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Client Information Bulletin

October 2010

Introduction to New Basis Reporting Rules

IRS provides clarification in new regulations

New basis reporting rules required by a 2008 law will ease some of the burden for establishing gains and losses from securities sales. But the new rules will coexist with the old rules, so it is still important to retain the necessary records. The IRS recently issued new proposed regulations on this complex issue.

Background: When you sell securities, you may show a taxable capital gain or a deductible capital loss for the difference between the sale price and the basis. For this purpose, "basis" is generally your acquisition cost, plus certain adjustments (including broker commissions).

If you have owned the securities for more than one year, any capital gain is treated as long-term gain, taxed at a maximum rate of 15% in 2010 (0% for certain low-income taxpayers). Losses offset capital gains plus up to $3,000 of ordinary income. But complications often arise if you sell only some of the shares of a security. In addition, you may not have adequate records showing the initial cost of the securities.

Currently, brokers and other financial institutions must report the amount of proceeds received in a security sale to the IRS, but not the basis of the shares. The IRS has long claimed that some investors inflate their basis in order to maximize the tax benefits.

New rules: Under the Emergency Economic Stabilization Act of 2008, a broker is required to submit information returns including the basis of covered securities that have been sold, in addition to the amount of the sale proceeds. It must also indicate if a gain or loss is short-term or long-term. These rules apply to stock and mutual fund shares acquired after 2010; stocks in a mutual fund or dividend reinvestment plan acquired after 2011; and other securities (e.g., notes, bonds, and commodity contracts and options) acquired after 2012.

Therefore, for acquisitions made before these dates, the old rules remain in effect. For instance, if you acquire stock in 2010, you are responsible for establishing the basis.

The new proposed regulations provide guidance to financial institutions. Here are some of the highlights:

♦ Your basis must be adjusted for transactions within an account, but other transactions that take place outside of an account, such as "wash sales," may be ignored. A wash sale results in a disallowed loss when substantially identical securities are acquired within 30 days of a sale.

♦ Information must be reported on a single return for multiple purchases of securities. Separate returns are required if sales are both long-term and short-term or involve "covered" and "noncovered" securities.

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♦ A security transferred into an account will be presumed to be a covered security unless the receiving broker receives an inadequate transfer statement.

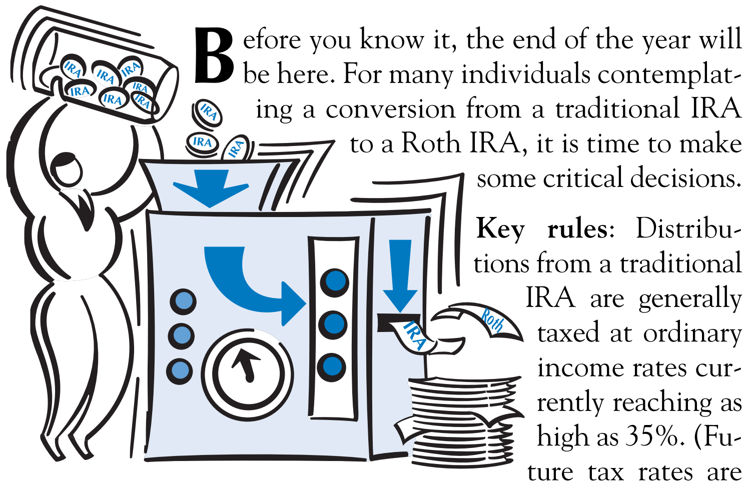
♦ A broker, custodian or issuer transferring a covered security must provide the basis and acquisition date to the receiving broker no later than 15 days after the transfer.

♦ A stock issuer must report to the IRS any organizational action affecting basis, such as a merger or stock split, within 45 days of occurrence. Stockholders must receive the information by January 15 of the following year. Alternatively, the stock issuer can post the information on its Web site.

Remember that the new basis reporting rules are being phased in over a three-year period. Furthermore, the old rules continue to apply to any pre-2011 acquisition. Obtain professional assistance to address the complexities.

Deciding About a Roth IRA Conversion

Consider all the relevant factors this year



Before you know it, the end of the year will be here. For many individuals contemplating a conversion from a traditional IRA to a Roth IRA, it is time to make some critical decisions.

Key rules: Distributions from a traditional IRA are generally taxed at ordinary income rates currently reaching as high as 35%. (Future tax rates are currently scheduled to rise.) The taxable portion includes earnings within the tax-deferred account and amounts attributable to deductible contributions.

