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Client Information Bulletin

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Seize Tax Breaks for Year-end Securities Transactions

Unique opportunities for tax-wise investors

Tax planning is a year-round proposition, but there are certain unique opportunities available to taxpayers at the end of the year. **Prime example**: By effectively "timing" securities transactions, you may be able to realize certain tax benefits on your return. But you only have until December 31 to take advantage of the rules for this year.

Furthermore, there is an added element to year-end tax planning in 2008. Some individuals who sell securities qualifying for long-term capital gain (i.e., gain realized from securities held for more than a year) will pay a zero percent tax rate on those gains this year. That is not a misprint—the capital gains are completely tax-free.

This tax break applies to investors in the regular 10% and 15% ordinary income tax brackets, but higher-bracket investors may also realize a partial tax benefit. Normally, the long-term capital gains of individuals in a federal income tax bracket of 25% or above are rated at a maximum tax rate of 15%.

Keeping those rules in mind, here are several common tax techniques for investors to consider at the end of the year.

- Sell securities at a gain to offset losses realized earlier in the year. In effect, the gains you receive late in the year are tax-free up to the amount of the losses already recognized. Any remaining long-term capital gain is taxed at no more than 15%.
- Sell securities at a loss to offset gains realized earlier in the year. In effect, the losses absorb the gains so they are tax-free. Any losses exceeding the amount of capital gains can be used to offset up to $3,000 of ordinary income (e.g., wages from your job). You can carry forward the excess above $3,000 to future years.
- Avoid the "wash sale rule." Briefly, you cannot realize a loss from a securities sale if you acquire substantially identical securities within 30 days. The simplest thing to do is wait until after the 30-day period has passed. Alternatively, you might acquire replacements first and wait at least 31 days before selling the original shares or buy similar (but not substantially identical) securities.
- Depending on your situation, it may make sense to accelerate or postpone securities transactions. For example, if it will not be helpful to realize capital gains this year, you might hold on to securities a little longer to qualify for long-term capital gain treatment for 2009.

Of course, taxes are not the only issue for investors to address. Make sure to

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consider other economic factors, as well as your personal circumstances, when buying and selling securities at year-end. It is recommended that you obtain professional assistance with respect to securities sales and purchases.

Who Needs a Buy–sell Agreement?

Protection for families of business owners

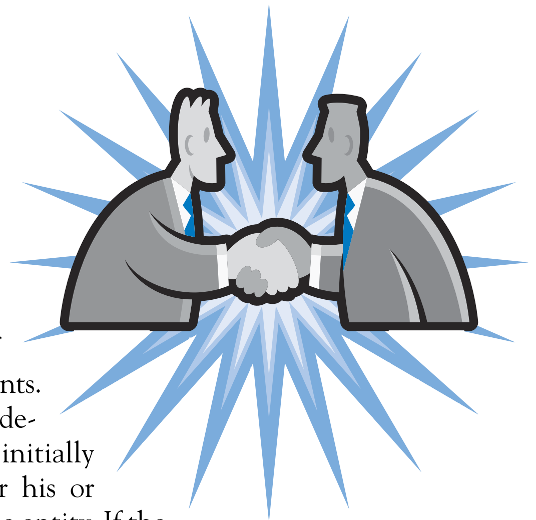
A buy–sell agreement is an essential component of operating a business entity. In fact, it is a virtual necessity for a business owner or a partner in a partnership, especially if there are multiple owners or partners. What's more, a buy–sell agreement may be legally required under state law for closely held companies.

In any event, having a buy–sell agreement in place is a sound business practice. It can help protect your family's interests should you become disabled or die prematurely, or choose to sell the business.

Buy–sell agreements are viable for all types of business entities, including S corporations and limited liability companies (LLCs). Although some variations exist, there are three basic types of buy–sell agreements.

1. Cross-purchase agreement: With a cross-purchase agreement, a departing owner agrees to sell his or her business interest to the remaining owners. Because this is the simplest form of a buy–sell agreement, it may be suitable for a small business with just two or three owners. However, a different type of agreement may be preferred for a business with numerous owners.

2. Entity-purchase agreement: Also called a "redemption agreement," this form of buy–sell agreement involves the sale of the owner's business interest to the business entity itself. Thus, the ownership interest is effectively absorbed by the company or partnership.



