WINTER 2010

KKAJ King King Alleman Jensen
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Now May Be the Perfect Time to Transfer Assets

by Dennis V. King, Managing Partner
King, King, Alleman & Jensen

When business is in survival mode, planning for retirement and succession may be the farthest thing from an owner's mind. Actually, a sour economy is a great time to position the company for better times and the owner for eventual retirement. In a way, it's the silver lining of a recession or economic downturn.

Values Are Low, Interest Rates Are Low—Transfer Now

A company's value affects the tax-related costs of selling, gifting or bequeathing its business interests. In particular, today's low asset values create a window of opportunity to transfer ownership interest to family members, employees or other successors while minimizing tax liability.

As example, let's say you have a valuable employee that you have promised a small percentage of your business. That may be a good incentive but it can create a huge problem for the employee. At the time you actually make the transfer of ownership to the employee, he or she has to recognize compensation income for the value of the ownership interest at the time of the transfer.

Let's assume you promised a five percent interest in your business that would have been valued at $200,000 two years ago. On the date of the transfer of the interest he or she might have celebrated – only to get a rude awakening in the form of an $80,000 tax bill at the end of the year. And because your succession candidate received an illiquid asset in the transfer, he or she may not have had the cash to cover that tax liability.

Today, it's a different story. With much lower asset values, your five percent ownership interest might be valued at only $100,000, resulting in a much more digestible tax bill for the recipient. Further, if your successor needs to borrow money to pay taxes, current low interest rates make borrowing a less expensive proposition.

Or what might be a better solution would be for the employee to buy company stock with a promissory note at a very low interest rate, and not have to recognize any tax at all.

Family Values

If you are planning to transfer assets to family members, you can save them a heavy tax burden by taking advantage of your gift tax exclusion now rather than wait until you pass away. By making the gifts now, you can give a larger portion of your assets without incurring a gift tax. Add to that, all appreciation in value from the date of the gift until you pass belongs to your family members and would not be subject to estate taxes.

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KKAJ news briefs

The 2009 Tax Organizers were sent out in December. You can also download a copy by visiting kkajcpa.com.

Consult with your KKAJ professional on tax changes for 2010. Now is the time to review for tax planning strategies.

*Deadlines and Reminders**

January 31
W2's and 1099's Due

March 15
Corporate Tax Returns Due

April 15
Individual Tax Returns Due

*This is not intended as a comprehensive list of deadline dates. Consult with a KKAJ tax professional for deadlines applicable to your situation.

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Tax Predictions For 2010

By Bud Alleman, Partner

In a perfect world, the turbulence of the 2009 economic storm would miraculously transform into sunny skies in 2010. Not likely. The reality is that while certain tax programs due to expire will be extended, there's a consensus of opinion that rates on small business and the wealthy will go up. How high and when – 2010 or 2011 – is debatable.

Income Tax Rates

Some of the tax cuts enacted in 2001 and 2003 will likely stay in place, such as lower rates for middle-income families and the expanded child care credit. The current outlook is that come January 1, 2011, taxpayers will see an increase in the top ordinary income tax rates to where they were before the Bush rate cuts. That will increase rates from 33% and 35% to at least 36% and 39.6%.

The top rate on capital gains and ordinary dividends will increase from 15% to 20%, but with lower or zero rates remaining in place for middle and low-income taxpayers. Meanwhile, the phase-out of personal deductions and trims to itemized deductions, which effectively raise the top marginal rate by another percentage point, will return affecting couples with income above $250,000 and singles with income above $200,000. Should something be done on the health care front, marginal rates could go higher or raise them sooner.

Estate Tax

Just as 2009 was speeding to a close, the House narrowly voted to make the current estate tax permanent. Namely, the first $3.5 million of an estate would be exempt from taxes and the estate tax imposed at a top 45% rate. It makes for an interesting scenario given the House did not vote on an alternative proposal favored by the Senate, which provides for a $5 million estate tax exemption and 35% rates.

Taxes and Health Care

Conventional wisdom is that some health care bill in one form or another will pass this year. Whether it's the full-blown package currently debated in Congress or a more modest package focused on insurance reforms remains to be seen.

Whatever version is passed, expect to pay for it. Some of the predictions for new taxes and credits include:

- An increase of the Medicare payroll tax from 1.45% to 1.95% on earnings above $250,000 for a couple;
- A 40% tax on "Cadillac" insurance plans;
- Tax penalties on businesses that don't provide adequate health insurance;
- Small penalties for individuals who don't purchase health insurance;
- A tax credit to help middle-income earners pay for health insurance; and
- A tax credit for small businesses that provide health insurance, with a possible phase out for businesses with more than 10 employees.

The Senate has also proposed that the pharmaceutical industry, medical device industry and insurance industry pay billions of dollars in taxes per year based on market share. Expect a lively debate on the methods used for determining the amount each business will pay. Congress has already stated it doesn't matter if the company has a large profit margin, a small profit margin, no margin, is bankrupt, is a publicly traded company, is a private company, or is a pass-through company (LLC, S Corp., partnership). Companies will pay these billions of dollars in new taxes based solely on gross receipts and market share. If implemented, expect to see the same concept of tax based on market share and sales alone applied to other industries in the future.

A big concern for upper income taxpayers is the House-proposed individual income tax surcharge of 5.4% for couples with adjusted gross income above $1 million and singles earning more than $500,000. The same 5.4% rate would apply to all income, boosting the top capital gains rate dramatically from 15% now to 25.4% once the Bush tax cuts expire and the surcharge is imposed.

