

taxolutionsSM

Using The 2003 Tax Act To Your Advantage

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Since the goal of the 2003 Tax Act was to spur the economy, it offers some significant tax breaks for investors and businesses. This article covers some of the “universal” planning ideas. For ideas unique to your situation, be sure to contact us.

Capital Gain & Dividend Rate Cuts

The long-term capital gain rate is the lowest since 1933, and dividends are now being taxed at the lowest rate since 1916. These new rates can have a big effect on your tax bill and on your tax planning. For instance, you might benefit by shifting money from interest-paying investments (taxed at rates of up to 35%) to stocks that earn dividends taxed at the lower rates. Although many stocks don’t pay dividends, the equivalence of dividend and capital gain rates also makes it easier to focus on total return when investing in stock.

On the other hand, the 15%-tax-rate on dividends doesn’t matter a bit for investments in retirement accounts because distributions from those accounts are taxed as ordinary income. To keep your portfolio balanced while taking advantage of the dividend rate, arrange your investment holdings so that stock earning 15%-tax-rate dividends is held outside of your retirement accounts – keep investments earning interest, non-

qualifying dividends, or other ordinary income in your retirement accounts.

When planning your long-term investment strategy, remember that neither of these 15% rates will be around for long.

To take maximum advantage of these tax rate cuts, consider giving appreciating property and stock to your kids who are 14 and older. Because they’re in a lower tax bracket, they can sell the asset and pay tax at 5% (zero tax in 2008). It’s also a great way to pay for the child’s college education. Give your kids the property, let them sell it and pay the tax, and then use the proceeds for college costs.

Capital Gains & Business Tax Planning

The differential between the new long-term capital gain tax rate and the highest marginal rate on ordinary income is now 20%. While the issue of capital gain vs. ordinary income has always been around, planning your purchases and sales to maximize use of the capital gain rate is even more important because of that differential.

Watch how you classify assets at the time of purchase and when they are sold. Carve out everything you can as capital gain property. Consult with us before you make

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Buying A Business? Consider Every Angle – Especially The Tax Ones

When buying a business, so many details demand your attention that it's sometimes hard to concentrate on taxes. But if you don't, you may be unpleasantly surprised when it comes time to prepare your tax return.

A taxable sale of a corporate business can be structured as either an asset sale or a stock sale. Historically, sellers have preferred a stock sale in order to get capital gain treatment. Now, with the lower tax rates under the new law, more sellers may be open to asset sales. Asset sales generally benefit the buyer since they can maximize future depreciation write-offs.



Buyers may believe a purchase acquisition is simple. However, even an outright asset purchase has tax effects that should be planned for. One of the most important is identifying the character of the assets purchased.

Intangible assets, such as goodwill and intellectual property rights, both inside the business and outside the business (if any)

will need to be identified. This is also true of tangible assets, which are usually more easily classified. This classification dictates the character of the assets and the resulting tax treatment. As with so many other things, the IRS has detailed rules on how to identify such property.

Why Is Classification So Important?

Classification is important because different business assets have different tax treatment.

Tangible assets are depreciated over 3, 5, 7, 15, 27½, or 39 years. Many intangible assets are amortized over 15 years. Intangibles include items such as: customer lists, licenses or permits, formulas or processes, goodwill, and non-compete agreements. Some items, which might have a shorter amortizable period on their own (such as a non-compete agreement), become 15-year property simply because they are part of the purchase of a business, or a group of business assets.

The IRS requires that the purchase price be allocated to assets using what is referred to as the “residual valuation method.” This means that you take the total purchase price and subtract-out specific classes of assets until you get to the “residual.”

Asset classes start out with the easiest to value: cash, deposits, marketable securities, receivables, and inventory; and then proceed through depreciable tangible assets (furniture, equipment, and buildings) to the intangibles. The very last asset class is for goodwill and going concern value. This class is considered the “residual” with any unaccounted-for purchase price amount being automatically classified as goodwill.

Unless the purchase price is clearly defined, more of it is apt to be classified as goodwill subject to 15-year amortiza-

tion. The buyer will be better off if more of the cost of the business is allocated to assets with shorter depreciable lives.

While the buyer wants assets with shorter lives, the seller generally wants more of the cost to be allocated to intangibles, such as goodwill, since they get capital gain treatment. This creates a tension between the buyer and the seller.

