

Management



Tax Concepts



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New York Statutory Residency: a Tri-State Trap for the Unwary

By Joshua K. Lawrence, Esq.

Commuting to New York City is a fact of life for many in the tri-state area. So is the prospect of a New York tax audit for those who have a home in New Jersey, Connecticut or Long Island and an apartment in the City. The stakes are high for those unaware of the complex rules and some very recent developments in New York's residency laws (including the *Gaied* case decided June 16, discussed below).



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In *Matter of Robertson*, the taxpayer lived on Long Island but commuted to Manhattan, where he also maintained an apartment. A residency audit confirmed that Robertson's true "home" was on Long Island, but he was nonetheless determined to be a New York City resident for tax purposes. The City income tax bill was \$26.7 million! The issue, after a four-day hearing and an appeal to the Tax Appeals Tribunal, was where he was physically located (i.e. NYC or LI) on *two days* during the tax year.

To understand the risks involved with New York "statutory residency", it is critical to understand that a person can be taxed as a "resident" of New York City or State in one of two ways: (1) being "domiciled" in New York; or (2) maintaining a "permanent place of abode" in New York **and** being

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Staying on steady ground

Health care law entails ongoing planning, preparation

Although the passage of the Patient Protection and Affordable Care Act (PPACA) is no longer news, the law itself seems hardly a done deal. Opponents are still lobbying for its repeal, and there remain questions about whether every provision will come to fruition. In terms of your company's PPACA compliance, staying on steady ground entails ongoing planning and preparation.

To offer or not

Starting in 2014, your company might face a tax penalty for not offering a health care plan. The PPACA rules affect only midsize to large companies, but they aren't straightforward. In a nutshell, employers with 50 or more "full-time equivalent workers" (FTEs) that don't provide a health care plan and have at least one full-time employee who receives a health care premium tax credit (a new tax break for certain individuals who buy coverage for themselves) will face a \$2,000 annual fee per FTE — though not including their first 30 FTEs.

On the other hand, if you're a small business looking to buy group health coverage, PPACA harbors a helpful incentive: For the 2010, 2011, 2012 and 2013 tax years, eligible companies may be able to claim a tax credit of up to 35% of their health plan premiums as long as the business contributes at least 50% of the plan's total premium or 50% of a benchmark premium. A maximum credit of 50% will be available in 2014 to qualifying small businesses that buy coverage via a state exchange (programs that will allow employers to form groups to negotiate with insurers) and contribute at least 50% of the total premium cost.

Ask your financial or benefits advisor about whether you could incur a tax penalty for not providing coverage or gain a tax break for offering it. Eligibility requirements and applicable rules for the credit are complex but worth exploring.

Your employees' children

Businesses also need to stay on top of the newer rules regarding coverage to employees' dependent children. That is, for plan years beginning on or after Sept. 23, 2010, employers that offer coverage to employees' children must continue covering those children until the children turn age 26. You may continue providing benefits thereafter, but you don't have to.

Naturally, there are tax issues you may want to communicate to your employees. Internal Revenue Code Sections 105 and 106 have long excluded from an employee's taxable income:

- Coverage under an employer-provided health care plan, and
- Employer-provided reimbursements for the medical care of an employee as well as that employee's spouse or dependents.



Going to the cafeteria

For companies implementing new health care coverage or revising their existing benefits, one fairly simple option is a cafeteria plan. Under this arrangement, participants may choose from a variety of benefits while the employer enjoys a relatively lower administrative burden.



For tax years beginning after Dec. 31, 2010, small businesses have the option of adopting a simplified cafeteria plan. To qualify, your company must have employed 100 or fewer employees during the preceding two years. Plus, your health care plan needs to provide certain minimum employer contributions.

The simplified plan will satisfy nondiscrimination requirements if it meets basic guidelines. An advantage of one of these plans for your employees is that the Internal Revenue Code provides a “gross income exclusion” for some benefits. That is, it allows employees to elect between cash and certain qualified benefits that won’t be included in their gross income for tax purposes.

