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Tax Concepts



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Tax Relief Act Extends Breaks For Individuals and Businesses

By Jay Trien, CPA, Esq.—Senior Partner

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, signed into law Dec. 17, extended and expanded a wide variety of valuable tax breaks and includes tax provisions affecting individuals and businesses. Below is a brief summary of the Act, but also see page two.



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Individual tax provisions

General:

- New two-percentage-point payroll tax cut for 2011
- Extension of the lower ordinary income tax rates for all tax brackets through 2012
- Extension of marriage penalty relief through 2012
- Extension of the elimination of itemized deduction and personal exemption phase-outs through 2012
- Extension of the deduction for state and local sales taxes in lieu of state and local income taxes through 2011
- Extension of the increased alternative minimum tax (AMT) exemptions through 2011
- Extension of the ability to offset AMT liability with certain nonrefundable personal credits through 2011



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New tax law expands, extends multiple provisions

It was a long time coming but, on Dec. 17, the president signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Here are some highlights.

For individuals

If you're worried about your income tax rate going up, you can rest easy — until 2013. That's when ordinary rates are now scheduled to rise, instead of 2011. Under the Tax Relief act, you'll also pay less payroll tax in 2011.

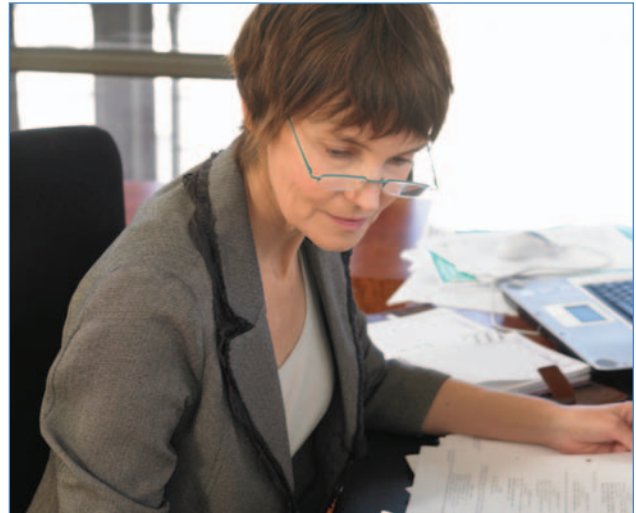
The 15% long-term capital gains rate, scheduled to increase to 20% in 2011, will remain at 15% through 2012. The act also extends the 15% tax rate on qualified dividends through 2012, rather than subjecting them to generally higher ordinary rates.

The act extends some tax breaks related to raising children and funding an education, too. And it contains alternative minimum tax "patches" for 2010 and 2011, reducing the chance you'll be subject to the tax.

For estate planning

Finally, some — albeit temporary — estate planning certainty. The act reinstates the estate tax for 2010 with a 35% top rate (down from 2009's 45%), a \$5 million exemption (instead of 2009's \$3.5 million) and a generally unlimited step-up in basis. But for those who died in 2010, the estate can elect to follow the previous estate tax regime (estate tax repeal but a limited step-up in basis). The generation-skipping transfer (GST) tax has also been reinstated for 2010 with a \$5 million exemption but at a 0% rate.

The top estate and gift tax rates and the GST tax rate will be 35% for 2011 and 2012. Meanwhile, the



estate, gift and GST tax exemptions will be \$5 million for 2011 and be indexed for inflation in 2012.

For business owners

The Small Business Jobs Act of 2010 (SBJA) extended 50% bonus depreciation, generally for 2010. The Tax Relief act temporarily increases that percentage to 100% for qualifying assets placed in service after Sept. 8, 2010, and before Jan. 1, 2012. Then the act brings back 50% bonus depreciation, generally for qualifying assets placed in service in 2012.

SBJA also increased the Section 179 expensing limit to \$500,000 and the phaseout threshold to \$2 million, generally for 2010 and 2011. Under the Tax Relief act, the Sec. 179 limit will drop to \$125,000 with a \$500,000 phaseout threshold (both indexed for inflation) for 2012. But that's still better than the \$25,000 limit with a \$200,000 phaseout previously scheduled.

For your consideration

We've noted here just a few of the Tax Relief act's provisions for your consideration. Consult your tax advisor for more complete details. ♦

3 business financing alternatives to consider

The standoff continues between conventional lenders and small to midsize companies. On one side are the banks, which show no signs of backing down from their strict provisions and are taking more time than ever to approve loans. On the other are the business owners, many of whom are desperate for capital infusions to compete in a tough marketplace.

