

# IBBA News

International Business Brokers Association, Inc.

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## INSIDE

- 2** Officers and Directors  
Public Relations and You  
by Brian Knight
- 3** Dual Agency and the Business  
Broker by Robert J. Gurrola
- 4** Will the Real Buyer Please  
Stand Up? by Julie Johnson
- 5** Dealing with "Skimming"  
Sellers by Paul R. Hyde
- 6** Do It Yourself Brokerage  
by James Hines
- 7** Practice Pointers –  
Qualifying Seller Clients  
by Henry "Hank" James
- 8** Broker Due Diligence?  
by Ken Oppeltz
- 9** IBBA News to Feature  
Display and Business  
Card Advertisements  
by Christina Tomaso
- 10** Feeling Disconnected?  
The Future of Internet  
Connections by Azurdee Veigel
- 11** Web Security Breakdown  
by Jack Schumann
- 13** Lo-Tech Networking  
by Gene Pepper
- 14** Preparing a Marketing Package  
by William Tabar
- 15** IBBA Membership –  
Professional Development  
by Henry Hicks
- 16** Millennium M&A Mantra:  
"May the Source Be With You:  
by Michael Hannon
- 17** Why Wouldn't You Use Pratt's  
Stats? by Shannon Pratt and  
Doug Twitchell
- 18** The Non-Bank Alternative  
by Paul Jokerst
- 19** You're Not in the Sales  
Business, You're in the  
Relationship Business  
by Alan Weiss
- 20** IBBA PR Tips and Tactics  
by Tim Gorman

## Message from the President

By A.T. "Fred" Zirkle, CBI, Zirkle & Co., Salt Lake City, UT



IBBA members experience a wide range of incomes. We each possess different levels of experience and serve varying markets, but better results await

those who work smarter. Evaluate your engagements and the resulting workload. Could you be focusing on more productive activities? I counsel my associates to take 30 minutes each week and ask: "What action(s) would increase my income if no tasks were competing for my attention today?"

Review the deals that haven't closed. Why did you take the assignment? What has changed? If a deal goes stale then learn something and avoid making the same mistake in the future.

Are you utilizing your IBBA membership? Do you have a "CBI" after your name? IBBA's site (<http://www.ibba.org>) is receiving significant traffic. Have you entered your deals in the Deals Database? Are you networking with members? A great way to meet members is serving on an IBBA committee and attending conferences.

Our Denver Conference will cover the usual courses plus industry-specific workshops, installment tax treatment and interstate licensing. Be sure to attend the conference (June 4-10) and meet buyers, lenders, franchisors and lenders.

Special thanks for the ongoing efforts of IBBA members – especially

Gary Johnson and Mike Adhikari, IBBA Government Relations committee, for speaking out on the Seller Financing/Installment Sales tax. Our representatives have met with the Department of Treasury. The Department appears willing to consider legislation to limit the potential impact on small business; they are just not willing to support full repeal. As of this writing, it is clear to us that the only thing we can do is push for the two bills on the Hill.

Jim Afinowich, CBI, first vice president and treasurer, completed our annual budget after extensive input from Committee chairs. We're spending over \$1 million on conferences and member services. Special thanks also to George Rosinger, CBI for the outstanding job he has done in serving as the editor of *IBBA News*. We also appreciate your positive feedback regarding our weekly e-mail update.

See you in Denver.

*Fred Zirkle, IBBA president, has served as president of two global Nasdaq-traded companies and founded a venture capital firm. Zirkle is president of Zirkle & Co, and chairman of IndustryPro.com, an Internet database and research service that owns BizQuest and has developed Web sites for over 100 M&A organizations.*

# Dealing with "Skimming" Sellers

By Paul R. Hyde, EA, CBA, BVAL, Hyde Business Properties and Valuations, Parma, ID



When listing a business for sale, the last thing I want to hear as a business broker is "the tax returns show that I only made \$x,xxx, but I really make \$yy,yyy, and I want \$z,zzz,zzz for my business." Anyone who has worked as a business broker for any length of time has heard something like this an untold number of times.

The best response for this type of comment is that a buyer will only pay for the income you can prove. Buyers will not pay for hidden, stolen, skimmed or unreported income unless it can be proven to exist. A Seller that has skimmed income for many years has already been paid for part of the business – the unreported income has gone into his/her pocket. He or she cannot expect to be paid twice for the same thing.

I am not talking about the legitimate, and sometimes illegitimate, expenses that are verifiable from a Seller's books such as personal cars, personal insurance, and expensive owner's toys, etc. that are charged to the business. The business broker can with relative ease identify these items and make adjustments to derive the actual cash flow of the business. I am talking about cash that comes in the door, but doesn't make it to the cash register – income that is not reported at all. Often, "cash" businesses such as restaurants are where this type of activity most commonly occurs.