Those particular sections of the tax code have been amended to include coverage for an employee’s child who has yet to reach age 27 as of the conclusion of that worker’s taxable year. (Children of self-employed individuals who claim the health insurance deduction on their federal returns may also qualify for this benefit.)

Under the law, a “child” may be an employee’s son, daughter, stepson or stepdaughter. That includes children legally adopted and lawfully placed with a worker for adoption. Foster children placed by an authorized placement agency or by court order also qualify.

Stricter restrictions

As you may have heard or read about at the time PPACA was passed, it greatly restricts insurers’ ability to reject plan participants or charge them more money. So, if you’re shopping for a plan or reviewing your current one, keep an eye out for provisions that may cut a little close to a violation of these provisions.

For instance, PPACA immediately forbade plans from imposing a lifetime dollar limit on “essential”

benefits. These may include offerings such as immunizations, women’s preventive care, and screening for high-risk diseases such as cardiovascular ailments and high blood pressure.

Pre-existing conditions and cancellations are also hot-button issues. For 2011 and 2012, a plan may not exclude children under 19 years of age because of a pre-existing condition. And, starting in 2013, a plan may not contain a pre-existing exclusion whatsoever. Plan cancellations are also generally prohibited aside from where fraud or intentional misrepresentations of material fact have occurred.

Costs rising

For employers, health care benefits are already expensive. In fact, business owners who participated in a 2010 National Business Group on Health survey estimated that their health care costs would rise by an average of 8.9% in 2011. Add legal costs or tax penalties to that and the expense of offering these benefits could skyrocket. Work with your financial and legal advisors to ensure your company is complying with the rules that affect you. ♦

Limited time only: The \$5 million gift tax exemption

Late last year, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 brought some important developments to estate planning. For example, the law reduced the top gift and estate tax rates to 35% for 2011 and 2012. And it increased the lifetime gift tax exemption to \$5 million for 2011 and inflation-indexed it for 2012. For some taxpayers, that exemption increase offers a potentially limited-time-only opportunity that's worth exploring.

Weigh your options

The \$5 million exemption will generally most benefit people with relatively sizable estates. If you're among those taxpayers, making gifts up to the maximum (less any lifetime exemption already used) this year and next could be an effective way to remove dollars from your estate without incurring gift tax liability.

“Gifted assets aren't entitled to a 'stepped-up basis,' which could lead to higher capital gains taxes for the recipients should they sell the assets.”

In fact, if you're concerned about the gift and estate tax rates returning to their pre-2011 levels in 2013, you may even want to make taxable gifts *beyond* your available exemption. Why? By doing so, you can take advantage of the lower 35% gift tax rate before it possibly jumps up to 55% in 2013.

Of course, it's still possible that Congress may extend the current exemptions and rates. But



that doesn't mean you shouldn't make gifts now, because doing so will also remove future appreciation on the gifted assets from your estate.

An important caveat, however, is that gifted assets aren't entitled to a "stepped-up basis," which could lead to higher capital gains taxes for the recipients should they sell the assets. Thus, you'll need to compare the gift and estate tax savings with how severely capital gains taxes could affect your heirs.

Beware the clawback

Another important consideration is a potential "clawback." If the estate tax exemption falls to \$1 million at the time of a taxpayer's death, any lifetime gifts exceeding that amount — even if made under the \$5 million exemption — could possibly be "clawed back" into the person's estate and subject to an estate tax rate as high as 55%.

On the bright side, many pundits dismiss the specter of clawbacks. And, even if the date-of-gift value is later subject to estate tax, making use of the gift tax exemption is still worth considering because the post-date-of-gift appreciation is removed from your estate. So you'll still be reducing your taxable estate — and, therefore, your estate tax liability.

Review your plan

It's been easy to neglect estate planning recently because of the great uncertainty surrounding it. But, now that we have some temporary specifics, the time is right to review and perhaps revise your estate plan. ♦

Are you on top of your cash flow?