Another dark-horse tax hike would limit the value of itemized deductions for high income earners. While the top rate paid would go up to 39.6%, they could only take deductions against the current top 35% rate, increasing the top marginal rate. The Obama administration favors this idea despite the fact that it is not included in either the current Senate bill or the one that recently passed the House.

Overall, consider tax law a moving target. The best advice is to keep open lines of communication with your KKAJ tax and accounting professionals. As the year progresses, we'll be able to advise you on tax planning strategies given your individual circumstances, goals and objectives.

Transfer assets cont.

If you intend your child to succeed you in your business, he or she can use an intrafamily loan to purchase ownership of the company or obtain a stake in a privately-held business or partnership.

In this way, your child can purchase the asset on an installment plan at a low interest rate with minimal tax liability. It's also a good time to use this strategy for transferring commercial real estate to a family member before values skyrocket once again.

Careful planning is crucial when transferring a business interest or making an intrafamily loan, so don't move ahead without professional help from a business-savvy tax advisor, as well as a lawyer to make documentation legally binding.

It's Never Too Early to Plan Ahead

Transfer of ownership is only one component of a well thought-out plan for exiting your business. If you or your company are still young, you may find it unpleasant to think about a time when you're no longer in charge of your business. But whether you plan for it or not, exit will inevitably follow startup and growth as the third natural stage of your business life cycle.

There are only four ways to leave a business: early exit for personal reasons (e.g., to pursue different interests), retirement, disability or "feet first." Even if you are committed to the business and far from retirement age, a succession plan is essential to prepare for unexpected events, such as a prolonged illness, debilitating accident or even death.

If you're a sole owner, decide whether you want to transfer your ownership interests to family members or other successors during your life or at death or sell the business to an outsider. If your business is a partnership, such as a family limited partnership, consider creating a buy-sell agreement to specify who will buy an owner's interests (and at what price) when that person leaves or retires.

In addition to ownership transfers and buy-sell agreements, a comprehensive plan may include employee benefit plans, arrangements to retain key employees, life and disability insurance, estate planning and tax strategies. Without a plan the value of your business will be diminished and whatever happens when you exit may not be what you had in mind. Your business might even need to close and all you worked for could be lost.

Even though you may be very good at starting and running a business, succession planning probably isn't your forte. To cover all the bases and make the right decisions, work with a business and tax advisor who has expertise in succession planning. Not only will an advisor make the task of devising a plan easier, but the result will be more likely to achieve the type of leadership succession you envision for your business.

How We Can Help

King, King, Alleman & Jensen is your big-picture business and tax resource. We go beyond transactional, reactive or preventive accounting to offer a broad-based menu of long-term asset building strategies, including financial, personal, estate and business management perspectives.

KKAJ can also help you take advantage of the tax incentives introduced through the American Recovery and Reinvestment Act of 2009 (ARRA), such as bonus depreciation, Code Section 179 expensing, extended net operating loss carry-back for small businesses, and energy tax credits. We can also guide you through the maze of Enterprise Zone regulations for substantial California state tax credits.

Regardless of the state of the economy, the tax and business experts at KKAJ can help you benefit from the opportunities available in the current environment.

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New California Use Tax Requirements

By Louis Hamel, Partner

In September 2009, California's State Board of Equalization issued a Special Notice regarding "New Registration and Reporting Requirements for Certain Purchasers". Assembly Bill x4-18 (Stats. 2009, Ch.16) added section 6225 to the Revenue and Taxation Code, which requires a qualified purchaser to register with the Board of Equalization (BOE) and report and pay use tax directly to the BOE. Under this section, a "qualified purchaser" includes businesses with at least $100,000 in annual gross receipts from business operations.

Generally, use tax applies when a person or business in California purchases tangible merchandise to be used, consumed, given away, or stored in this state from a retailer outside of this state who does not collect California tax on the sale. As a general rule, if sales tax would apply when a particular item is purchased in California, use tax applies when a similar purchase is made from a retailer outside the state and no tax is charged.

Use tax is not a new tax. It has been a part of the Revenue and Taxation Code since the 1930's. Only the registration requirement is new under AB x4-18.

A qualified purchaser is required to file a return reporting the total sales price of tangible merchandise purchased that is subject to use tax during the preceding calendar year, and for which tax was not paid to a retailer required to collect the use tax. The provisions of section 6225 do not apply to the purchase of a vehicle, vessel, or aircraft, since there are special rules and reporting requirements applicable to those types of purchases.

The return for 2009, along with payment, is due by April 15, 2010. While the BOE will attempt to notify qualified purchasers in order to register them, it remains the qualified purchaser's responsibility to register with the BOE. For more information, visit www.boe.ca.gov or consult with the tax and accounting professionals at KKAJ.

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Let's say you're in the business of clothing design. Over the years, you've expanded your market and built your business from a local showroom to a national label. Now you're thinking about going global. Who are you going to call? The first call you might consider making would be to the accounting, tax and business consulting professionals at KKAJ.

As members of GMN International, a global alliance of leading independent accounting and consulting firms, and Enterprise Worldwide, an international association of accountants and advisors, KKAJ delivers a competitive advantage for clients interested in doing business in other parts of the world.

KKAJ Partners travel to conferences throughout the year to meet with their counterparts in other parts of the world. So if you are interested in doing business in China, for example, the KKAJ tax and accounting professionals will connect you with the right professionals to make it happen. Or you may have a specific need closer to home but in another state. KKAJ can help with that too. It's that simple. Give us a call to discuss your specific situation.

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