To ensure consistent treatment, both buyer and seller are required to file Form 8594, “Asset Acquisition Statement,” with their tax return for the year of the sale. This form requires both parties to show how the purchase price was allocated to various classes of assets using the residual method.

But, it doesn't stop with the assets purchased as part of the business. Related payments, such as covenants not-to-compete or employment agreements with owners or employees of the seller, must also be disclosed and brought within the longer amortization period dictated by the “asset acquisition” rules. Because buyers are often caught unaware of this rule, they can end up with longer write-off periods than anticipated.

Get Us Involved

These rules make it critical that you consult with us before negotiations are too far under way. As part of your negotiations, you will want to consider the asset purchase price allocation and the resulting tax effect.

This article has barely scratched the surface of the tax issues involved in buying a business. Don't be caught unprepared! Get us involved in the drafting and review of the entire contract. ▲

The Nuts & Bolts Of Required Minimum Distributions

The IRS has always made it clear that Social Security “won’t be enough” when we are ready to retire. The mantra continues to be “save, save, save” through IRAs and employer-sponsored qualified retirement plans.

At the same time, the IRS also orders the direction for the use of these savings during retirement, namely the Required Minimum Distribution (RMD) rules. The RMD is the minimum amount that must be distributed to retirement plan owners beginning in the year the owner turns 70½. Final regulations issued in April 2002 simplify many of the proposed regulations and are now effective for determining required minimum distributions.

Required Beginning Date For IRA Owners

Minimum distributions must be made on or before December 31st of each year. However, the first required minimum distribution may be postponed until April 1st of the calendar year following the year the IRA owner reaches age 70½. This is the “required beginning date.”

For instance... Amanda turned 70 on March 5, 2003 and 70½ on September 5, 2003. Amanda’s required minimum distribution is due December 31, 2003, but may be postponed until the “required beginning date” of April 1, 2004. Her second required minimum distribution would be due on December 31, 2004.

Required Beginning Date For Qualified Plan Participants

There is one difference in the rules for participants in qualified retirement plans... effective for years beginning after 1996, any active participant who is not a 5% owner may postpone the required beginning date until April 1st of the calendar year following the year of retirement, if allowed in the plan document.

Just as there are penalties for withdrawing money too soon, there are penalties for not taking the RMD. A 50% excise tax is imposed for failing to take these required minimums.



A New And Simpler Table

The final regulations produced a new table for calculating the life expectancies that determine RMDs. Known as the Uniform Lifetime Table, it reflects longer life expectancies, decreases the required minimums, and results in larger tax-deferred account balances. This table must be used for 2003 distributions.

For example: Joshua’s required beginning date is April 1, 2004. He is 71 and his wife is 72. The combination of his IRAs that total \$1,000,000 would result in distributions of \$51,546 under the 1987 Joint Life Expectancy Table, \$39,526 under the 2001 proposed Uniform Lifetime Table, and \$37,736 under the 2002 final Uniform Lifetime Table.

The Joint Life Expectancy table is still available to use if the sole beneficiary is the participant’s spouse and the spouse is more than 10 years younger than the participant. This combination would result in an even smaller minimum required distribution.

Distributions Upon Death

In general, under the new rules, the Single Life Expectancy Table is used regardless of who is the designated beneficiary. Distributions must begin by December 31st of the year following the year of death and are based on the beneficiary’s life expectancy. If there are multiple benefici-

aries, the life expectancy is based on the oldest beneficiary, or separate accounts may be established for each beneficiary.

Spouse beneficiaries may elect at any time to treat the owner/participant’s IRA as their own; and only spouse beneficiaries may roll over death benefits to their own IRAs. A spouse beneficiary may also delay the first distribution until the owner/participant would have reached age 70½.

If there is no designated beneficiary and the owner/participant dies before the required beginning date, the funds must be distributed within 5 years.

Under the old rules, the beneficiaries were “fixed” as of the required beginning date. Under the new rules, beneficiaries have until September 30th of the following year to determine how the death benefit should be distributed. For instance, one of the beneficiaries may disclaim all or a portion of his or her benefit.

IRS Eases Up On Rules

Taxpayers who take IRA distributions in a series of “substantially equal periodic payments” may be able to change the method of calculating these payments without incurring a 10% early withdrawal penalty tax.