It's all about the numbers ... and good timing

In a good economy, cash flow is important. But, in a questionable economy, it's very important. Are you staying on top of your company's cash flow? Granted, doing so is no easy task. But a sound budget, regular cash flow statements, ongoing reviews of expenses and a knack for good timing can keep you sailing along.

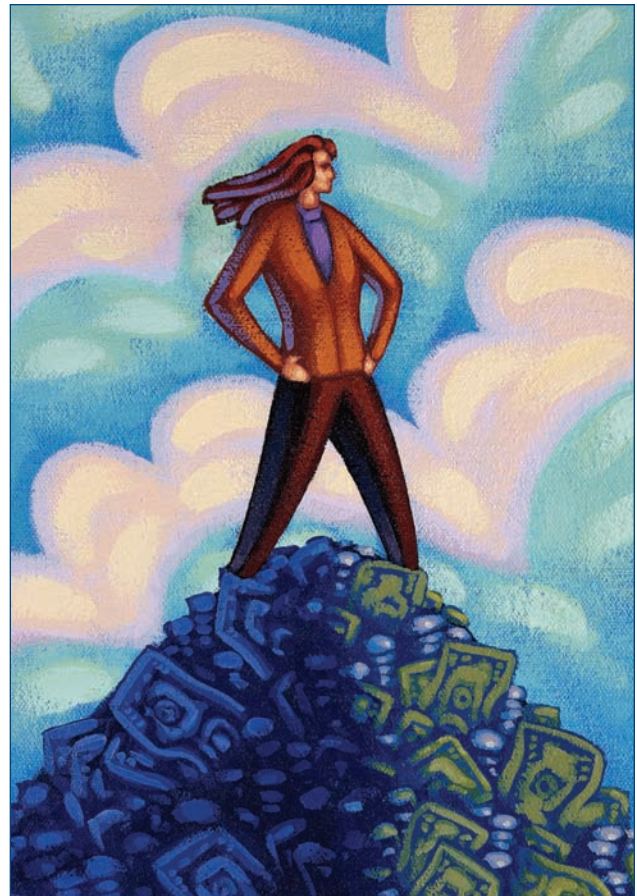
Bearing down on a budget

The first essential cash flow analysis tool is your annual budget. Although maintaining a detailed budget for all company expenditures can be tedious, it's fundamental to good cash flow management. Your budget can facilitate expense tracking and help guide spending decisions to align with your business goals.

Items in your budget should tie into and support overall business goals. If you can't effectively demonstrate how an item enables a particular goal, question its merit. This will help you avoid unnecessary spending and make more funds available for allocation to worthier business needs.

Also bear in mind that, for analysis purposes, a budget is useful only if you update it regularly to accurately reflect your actual spending. For

instance, you may have overbudgeted or underbudgeted on some items and, thus, spent more or less than you'd anticipated.



Making a statement

With your budget as the foundation, work with your CPA to create a cash flow statement. The purpose of this document is to report your business's net increase or decrease in cash.

The statement factors in the cash inflows and outflows of daily business operations, asset purchases, sale proceeds and financing activities. Because it excludes noncash accounting items, you can use it to pinpoint cash flow problems.

“Maintaining accurate expense records gives a more complete view of your financial situation, putting you in a better position to effectively manage your company and ensure ongoing profitability.”

If you want to get the most from your cash flow statement, you're likely best off generating one monthly. But quarterly and annual statements can be useful for identifying cash flow trends.

Accounting software packages can help automate and simplify the process of preparing these and other essential financial reports.

Examining expenses

After securing an overview of your company's cash flow, you can start examining specific areas. One in particular is expenses. Here, too, you should look to your records.

Maintaining accurate expense records gives a more complete view of your financial situation, putting you in a better position to effectively manage your company and ensure



ongoing profitability. Accounting software can help you automate the meticulous process of expense account organization and records tracking.

As you review your expense data, seek out ways to reduce your company's day-to-day operating expenses. For example, you may find it more economical to outsource noncore areas of the business such as human resources, payroll and benefits management, or information technology support.