Conversely, "qualified distributions" from a Roth IRA are completely tax-free. A qualified distribution is one from a Roth in existence for at least five years that is made after you have reached age 59½; upon death or disability; or to pay for first-time homebuyer expenses (up to a lifetime limit of $10,000). Other distributions are treated as coming first from Roth IRA contributions, second from amounts transferred to the Roth and third from earnings.

In effect, a conversion of assets from a traditional IRA to a Roth is treated as a withdrawal for tax purposes. So you are generally required to pay the usual amount of tax when you convert.

But the current tax cost may be worth it in exchange for future tax-free distributions. Furthermore, unlike a traditional IRA, you don't have to take minimum distributions from a Roth after age 70½.

What has been holding you back? Prior to this year, a conversion was not allowed in a year in which your modified adjusted gross income exceeded $100,000. However, beginning in 2010, this restriction has been removed. Therefore, high-income individuals may be eligible to convert to a Roth for the first time. **Another incentive**: For a conversion in 2010—and 2010 only—you can choose to have the taxable income from the conversion split evenly over the following two years—2011 and 2012.

But there are potential drawbacks. For instance, if you have to use funds from your IRA to pay the resulting tax, converting will likely dilute future benefits. Also, you might not choose the two-year tax deferral if you expect to be in a low tax bracket this year or in higher tax brackets in the future. Some other factors include

♦ Your age, your spouse's age (if married) and the ages of the beneficiaries

♦ The value of the assets in your IRA

♦ The need to receive Roth IRA distributions in the future

♦ The projected investment rate of return

♦ Any state and local tax implications

♦ Any nondeductible contributions to traditional IRAs

This requires a careful analysis. Be wary of online calculators that leave out any of the critical factors.

If it suits your purposes, you might opt for a partial conversion. Obtain expert guidance from your professional advisers.

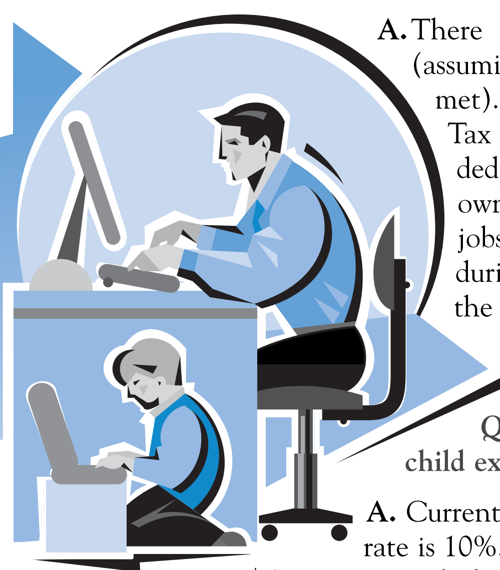
Give Us A Call!

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.

Hiring Your Child: Answers to FAQs

Tax-related benefits of hiring a child

Suppose that your child needs an after-school job while your company is looking to hire extra help. **Practical solution**: If you are in a position of authority, you could put your child on the payroll.



There are several tax incentives for hiring a child to work for your business. In effect, you are "splitting income," by paying your child a salary instead of taking compensation and paying the child an allowance. In addition, your child may be in line for fringe benefits. Of course, the wages paid to the child are deductible by the business.

Here are the answers to some frequently asked questions on this topic:

Q. What about the "kiddie tax" on income earned by young children?

A. The kiddie tax generally applies to unearned income of a child younger than 19 or a full-time student younger than 24. For 2010, the income is taxed at the parent's tax rate to the extent it exceeds $1,900. However, this rule only affects unearned income. Earned income—such as income your child receives working for your business—is exempt from the extra tax.

Q. How old does a child have to be to work for my business?

A. There are no definite age limitations (assuming that state child labor laws are met). In fact, in one classic case, the Tax Court allowed an employer to deduct wages paid to the business owner's seven-year-old for doing odd jobs on weekends, after school and during summer vacations. Of course, the wages you pay your child must be a reasonable amount for services actually rendered.

Q. What income tax rate can my child expect to pay?

A. Currently, the lowest federal income tax rate is 10%. However, a child can earn up to $5,700 in 2010 before he or she has to pay any tax. If your child expects to incur no tax liability this year (and had no tax liability last year), wages may be exempted from income tax withholding on the child's W-4 Form.

