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Client Information Bulletin

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What Are the Benefits of Buy–sell Agreements?

Three types of agreements for small-business owners

If you are a small-business owner, you don't have to sell your business to benefit from a buy–sell agreement. In fact, having a buy–sell agreement may be required under state law for certain companies.

Whether mandated or not, having a buy–sell agreement in place is a fundamentally sound business practice. It can protect your family's interests in the event you become disabled or die prematurely, as well as establish ground rules for the disposition of a business. The agreement is often funded with life insurance.

Who can benefit? Buy–sell agreements are viable for virtually every type of business entity, including C corporations, partnerships, S corporations and limited liability companies (LLCs). Although some variations exist, there are three basic types of agreements.

1. **The cross–purchase agreement**: With this agreement, a business owner agrees to sell his or her interest to the remaining co-owners or partners. Because this is the simplest form of a buy–sell agreement, it may be suitable for a small business with a small number of owners. However, another type of agreement may be preferable for a business with numerous owners.

2. **The entity–purchase agreement**: As the name implies, this form of buy–sell agreement—sometimes referred to as a "redemption" agreement—requires the business owner to sell his or her interest directly to the entity. Therefore, the ownership interest is effectively absorbed by the business operation.

Usually, either of the first two types of agreements will suffice, but there's a third option.

3. **The "hybrid" agreement**: This method combines the first two types of buy–sell agreements. Generally, the owner is initially required to offer his or her interest to the entity. If the entity declines or cannot make the purchase, other co-owners or partners are able to purchase the shares. **Note**: A hybrid agreement may also enable key employees—such as longtime company officers—to buy the interest.

What are the benefits of using a buy–sell agreement? Some are immediate while others take time. **Example**: Upon the death or disability of the owner, a ready-and-willing buyer is obligated to purchase shares at a fixed price or formula. Absent 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.

Inside

The proceeds from the sale of a deceased owner's interest can go toward certain estate settlement expenses (e.g., death taxes and estate 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 (but see your tax adviser for more details). Finally, be aware that state law may have an impact on buy–sell agreements.

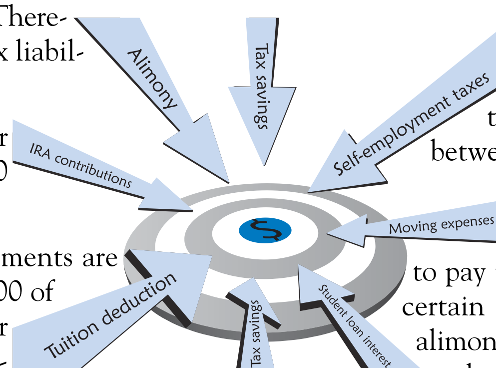
Caution: This is not a do-it-yourself proposition. Seek expert advice for your situation.

Don't Miss Out on Above-the-line Deductions

Pinpoint tax savings on your 2010 tax return

Not all tax deductions are created equal. In contrast to deductions claimed by itemizers after adjusted gross income (AGI) has been calculated—such as deductions for charitable donations and mortgage interest—other deductions are available prior to the AGI calculation (i.e., "above the line" on Form 1040). Therefore, they can help you reduce your tax liability on your return in other ways.

There are plenty of opportunities for above-the-line deductions on 2010 returns. Here are several examples:



Tuition deduction: If certain requirements are met, you can deduct as much as $4,000 of tuition and related fees paid for higher education. The $4,000 deduction is available for single filers with an AGI up to $65,000; $130,000 for joint filers. Otherwise, single filers can claim a $2,000 deduction for an AGI up to $80,000; $160,000 for joint filers. **Caveat**: This deduction expired after 2009, but at this writing it is expected to be reinstated for 2010.

Self-employment taxes: If you are a self-employed individual, you may claim several tax deductions above the line. This includes 50% of the required annual self-employment tax and 100% of health insurance coverage. Similarly, you can deduct your annual contributions to a qualified retirement plan—such as a Simplified Employee Pension (SEP)—within generous limits.

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.

IRA contributions: You may be able to deduct IRA contributions unless you actively participate in an employer-sponsored retirement plan. In that case, deductions for the 2010 tax year are phased out for single filers with an AGI between $56,000 and $66,000; $89,000 and $109,000 for joint filers if both spouses are active participants. If only one spouse is an active participant in an employer plan, the deduction is phased out for an AGI between $167,000 and $177,000. **Note**: See page 4 for the new thresholds for 2011.

Alimony: The alimony you are required to pay to an "ex" is generally tax-deductible if certain conditions are met. For example, the alimony must be paid under a decree of divorce or legal separation agreement, written separation agreement or decree of support. **Note**: Alimony payments are taxable to the recipient.

Moving expenses: If you make a job-related move, you can deduct moving expenses under two conditions: (1) The new job is 50 miles farther from your old home than your old workplace was from your old home. (2) You stay at the new job for at least 39 weeks of the next 12 months. Assuming you qualify under these two tests, you can deduct the cost of transporting household goods and personal effects, plus related travel and lodging expenses (but not meals).

Student loan interest: A taxpayer who is paying off a student loan for higher education may deduct up to $2,500 of the interest on his or her tax return. For 2010, this deduction is phased out for a single filer with an AGI between $60,000 and $75,000; $120,000 and $150,000 for joint filers. **Note**: Your child can deduct the interest on any portion of the loan you repay as long as he or she cannot be claimed as your dependent.

Be aware that this is not the complete list of above-the-line deductions. For more information, contact your tax adviser.

Keeping Records for Your Business Car

New case points out the tax roadblocks

The rules for claiming business car deductions are tough. In lieu of keeping all the required records, you might simplify matters somewhat by using the standard mileage rate (see box below).