Or you might implement just-in-time inventory management, with suppliers maintaining inventory for your business as long as possible, saving you storage and interest costs.

Getting your timing down

Timing is critical when it comes to both the money coming in and going out. Conduct credit and reference checks on new customers to validate their payment histories and minimize the risk of collection problems. Consider requiring customers to provide deposits on product orders or services to be rendered and offering discounts for paying invoices early.

Are mistakes hurting you? Prevent invoicing errors and costly collection delays by maintaining current and accurate customer account data. Promptly send invoices to customers — fax or e-mail delivery could quicken the process. Also, follow up quickly on past-due accounts. Don't wait until accounts are 60 or 90 days late.

On the flipside, take a look at your payables. Generally, you shouldn't pay invoices earlier than required unless you're offered a discount. Use your buying power for large-volume and frequent purchases as leverage to negotiate discounts, free financing or extended payment terms.

Staying strong

Cash isn't just king. It's your best friend, business partner and star employee. Be sure to review your cash flow regularly and work with your financial advisors to ensure it never weakens to a dangerous level. ♦

3 money-management tips for married couples

Love and marriage may go together like a horse and carriage, but taking a smart approach to money can help make the ride much smoother. Matrimony creates the potential for both great opportunities and difficult problems, depending on the approach taken. Here are three money-management tips that married couples should consider:

1. Balance and clarify your goals.

Many couples have a tendency to tiptoe around financial issues because of the great potential for conflict. Yet, if you openly communicate about where you'd like to go, you're more likely to get there.

Each spouse needs to talk about his or her individual financial goals and financial wishes for the marriage. Where do you share goals? Where do you differ? Ultimately, you want to balance your goals to put your household in the most secure, advantageous position while allowing each spouse a reasonable opportunity to pursue individual objectives.

2. Find ways to save.

It's a familiar refrain: He wants to save, she wants to save, yet, together, they just can't do it. Granted, saving money isn't easy — but, in today's unpredictable economy, a healthy savings account is an absolute necessity to financial security. And, indeed, saving should play a prominent role in your monthly

budget (which, in and of itself, is also a financial necessity).

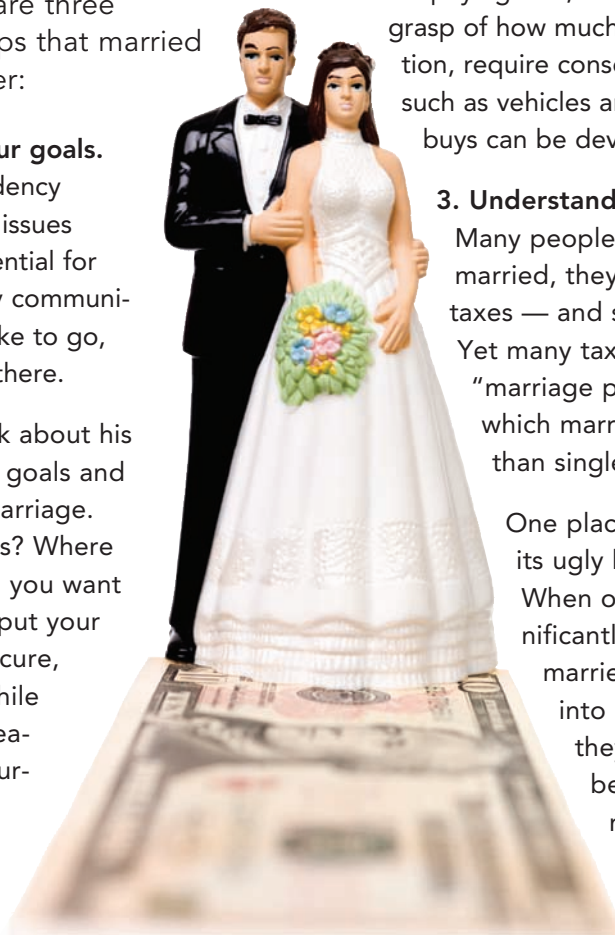
How can you better ensure a percentage of your income gets earmarked "savings," not "disposable"? Review your expenses regularly and take turns paying bills, so both parties have a clear grasp of how much money is available. In addition, require consensus on big-ticket purchases, such as vehicles and home electronics. Impulse buys can be devastating.

