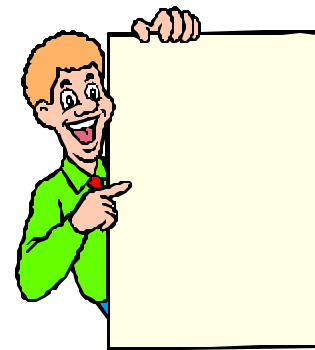
*Trust fund penalty.* Corporate directors should bear in mind their potential exposure to liability for the trust fund recovery penalty. "Trust fund" taxes include withheld income tax and Social Security tax that the corporation deducts from employees' wages and remits to the government. When these taxes are not properly collected and paid, the persons responsible for collection and payment are liable for 100% of the shortfall. Obviously, the amount of this penalty can add up very quickly.

There is no rule that automatically makes corporate directors liable for the trust fund penalty if taxes are not paid. Rather, the critical issue is who had the authority and

the duty to see to it that the trust fund taxes were paid. However, there have been cases in which directors were held liable for the penalty, so this possibility should not be ignored.

*D & O Insurance.* One important, but final item, is that prior to serving on a board of directors you should ascertain if the company has sufficient Directors' and Officers' Insurance.

We would be happy to discuss this topic with you further.

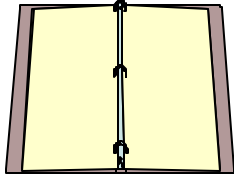


## Speeches and Seminars

Employees of The Chalfin Group frequently speak to business groups on topics covering the purchase and sale of businesses, strategic planning, valuation and financial benchmarks.

We are available to speak to your group.

This information is designed to be accurate and authoritative; however, this publication is distributed with the understanding that it does not render legal, accounting or other professional advice, and no liability is assumed in connection with its use.



## Due Diligence

continued from page 1

seller to understand the process and cooperate in it. Inaccurate or incomplete disclosure to the buyer during the due diligence process could delay the purchase, reduce the price paid for the business, and even create a potential future liability. Thus a prudent seller will regard due diligence as a kind of necessary evil.

Seen from another perspective, the due diligence list and the requested information should be viewed as an operations manual for a successful and properly managed business. Ideally, then, you should always be prepared for the requests that will be made during the due diligence period. Every business owner should prepare for the eventuality of selling his or her business. There is a tremendous psychological advantage for the seller if they have all of the requested information readily available.

In preparation for the due diligence process, a valuable exercise for the business owner and the entire management team is to carefully review the items and information that a buyer can be expected to request and determine what issues or concerns will and should arise. It will probably be beneficial if this list is reviewed with the business' attorney, CPA and any other outsiders with whom the business owner has confidence.

Since each buyer has its own concerns and reasons for purchasing a business, every due diligence process is unique with its own special requests and demands.

Please contact us if you would like to discuss the due diligence process further.

## 1999 Financial Benchmark Survey Questionnaires Mailed

The questionnaires for The Chalfin Group's 1999 Financial Benchmark Survey are now being mailed to CEOs, CFOs and key executives of information technology firms. This will be our firm's fifth annual Survey, and it promises to be our most extensive Survey ever.

The Survey provides information on topics that are important to the operation of IT firms including:

- Revenues
- Sales/Employee
- Profits
- Compensation Costs
- Officers' Compensation
- Bonus and Equity Sharing
- Billing Rates
- Lines of Credit
- Maintenance Fees
- Deposits at the Time of Contract

As has been the case in the past, the Survey results will be grouped and reported in the following categories: firm revenues, number of employees, profitable versus not profitable firms, firm type and past and expected future growth rates.

All information received by The Chalfin Group will be analyzed and provided in summary form only. Specific data for individual companies will not be revealed. To insure your confidentiality, the Survey questionnaire does not have to be signed.

A postcard is provided for Survey respondents to request a complimentary copy of the publication, which was over 160 pages long in 1998. If you would like to purchase a copy of the prior years' publications or would like to participate in this year's Survey, please visit our web site at [www.chalfin.com](http://www.chalfin.com).



This information is designed to be accurate and authoritative; however, this publication is distributed with the understanding that it does not render legal, accounting or other professional advice, and no liability is assumed in connection with its use.

# How The Chalfin Group Can Help You

The Chalfin Group provides strategic planning and valuation services to information technology firms. This includes advisory services relating to the purchase and sale of information technology firms. If you would like more information on our services, please check the appropriate boxes below and return this page via facsimile to 732-321-1066 or email your request to [services@chalfin.com](mailto:services@chalfin.com).

## Services

- Advisory services relating to the purchase and sale of information technology firms
- Positioning companies for sale
- Business valuation
- Programs to increase the value of your business
- Business and strategic planning
- Structuring compensation and long-term incentive plans

The Chalfin Group has once again mailed its complimentary tax tables. Please contact us if you have not received your copy or if you know of someone who would like a copy.

The Chalfin Group Inc.  
45 Bridge Street; P.O. Box 4519  
Metuchen, NJ 08840-4519  
[www.chalfin.com](http://www.chalfin.com)

BULK MAIL  
US POSTAGE  
**PAID**  
METUCHEN, NJ  
PERMIT NO. 6

RETURN POSTAGE GUARANTEED

This information is designed to be accurate and authoritative; however, this publication is distributed with the understanding that it does not render legal, accounting or other professional advice, and no liability is assumed in connection with its use.