Occasionally, we run into a "good" business where the owner has skimmed, but we have a buyer who wants it anyway. In cases like this, the business broker can structure the deal to cover both the Buyer and the Seller. An example is a restaurant that I recently sold.

I have sold numerous restaurants and know the dollar range in which both the food costs and payroll expenses should be. After reviewing the "books"

the Seller provided to me, it was obvious that significant skimming was taking place. The Seller represented to me that he was skimming approximately one-half of the sales – the total amount that came in green paper. He represented that the business was doing \$33,000 a month in sales, but had bank statements and records showing deposits of \$17,000 to \$18,000 a month – a big discrepancy. He was also paying a number of his employees "under the table." In short,

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*When I find someone skimming, I advise him or her to stop and to properly report all income. It simply is not worth it to practice tax fraud.*

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he was running an IRS agent's dream come true – verifiable tax fraud!

Some of you may be wondering at this point about the broker's liability or responsibility to report this type of tax fraud? I have wondered about the same thing. Since I was writing an article on the topic, I decided that perhaps I had better investigate the issue.

My first call was to my attorney. He told me that I could not participate in, or in any way be party to, a fraud. However, in his opinion, I was not in anyway obligated to turn in my client to the IRS. My second call was to the person in the Idaho Real Estate Commission in charge of ethics. His response was that I had three options: 1) I could do nothing; 2) I could advise my client to report all of

his income; and 3) I could turn in my client to the IRS.

As he suspected that I would not be too excited about option number three, he recommended that I consider advising the client to report all of his income, and make a notation in my file that such a recommendation was made.

My third and most interesting call was to the Internal Revenue Service. I talked with a number of agents who kept passing me on to others. The final resolution was best summed up as the following: I have no obligation to report fraud; however, I should consider it my civic duty to report fraud to the IRS criminal investigation group. As an Enrolled Agent, my conduct with the IRS is governed by a document called Treasury Department Circular 230 – Practice Before the Internal Revenue Service.

In Subpart B – Duties and Restrictions Relating to Practice Before the Internal Revenue Service – paragraph 10.21 states:

*"Each attorney, certified public accountant, enrolled agent, or enrolled actuary who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error or omission from any return, document, affidavit, or other paper which the client is required by the revenue laws of the United States to execute, shall advise the client promptly of the fact of such noncompliance, error, or omission."*

In other words, I interpret this statement to mean that if I have a client committing tax fraud, I should advise him to report all income and advise him against tax fraud. My personal policy is to do just that. When I find someone skimming, I advise him or her to stop and to properly report all income. It simply is not worth the risk of practicing tax fraud. A good accountant and/or tax attorney can help you minimize your income taxes. Beyond

**"SKIMMING" SELLERS**, continued on page 6

**"SKIMMING" SELLERS**, continued from page 5

that, everyone has an obligation to pay his or her fair share. However, beyond advising a client not to commit tax fraud, I do not advocate turning them in. One, I do not think it is my responsibility to be the IRS's policeman. Two, I doubt that turning in clients for suspected tax fraud is acting in their best interest. As their agent, I believe I do have an obligation to act in their best interest.

Back to the case at hand. I had a Buyer that wanted the type of restaurant I was representing. We agreed on a price of \$120,000 for the business, including a lease transfer for the building based on the Seller's claims of doing \$33,000 a month in gross sales. I structured the deal with a \$60,000 cash down payment and the balance due in ninety days, based on the following formula:

$\text{Sales for } 90 \text{ days} \times \$60,000 \text{ remaining note}$   
\$100,000

The \$100,000 denominator represents the minimum expected sales for the 90-day period – \$33,000 per month times three months. If the actual sales for 90 days were at least \$100,000, the Seller would receive 100 percent of the remaining \$60,000. In other words, the full payment of the balance owing. If the sales for 90 days were only \$75,000, the Seller would receive 75 percent (\$75,000 divided by \$100,000) of the \$60,000 note, or a cash payment of \$45,000 in full settlement of the remaining note. Of course, the Seller asked, "what if the sales are over \$100,000, will I get more money?" My answer was, "No. We are doing this convoluted transaction to prove that sales are at least what you claim they are." He went along.

Both the Buyer and Seller were to work in the restaurant during the 90-day note period, with the Seller being paid an hourly wage for his time. The actual sales were verified during this period. Both the Buyer and Seller were happy

with this approach.

At the end of the 90-day period, the Buyer paid most of the balance owed to the Seller. The Buyer was happy, the Seller was happy, and the broker was also very happy – I received a commission that ordinarily would have been missed.

*Paul R. Hyde is president of Hyde Business Properties and Valuations, Inc., a business brokerage and business appraisal firm. Hyde is enrolled to practice before the Internal Revenue Service (an Enrolled Agent), is a Certified Business Appraiser, and has received his Business Valuator Accredited for Litigation designation. He holds B.S. and M.S. degrees.*