3. Understand the "marriage penalty."

Many people assume that, by getting married, they'll save on federal income taxes — and sometimes that's the case. Yet many taxpayers are subjected to the "marriage penalty," a disparity under which married couples pay more in taxes than single filers.

One place the marriage penalty rears its ugly head is in the tax brackets. When one spouse doesn't earn significantly more than the other, a married couple may be pushed into a higher tax bracket than if they could file as singles. This is because the thresholds for married filers to become subject to the 28%, 33% and 35% tax rates are less than double those for single filers.

And you can't avoid the penalty by filing separately — these rates' thresholds for separate filers are half those of joint filers, and thus also lower than those for single filers. So smart tax planning for married couples is especially important. ♦



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New York ... continued from page one

physically present in the State or City for more than 183 days during a tax year (a “statutory resident”). The burden of proving “days out” of New York rests on the taxpayer. For Robertson, the difference between being taxed as a resident of New York City (that is, liable for State and City income tax on 100% of his worldwide income) and being a nonresident (liable only for New York **State** tax only) was whether he spent 182 days in the City or 184 days.

The statutory-residency test may look straightforward, but ambiguities over what constitutes “maintaining a permanent place of abode” and what constitutes a “day” in New York abound. Those who live in proximity to New York City or State should be aware that, for purposes of the 183-day test, tax auditors will treat **any part of a day in New York a New York day** (with the exception of passing through for travel elsewhere). This has produced bizarre results. In *Matter of Klingenstein*, a couple owned a Manhattan apartment but lived in Greenwich CT, **two miles** from the New York State border. They were taxable as New York State residents because their “day count” included not only the husband’s workdays in the City, but the couple’s brief crossings from Greenwich over the New York State border to dine out or go to the store.

Just this month, the New York State Tax Appeals Tribunal also lowered the bar for what it means to “maintain a permanent place of abode.” Although owning or renting an apartment and staying there can suffice to expose a person to tax residency, what if the taxpayer maintains the apartment exclusively for a child or a parent? The Tax Department’s audit guidelines indicate that a dwelling maintained by a taxpayer but used exclusively by another shouldn’t be factored.

But that policy is now in doubt, courtesy of the Tribunal’s June 16 decision in *Matter of Gaied*. In *Gaied*, a New Jersey domiciliary who owned a business on Staten Island was audited and found to be a City resident based on his ownership of a multi-family home on Staten Island. He leased out two units to tenants but retained one to house his ailing parents. The taxpayer initially proved to the Tribunal that, even though he occasionally stayed overnight (on a couch) at his parents’ request, the apartment was not a permanent place of abode for **him**. However, after the Tax Department successfully moved to reargue the case, the Tribunal reversed itself entirely, holding (among other things) that “[t]here is no requirement that the petitioner actually dwell in the abode, but simply that he maintain it.” According to the Tribunal, the abode in question need not even have a **bed!** The *Gaied* case could thus have far-reaching implications for anyone who owns or rents an apartment, regardless of how it is used.

These examples demonstrate the thorny issues for nonresidents who have a regular presence in New York City but live elsewhere. Those who maintain a City apartment must be extra vigilant, as “statutory residency” is a trap for the unwary.

Editor’s note:

Joshua K. Lawrence, Esq., an associate with Hodgson Russ LLP in New York City and Buffalo, is a member of Hodgson Russ’s State and Local Tax (SALT) Practice Group. Our clients have used his firm for New York City and New York State tax matters, including handling residency audits, sales tax controversies, and corporate-tax matters. For complicated New Jersey SALT matters our clients have used Florham Park based Alan J. Preis, CPA.

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