According to the Pepperdine Private Capital Markets Project — a twice-annual survey of 559 privately owned companies — the primary concern of many business owners is access to capital. More respondents (31%) cited this as their top worry, rather than concerns about the economy (27%). If you're currently looking for business financing, here are three options (other than conventional lenders) to consider:

1. Microfinancing. Traditionally, recipients of microfinance loans were self-employed business owners and low-income individuals. But these arrangements have taken off with small businesses as well.

In fact, 56% of microfinanciers reported increases in loan applications in 2009 (the most recent data available), according to the Opportunity Finance Network (opportunityfinance.net). At least some of that increase is likely attributable to businesses. Your financial advisor or local Chamber of Commerce can point you to a potential microfinance institution.

2. Small Business

Administration (SBA) loans.

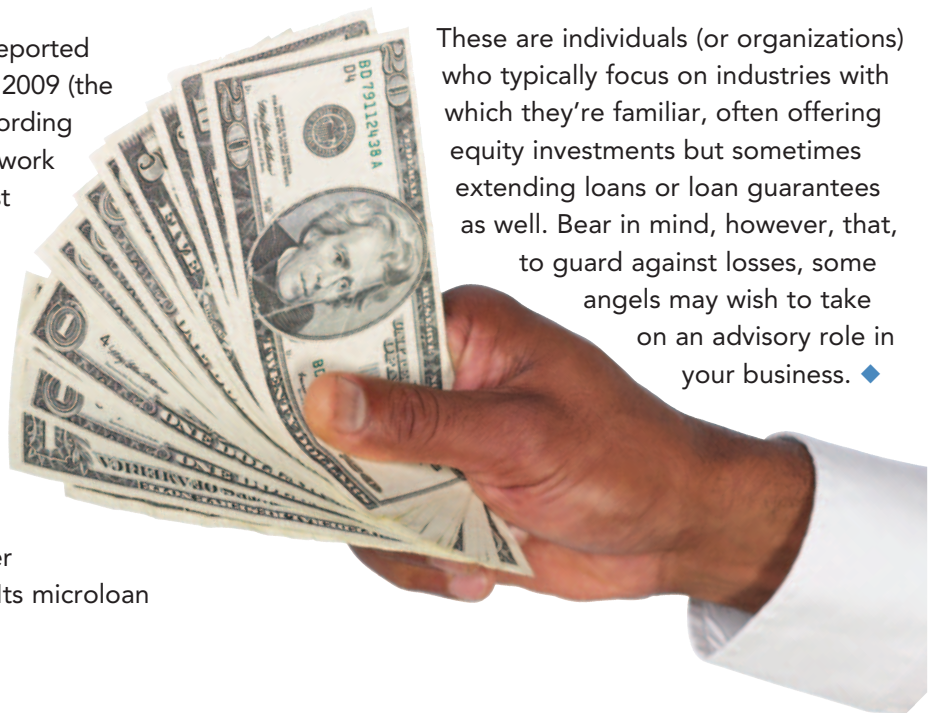
Speaking of microloans, another ready source may be the SBA. Its microloan

program offers qualifying companies up to \$35,000 in capital with a maximum six-year term. The interest rate will vary depending on the intermediary lender involved, but the agency's website reports that rates generally fall between 8% and 13%.

Of course, the SBA's financial assistance offerings don't end there. Its 7(a) loans, for example, help startups and existing small businesses with financing that's guaranteed for a variety of general business purposes. The SBA also offers low-interest disaster loans to businesses of all sizes. You can use one to repair or replace real estate, machinery and equipment, inventory, and other assets that have been damaged or destroyed in a federally declared disaster.

3. Angel investors. The word "networking" gets thrown around a lot in business improvement circles. But, when it comes to getting a business loan, networking really can pay off. Specifically, if you get the word around enough about your company, you may be able to track down an angel investor.

These are individuals (or organizations) who typically focus on industries with which they're familiar, often offering equity investments but sometimes extending loans or loan guarantees as well. Bear in mind, however, that, to guard against losses, some angels may wish to take on an advisory role in your business. ♦



Is it time for a check-up?

A business valuation can serve many purposes

If someone were to strongly suggest you have your company appraised, you might assume he or she either wanted to make you an offer or was subtly suggesting you retire. But a valuation can serve many purposes that every business owner should consider. Think of it as a check-up for your business that can help you gauge a variety of important issues.

Strategizing your future

Although the economy has shown signs of improvement recently, it still poses plenty of challenges for many companies across the country. Chief among these is financing — it's not easy to get because lenders are still imposing tough standards.

A business valuation conducted by an outside expert can help you present timely, in-depth financial data. Not only will it help bankers better understand how your business runs, but the discounted cash flow section will show how your expected future cash flows will build value. This

can go a long way toward easing a lender's concerns about your ability to compete in your local market conditions.