3. Hybrid agreement: This method combines the first two types of buy–sell agreements. Generally, the departing owner is initially required to offer his or her interest to the entity. If the entity declines or is unable to make the purchase, other owners have the ability to purchase the shares. Note that a buy–sell agreement may also be constructed so that key employees are able to purchase the shares. For example, this may be incorporated into a hybrid agreement.

There are several immediate benefits available for using a buy–sell agreement. They include the following:

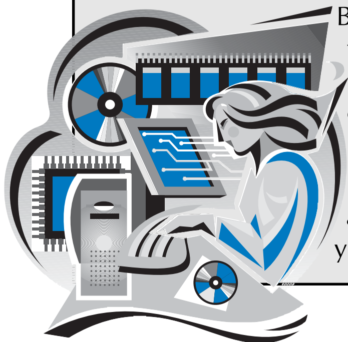
- Upon the death or disability of the owner, there is an obligated buyer for the business at a fixed price or formula. In the absence of such an agreement, the estate or the disabled owner may be forced to sell the business at a bargain-basement price.
- The buy–sell agreement provides a smooth transfer of the business in a manner agreed upon by the owners in advance of the triggering event. This can help minimize disruptions to customers or clients while the business is in the process of recovering.
- The proceeds from the sale of a deceased owner's interest can go toward certain estate settlement expenses (e.g., estate taxes and administration costs). In addition, part of the proceeds may be allocated to help pay the living expenses of the deceased owner's family members. If the owner is disabled, the proceeds may be used to pay all of the family's living expenses.
- The price established in the buy–sell agreement may be used to provide a valuation for federal estate-tax purposes. See your tax adviser for more details.

State law may also have an impact on the terms of the buy–sell agreement. This is not a do-it-yourself proposition, so seek proper guidance.

How to Write Off Computer Software

Are you buying new computer software for your company? Be aware of all the tax implications.

Key point: The exact method for deducting computer software depends on how it is acquired. For instance, a business is generally required to amortize the cost of the off-the-shelf software over a period of 36 months. But you may be able to deduct the full cost currently if you develop the software yourself. Other complications may arise if software is bundled with hardware.



Obtain advice about the tax aspects. This could affect your year-end software purchases.

Avoiding Age Discrimination Problems at Work

Take precautions in employment practices

As a business owner or manager, you cannot ignore potential problems relating to age discrimination. For instance, if you are not careful, it can lead to low morale, decreased productivity, and costly and time-consuming litigation. It is important to take preventative measures.

The key federal law in this area is the Age Discrimination in Employment Act of 1967 (ADEA). In brief, the ADEA prohibits discrimination on the basis of age against any employee age 40 or older. The ADEA has been amended by the Older Workers Benefit Protection Act of 1990 (OWBPA), which prohibits discrimination in plan benefits. The OWBPA also imposes requirements when an employee or job applicant is asked to waive certain rights under the ADEA.

The main objective for owners and managers is to recognize the dangers and take steps to avoid age discrimination. This may include making an honest appraisal of your organization's culture, instituting training sessions, updating hiring procedures and renewing your commitment to provide a bias-free work environment.

By doing a better job of training your staff, you can raise employee awareness of discriminatory practices. Participation should be required at every level of the company. In addition, encourage employees to report incidents that could be discriminatory in nature. Positive reinforcement may head off potential problems.

Age discrimination may take place during the hiring process or in the course of employment.

Hiring Practices

The following are a few suggestions for avoiding age discrimination in hiring practices.

- Salary should not be based strictly on the age of applicants. Don't ask age-related questions during the interview process.
- Remove "date of birth" entries from your job application form. Concentrate on talent and work experience instead.
- Develop guidelines for evaluating job candidates. Apply them evenly to all applicants.
- Post job advertisements where they will be viewed by workers of all ages.
- Be sure that interviewers are familiar with the ADEA, the OWBPA and related laws.
- Whenever possible, use a selection committee comprised of people with varying ages.

Employment Practices

Similarly, you may take these steps for workers currently employed.