Q. What about FICA tax?

A. Wages paid to a child age 18 or older are subject to the Federal Insurance Contributions Act (FICA). But younger children are exempt from FICA if wages are paid by an unincorporated business.

Q. Can I qualify for the new HIRE Act employment tax breaks?

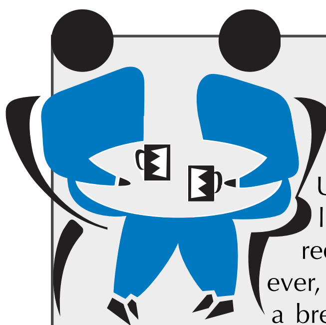
A. No. Both the employer exemption from Social Security tax and the tax credit for hiring previously unemployed workers under the Hiring Incentives to Restore Employment (HIRE) Act of 2010 are generally not available for relatives such as your children.

Q. Can I still claim a dependency exemption for my child?

A. Probably. You generally are entitled to a dependency exemption for a child younger than age 19 (or a child younger than 24 who is a full-time student) if you provide more than half of the child's support for the year. Each dependency exemption in 2010 is $3,650. But your child cannot claim a personal exemption if he or she is eligible to be your dependent.

***Reminder**: You must pay your child a reasonable rate for the work actually performed. If you don't, the deduction for wages may be disallowed.*

Gimme a Break!



Do you have to allow employees to take breaks? It depends. Under federal wage and hour laws, employers are generally not required to provide breaks. However, if you decide to give employees a break, the time is treated as compensable work time. Conversely, some states specifically require rest breaks of varying durations for non-exempt employees or hourly workers.

Finally, breaks may be required for employees with special needs. Make sure your company complies with all the applicable federal and state laws.

Collecting Data for a Business Valuation

Work through the extensive process

A business valuation can be extremely beneficial for several reasons. Naturally, you need a valuation if you are planning to buy or sell a business. It might also help to facilitate transfer of business ownership upon the death of a co-owner, to resolve legal disputes or for numerous other purposes. Essentially, it establishes a net worth for all the world to see.

But you cannot simply snap your fingers. One of the critical aspects of a business valuation is to collect and assemble the requisite data. Generally speaking, this vital data may be categorized into the following three groups:

- Data that is specific to the company
- Data about the company's industry and economic conditions
- Data about the market for ownership interests

The data should be provided in written form. It is gathered from on-site visits and interviews with those who are knowledgeable about the company. Generally, industry data is provided by the company and may also be available from public sources. Data concerning the market for ownership interests should include information about changes of ownership in competing firms, certain company transactions and various other factors (e.g., premiums or discounts) that might apply to the property.

The manner and timing of the data-collecting process can be significant. Most important, the process must be both thorough and efficient. For example, supporting analysts may be in the process of collecting data about the industry, various economic factors, the company's rate of return and company transactions. At the same time, the principal analyst may be working directly with the company's owners and top management team. These efforts must be coordinated to present an accurate picture of the business.

In any event, it is important for company management to reflect a balanced overview at an early stage in the proceedings. This way, all the analysts will be able to recognize important data as they progress with the valuation process.

When time permits, information being collected should be reviewed before any of the analysts formally visit the company. Then the focus can be shifted to the critical process of interviewing at the company's site without anyone being sidetracked by tangential issues. The objective is to minimize the inconvenience of the interviews while maximizing the productivity gained from visits to the physical property.

Much of the information needed to conduct a business valuation will be obtained through these interviews with company management. However, the consultations are usually corroborated by inspections of documents on the business premises. Copies may be required before you can obtain the information necessary to the task.

***Conclusion**: This is only a brief overview of this extensive process. Contact an experienced professional for more details.*

Facts and Figures

Timely points of particular interest

➡**Hiring Choices**—The new Hiring Incentives to Restore Employment (HIRE) Act of 2010 provides a tax benefit for hiring previously unemployed workers. An employer may avoid the 6.2% Social Security tax on a worker's wages. **Caveat**: If the employer takes the exemption, the employer cannot claim a Work Opportunity Tax Credit for the same worker.

➡**Stress at Work**—Reducing stress at work can lead to greater productivity. Here are three helpful suggestions: (1) Take responsibility for improving your physical and emotional health. (2) Identify knee-jerk habits and negative attitudes that affect the workplace. (3) Practice better communication skills to ease and improve work-based relationships.

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