When valuing your business, a valuator would likely examine several company-specific factors, including your and your managers' awareness of market conditions, what specific risks you face and your contingency planning efforts to mitigate these risks. As you go through the valuation process, you may even recognize some of your company's weaknesses and devise ways to strengthen these components.

Fine tuning a buy-sell

Another side effect of the difficult economy is owner conflict. With the pressure on to maintain profitability in a difficult environment, everyone may not see eye to eye. And, in some cases, owners may want to leave the business.

This is just one of many reasons why it's important to establish and maintain a buy-sell agree-

ment. This contract among a business's owners sets guidelines for the transfer of their ownership interests. The agreement gives the remaining owners (or the business itself) the right to buy an exiting owner's interest if a "triggering" event occurs. Such events may include an owner's desire to leave the company, divorce, disability, retirement, death, or loss of a professional license or certification.

So what does all of this have to do with business



valuations? An appraisal of your company plays a key role in the creation and maintenance of a buy-sell agreement. Specifically, an appraiser could help you address the preferred valuation method, the appropriate standard of value, the effective valuation date, and the applicability of valuation discounts and premiums.

Considering a transfer

There's no getting around the fact that often the primary reason for getting a valuation is to prepare for a business transfer. Even if you aren't sure you want to buy, sell or gift a business interest, an appraiser can help you get a better sense of whether now is the time.

“As you go through the valuation process, you may even recognize some of your company's weaknesses and devise ways to strengthen them.”

Most appraisers subscribe to transaction databases that report recent selling prices of similar private businesses. A valuator also can estimate how much you'd net from a deal after taxes, as well as brainstorm creative deal structures that minimize taxes, provide you with income to fund retirement and meet other transfer objectives.

4 valuation terms to be aware of

Business valuations have a language all their own. Here are four terms you may hear or see when interacting with an appraiser:

- 1. Fair market value.** The International Glossary of Business Valuation Terms (available for free at bvresources.com/freedownloads/BVGlossary09.pdf) defines this as: “The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.”
- 2. Going concern value.** This is the estimated worth of a business that's expected to continue operating in the future (known in valuation parlance as a “going concern”). There are a variety of intangible elements of a going concern that an appraiser looks at, such as whether it has in place a trained workforce, functional facilities and operational necessities such as proper procedures, technology and licenses.
- 3. Valuation premium.** This is the amount by which an appraiser increases his or her estimate of an ownership interest's value based on specified circumstances. For example, a control premium might apply to a business interest that possesses the requisite power to direct the management and policies of the subject company.
- 4. Valuation discount.** This is the amount by which an appraiser reduces his or her estimate of an ownership interest's value based on specified circumstances. For instance, a discount for lack of marketability is deducted from the value of an ownership interest to reflect that interest's inability to be converted to cash quickly and at minimal cost.

In the eyes of a potential buyer, a formal appraisal adds credibility to your asking price. And if you want to gift business interests to the next generation, a written appraisal is a must-have to survive IRS scrutiny.

Alternatively, if you're in a position to buy out a competitor or other business, a valuation should play a critical role in your due diligence. An appraiser can scrutinize the seller's asking price,

including the reasonableness of cash flow and risk assumptions, when negotiating the final sale price.

Going the extra mile

Granted, you probably have plenty of other things on your plate as you work hard to keep your business competitive. But obtaining an appraisal is one more way to go the extra mile to protect your company and get all the information you need to wisely plan for its future. ♦

The best defense

Taking the initiative to protect your assets

For those who build a substantial amount of wealth throughout their lives, creditors and potential litigants can present a serious threat to personal assets. That's why it's important to take the initiative to protect your assets from such future claims.

Gifts and property titles

A relatively easy way to protect assets from your creditors is to give them away to your children or other family members. But there are downsides to this approach. You lose control over (and enjoyment of) the assets, and the assets may become subject to claims by creditors of the other family members. Gift tax liability is also a risk.

“You can protect assets from your heirs' creditors by placing them in a trust with 'spendthrift' provisions.”

If you and your spouse live in a state that recognizes “tenancy by the entirety,” holding a home or

other real estate in that form protects the property from claims of your and your spouse's separate creditors. It doesn't protect you, however, from claims of joint creditors.

If one spouse has greater liability exposure, another option is to transfer title of property owned by that spouse to the spouse with less exposure. Even if you live in a community property state, you may be able to protect assets by partitioning community property into separate property or having one spouse give property to the other spouse.

Trusts and retirement plans

You can protect assets from your heirs' creditors by placing them in a trust with “spendthrift” provisions, which prohibit beneficiaries from selling or assigning their interests, either voluntarily or involuntarily. But a spendthrift trust you create won't avoid claims from your creditors unless you relinquish your entire interest in the trust assets.