- Provide training sessions for all jobs.
- Post your age discrimination policy on bulletin boards or in company media. The policy should cover, in writing, definitions, remedies, grievance procedures and antiretaliation language.
- Focus on professional development for all employees in performance evaluations. Emphasize skills, abilities and potential of employees—not their ages.
- Try to team up workers of varying ages on projects so they can learn from each other.
- Encourage mentoring. Workers of any age may pass on the benefit of their experience, knowledge and expertise.
- Avoid age restrictions for promotions or training.
- Set a good example yourself. Make it absolutely clear that discrimination of any kind will not be tolerated.

Finally, age discrimination claims may result if employment is terminated. In this case, legal counsel should be consulted.

Give Us A Call!

Do you have any questions or comments about this newsletter or your individual situation? Please do not hesitate to contact our office. We would be glad to serve you in any way we can.

More Flexibility for Inherited Plan Assets

Tax law change benefits nonspouse beneficiaries

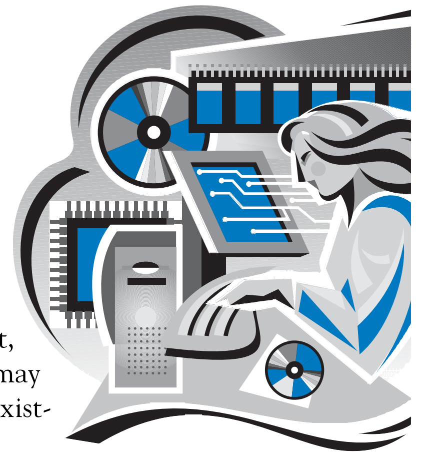
If you are the beneficiary of a relative's qualified retirement plan—such as a 401(k) plan or a pension or profit-sharing plan—you may be able to benefit from a recent tax law change. Due to the Pension Protection Act of 2006 (PPA), nonspouse beneficiaries have more flexibility than they did in the past.

Specifically, the PPA permits you to effectively "roll over" funds inherited from a relative's qualified plan to your own traditional IRA. Then you can take distributions based on the IRS-approved life expectancy tables. Previously, this option was not available to all beneficiaries.

Background: Prior to the PPA, only a spousal beneficiary could transfer inherited funds from a qualified plan to his or her own IRA. A nonspouse beneficiary was required to take a lump-sum distribution from the plan or deplete the account within five years. This could result in a hefty tax bill.

Under the current rules, a nonspouse beneficiary can transfer funds tax-free to an IRA, although it is technically not the same as a rollover by a spousal beneficiary. There are four basic steps involved in the process.

1. The funds are transferred directly from the qualified plan to the trustee of your IRA. You cannot touch the cash. In contrast, a spousal beneficiary has 60 days to redeposit the funds in an IRA, although this will result in automatic withholding on the distribution.



2. The funds are then transferred to a new IRA. You cannot use an existing IRA you had set up previously. In contrast, a spousal beneficiary may roll over funds into an existing IRA.

3. The new IRA account must be properly titled. Significantly, it must indicate the beneficiary of the decedent. If a spousal IRA is the beneficiary, the IRA can be titled in the spouse's name.

4. A nonspouse beneficiary cannot wait until after age 70½ to begin taking required minimum distributions (RMDs) from the IRA. This option for RMDs is still available only to spousal beneficiaries.

Despite the differences, the PPA provision improves planning opportunities for nonspouse beneficiaries. Instead of taking distributions over a maximum of five years, as previously required by law, you can spread out withdrawals over a much longer time period (especially if you are relatively young). The required amount of the annual distribution also depends on whether the plan participant started receiving RMDs prior to death.

Note that other special rules may come into play. This is a complex area of the tax law, so it is recommended that you obtain professional assistance.

Facts and Figures

Timely points of particular interest

➡**Legally Speaking**—Normally, an individual must pay tax on debt forgiveness. However, the IRS has made an exception: If a law school forgives a portion of a student's debt when he or she enters into public service for a nonprofit or government unit, the IRS says that the debt forgiveness does not constitute taxable income. **One catch**: The graduate must remain in the public service position for a specified length of time.

➡**Solo 401(k) Plans**—To clarify the contributions limits for solo 401(k) plans, elective deferrals don't count toward the percentage cap for the overall contribution limits, but they do count for the dollar limit. The general limit for 2008 is the lesser of 20% of self-employment income or $46,000. Thus, a sole proprietor can contribute no more than $46,000 this year in combined elective deferrals and employer contributions.

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