Due to the downturn in the market over the last few years, the account balances of taxpayers who chose the “fixed” methods are depleting more rapidly than they had expected. Our kinder, gentler IRS now allows a one-time election to switch to the RMD method without incurring any penalties. The RMD method permits the taxpayer to recalculate the payment using the life expectancy tables and the account balance each year.

If you have questions on the minimum required distribution or any matter concerning your retirement plans, please give us a call. ▲

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any purchase or sale of a business so we can structure the transaction in a way that gives you the most advantageous capital gains treatment. For existing installment sales, payments received after May 5th of this year will get the new lower capital gain rate. For new installment sales, don't forget that the 15% capital gain rate is only good through 2008. If your sale has payments that extend beyond 2008, you will need to factor-in the increased tax rate when negotiating your sale.

In light of these lower capital gain rates, reconsider whether to use tax-deferral techniques such as like-kind exchanges and tax-free corporate reorganizations. Now may be the time to pay tax on the appreciation and go forward with a stepped-up basis in the new asset or stock.

Business Incentives

The 2003 Tax Act has increased the amount of first-year depreciation and extended the

time for eligible purchases by several months. The new law sweetens the 30% bonus depreciation ushered in last year. Now, in addition to the regular depreciation allowance, you can write off 50% of the cost of assets purchased between May 6, 2003 and December 31, 2004.

The small business expense allowance (a.k.a. Section 179 expense) quadrupled from \$25,000 to \$100,000 under the 2003 Tax Act. The new rules apply to property placed in service in 2003, 2004, and 2005. The amount you can spend before hitting the "phase-out threshold" is now a whopping \$400,000, up from \$200,000. The expense allowance is completely phased out when annual purchases reach \$500,000. If qualifying capital asset purchases are in your long-range plan, consider making those purchases before 2006.

Timing your purchases is not the only planning opportunity. Be sure you pick

and choose which assets should get which write-off. For example, elect Section 179 or take bonus depreciation on your assets with the longest lives to maximize the acceleration of deductions.

Is It Time To Switch?

Individual tax rates are now as low as or even lower than corporate rates. For businesses still operating as C corporations, this is one more reason to switch to a pass-through entity. And because the tax on dividends was not eliminated – only reduced – C Corporations still have to bear the burden of double taxation. However, the dividend rate cut does offer a number of planning opportunities for C corporations.

There are many planning possibilities as a result of the 2003 Tax Act. However, many of them may be available for only a few years. Plan now to take advantage of these tax breaks and give us a call! ▲

News & Notes

9/30 Deadline Just Around The Corner

September 30, 2003, is the "drop dead due date" for companies who use Master and Prototype or Volume Submitter Plans to update their qualified retirement plans to conform to current law. These plans, sponsored by banks, investment brokers, retirement plan consultants, insurance companies, and lawyers offer employers many design options that have all been pre-approved by the IRS.

September 30, 2003, is also the deadline if your plan must be submitted to the IRS for a favorable determination letter. In general, these plans received automatic reliance from the IRS that the plan's form is qualified. However, if your Master and Prototype or Volume Submitter Plan was modified in any way, it may not have this required

reliance. Employers should contact their plan advisor NOW. The September deadline is not that far away. ▲

Deadline Extended For 2001 Depreciation Breaks

In the wake of the 2001 terrorist attacks, Congress passed the 2002 Tax Act, which contained relief for business asset purchases. It offered a depreciation break to qualified companies purchasing assets in the latter part of the year. Ordinarily, the mid-quarter convention limits depreciation for taxpayers who make more than 40% of their annual asset purchases in the last quarter of the year. This limit affects all assets purchased during the year, not just those in the last quarter.

The 2002 Tax Act allowed companies whose 3rd or 4th quarters included September 11 to avoid this limitation by filing an election on their 2001 tax return.

Because many taxpayers were not aware of the availability of this election, the IRS is providing an automatic extension of time to make the election for taxpayers who filed timely 2001 tax returns. Taxpayers now have until December 31, 2003 to make the election. They will be able to amend their 2001 tax returns, and any subsequent returns, in order to reflect adjustments stemming from the election.

The IRS has also extended depreciation relief to any taxpayer who timely filed its tax return for the tax year that included September 11, but failed to claim the 30% additional first-year depreciation. This may require filing an application for a change in accounting method. ▲