An alternative is a domestic asset protection trust (DAPT), now offered by a handful of states, which

potentially can allow you to protect assets from your creditors even if you retain a discretionary beneficiary interest. A discretionary beneficiary doesn't have unrestricted access to the trust assets but can receive distributions from the trust in the trustee's discretion.

You can take advantage of a DAPT in one state even if you live in another state. But bear in mind that DAPTs are relatively new and have yet to be fully tested in the courts, so their effectiveness remains uncertain.

Then again, you may not need a trust at all, or at least not immediately. A qualified retirement plan — such as a 401(k) or 403(b) plan — is one of the best places to safeguard assets. These plans are generally exempt from creditors' claims, at least until the benefits are distributed. IRAs also offer some limited protection.

A family limited partnership

Another technique for protecting assets is to transfer them to a family limited partnership (FLP) in exchange for limited partnership interests for you and your family. A properly structured FLP also can be used to reduce gift and estate taxes on transferred assets.

Generally, a limited partner's creditors can't reach the FLP's assets — they can only obtain rights to receive any distributions made from the FLP to the limited partner. By retaining a small general partnership interest (1%, for example), you can retain control over the property while keeping your liability exposure to a minimum. As a general partner you would have unlimited potential liability with respect to debts and



claims of the partnership, but the assets within the partnership should be protected from other claims against you.

Similar benefits can be achieved by forming a multimember limited liability company (LLC) rather than a limited partnership. Under this entity, you'd generally not have unlimited exposure to claims against the entity.

But FLPs and LLCs must be structured and operated carefully to survive an IRS challenge in court. Proper structure and operation are also necessary to help preserve liability protection.

Effective measures

Protecting your assets doesn't eliminate the need for liability insurance or equate to shirking responsibility for legitimate debts. In fact, fraudulent conveyance laws are in place to prevent doing the latter inadvertently or otherwise. But, the fact remains, no wealth management plan is complete without effective measures to protect your assets from creditors. ♦

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**Here's your latest edition of our
Management & Tax Concepts newsletter**

Tax Relief Act Extends Breaks ... continued from page one

Investing:

- Extension of the lower long-term capital gains rates through 2012
- Extension of the lower qualified dividend tax rates through 2012
- Extension of the 100% gain exclusion on certain qualified small business stock to stock acquired through 2011

Children and education:

- Extension of the \$1,000 child credit and other enhancements of the credit through 2012
- Extension of the higher adoption credit and income exclusion for employer-provided adoption assistance through 2012
- Extension of the higher dependent care credit through 2012
- Extension of the American Opportunity education credit through 2012
- Extension of the above-the-line tuition and fees deduction through 2011
- Extension of the income exclusion for employer-provided education assistance through 2012
- Extension of the enhancements to the student loan interest deduction through 2012
- Extension of the \$2,000 Coverdell Education Savings Account contribution limit and other enhancements through 2012

Charitable giving:

- Extension of the ability to exclude from income direct contributions from IRAs to qualified charities (up to \$100,000 annually) through 2011
- Extension of the ability to take a larger deduction for donations of long-term capital gains real property for conservation purposes through 2011

Estate planning:

- Reinstatement of the estate tax for 2010 with a top rate of 35% and a \$5 million exemption (compared to 45% and \$3.5 million for 2009)
- Option for estates of taxpayers who died in 2010 to elect to follow the pre-Tax Relief act regime — no estate tax but limits on step-up in basis for transferred assets

- Reinstatement of the generation-skipping transfer (GST) tax for 2010 at a 0% rate with a \$5 million exemption (compared to 45% and \$3.5 million for 2009)
- Decrease in the top estate and gift tax rates and the GST tax rate to 35% for 2011 and 2012
- Increase in the estate, GST and gift tax exemptions to \$5 million for 2011, indexed for inflation in 2012
- Ability of the estate of a taxpayer who dies in 2011 or 2012 to elect to allow the surviving spouse to use the deceased's unused estate tax exemption

Business tax provisions

Investment incentives:

- Increase in bonus depreciation to 100%, generally for assets placed in service after Sept. 8, 2010, and before Jan. 1, 2012
- Extension of 50% bonus depreciation, generally for assets placed in service Jan. 1, 2012, through Dec. 31, 2012
- Increase in the Sec. 179 expensing limit to \$125,000 (indexed for inflation) for 2012
- Increase in the Sec. 179 expensing phase-out threshold to \$500,000 (indexed for inflation) for 2012
- Extension of accelerated depreciation for qualified leasehold-improvement, restaurant and retail-improvement property through 2011

Tax credits:

- Extension of the research credit through 2011
- Extension of the Work Opportunity credit through 2011

Just the tip of the iceberg

The Tax Relief act includes numerous provisions, and many breaks are subject to a variety of rules and limitations, so it's important to discuss them with your tax advisor to determine exactly how they'll affect you. We'd be pleased to help.