Starting point: To claim deductions for business car expenses, you must establish the percentage of business use of the car and substantiate business expenses. Keep records of the time, place and business purpose of each business trip whether you are deducting actual expenses or using the standard mileage rate.

In addition, if you use the actual expense method, you must record the total mileage for the year, plus keep records and receipts for out-of-pocket expenses such as gas, oil, repairs and insurance. Your total expenses are prorated based on the percentage of business use for the year.

The IRS has indicated that the best method for proving business mileage is to keep a contemporaneous diary, log or other ledger.

New case: A couple owned a Mercedes-Benz, a Cadillac and a Suburban. Both the husband and wife were business owners. They claimed that the husband used the Mercedes exclusively for business driving, that the wife used the Cadillac exclusively for business driving and that both of them used the Suburban for personal driving.

For the 2004 tax year, the husband claimed that he traveled more than 51,000 business miles, and the wife reported travel of more than 43,000 business miles. They both maintained mileage logs on Excel spreadsheets and listed the dates and odometer readings for each trip.

However, the logs included numerous entries for holidays, and they regularly showed daily business travel of hundreds of miles. Also, the logs were vague and failed to list specific addresses for business visits. In one instance, the husband even deducted trips to the grocery store because he claimed the trips were to discuss business in the meat department and hand out business cards. **Result**: The Tax Court denied part of the deduction.

Of course, entries in logs made at or near the time of the events are more credible than those prepared at a later date. Keep your original logbooks and notes in case the IRS ever challenges your deductions.

End of the road: Alternatively, you might have your employer reimburse you for business travel expenses. If you are reimbursed for actual expenses, keep the same detailed records. However, if you receive a mileage allowance, you only have to show the time, place and business purpose of each trip and the total business mileage.

The Need for Speed

Are you required to file your individual tax return electronically? Not exactly, although the government is encouraging taxpayers to file by electronic means. It is a safe and secure method, and e-filed returns are processed faster than paper returns.

In fact, if you are due a refund, you should receive it in about two weeks, compared to around six weeks for a paper return refund. Also, the IRS provides prompt notice of receipt of electronic returns.

If you have any more questions about electronic filing, don't hesitate to ask your tax return preparer.

Tax Shortcut for Deductions

The standard mileage rate for 2010 tax returns is 50 cents per business mile, plus any business-related tolls and parking fees.

For simplicity, let's say your actual business car expenses for 2010 are $5,000. You traveled 12,000 business miles and incurred $200 in related tolls and parking fees. Therefore, the standard business mileage rate produces an overall deduction of $6,200 (50 cents × 12,000 miles + $200)—or $1,200 more than the actual business car expenses.

Caution: Every situation is different, and not everyone qualifies for this method. Obtain professional assistance.

IRS Announces Retirement Plan Limits for 2011

Few changes from the prior year

The IRS recently released its annual cost-of-living adjustments for certain qualified retirement plan thresholds. Because the needle on inflation barely moved last year, the limits for 2011 generally remain the same as they were in 2010, as shown in the chart below.

Retirement plan provisions	Limit for 2010	Limit for 2011
Maximum annual dollar benefit for a defined benefit plan	$195,000	$195,000
Maximum dollar limit on additions to a defined contribution plan	$49,000	$49,000
Maximum amount of compensation taken into account for qualified retirement plans	$245,000	$245,000
Dollar limit for definition of "key employee" in top-heavy retirement plan	$160,000	$160,000
Dollar limit for definition of "highly compensated employee" in qualified plan	$110,000	$110,000
Dollar limit for elective deferrals to a 401(k) plan	$16,500	$16,500
Dollar limit for contributions to a Savings Incentive Match Plan for Employees (SIMPLE)	$11,500	$11,500
Dollar limit for elective deferrals to deferred compensation plans of state and local governments and tax-exempt organizations	$16,500	$16,500
Dollar limit for catch-up contributions to a SIMPLE plan	$2,500	$2,500
Dollar limit for catch-up contributions to a 401(k), 403(b), 457 or Simplified Employee Pension (SEP) plan	$5,500	$5,500

However, the limits for certain IRA thresholds were bumped up slightly for 2011, as shown in the chart below.

IRA thresholds	Limit for 2010	Limit for 2011
Phaseout of traditional IRA deduction for single filers	$56,000–$66,000 of AGI	$56,000–$66,000 of AGI
Phaseout of traditional IRA deduction for joint filers	$89,000–$109,000 of AGI	$90,000–$110,000 of AGI
Phaseout of contributions for traditional IRA if one spouse has employer plan	$167,000–$177,000 of AGI	$169,000–$179,000 of AGI
Phaseout of contributions to Roth IRAs for single filers	$105,000–$120,000 of AGI	$107,000–$122,000 of AGI
Phaseout of contributions to Roth IRAs for joint filers	$167,000–$177,000 of AGI	$169,000–$179,000 of AGI

Note: See "Don't Miss Out on Above-the-line Deductions" on page 2 for the rules for IRA deductions.

Facts and Figures

Timely points of particular interest

➡**Tax Relief on Way?**—As this publication goes to press, Congress is hammering out the details of proposed legislation that could extend expiring tax breaks for individuals and businesses, modify scheduled estate-tax changes and create new tax-saving opportunities in 2011. When any significant new tax law is passed and signed by the president, we will cover the key provisions.

➡**Flu Season**—Have any of your employees been out sick for an extended time due to the flu? If a worker is incapacitated for more than three full consecutive days, visits a physician and receives a prescription for antibiotics, he or she may be entitled to unpaid leave under the Family and Medical Leave Act (FMLA). The same could be true for severe sinus infections, earaches and the like.