



DYER & ASSOCIATES, P.C.

Certified Public Accountants

10415 Armory Avenue

Kensington, MD 20895

(301) 654-6200 FAX: (301) 692-1990

Client Information Bulletin

September 2011

Five Smart Ideas for College Savings

Practical tips for setting aside funds

The price tag on a college diploma continues to escalate at a rate higher than the inflation rate. According to the College Board, tuition and fees for in-state students at four-year public colleges for the 2010–2011 academic year increased an average of 7.9% from the prior year. For out-of-state students, tuition and fees rose an average of 6.0%. And the cost at four-year private nonprofit colleges jumped an average of 4.5%. Meanwhile, inflation has remained close to the 3% level.

Despite these grim figures, you can put a sizable dent in the projected cost of a child's college education, if you are dedicated. Consider these five practical suggestions:

1. Start saving money on a regular basis. Make this a top priority, along with paying the mortgage and meeting other monthly obligations. Review your expenses, and try to determine the amount you can safely set aside each month.

Although your outlays may be relatively small, especially at the outset, the savings can grow substantially over time if you start early enough. Plus, it is a lot less painful than if you wait until the day your child receives his or her college acceptance letter.

2. Investigate Section 529 plans. One of the innovative ways that parents can save for college is a Section 529 plan. If certain requirements are met, the funds contributed

to the plan can grow without current tax and may be withdrawn tax-free if they are used for qualified education expenses.

There are two basic types of Section 529 plans: prepaid tuition plans and college savings plans. Generally speaking, prepaid tuition plans enable you to lock in future tuition rates at in-state schools. College savings plans generally provide more flexibility for choosing a school, but without the same guarantees.

3. Be tax smart about other investments. For instance, certain investments may generate income that is either tax-free or tax-deferred. You can also arrange to have the income paid out at regular intervals during the time your child will be attending school. Frequently, it makes sense to make investments in the child's name.

Caveat: Under the "kiddie tax," annual unearned income received by a child younger than 19 (or a full-time student younger than 24) is generally taxable at the top tax rate of the child's parents to the extent it exceeds a specific threshold (\$1,900 for 2011). One possible way to avoid or reduce tax complications is to invest in appreciating assets, such as growth stock.

4. Look into financial aid. While financial aid is often limited to the neediest families, your child still may

Inside

This Type of Trust Succeeds at "Failure"

How to Guard Against Supervisory Bias

Pay the IRS First

Debt Forgiven? You Are Not Home-free

Facts and Figures

be eligible for some type of state or federal financial assistance. This can come in the form of a grant, work/study program or a low-interest loan. Once your child has been accepted at a particular school, inquire about potential financial aid—it cannot hurt to ask.

5. Put your child on the payroll. If you own your own business, you can have your child work for you. Not only

does your child save money for college but the wages you pay your child may be deducted by the business. However, the amount paid to your child must be “reasonable” for the services actually performed.

These are just five ideas to consider. There are other possibilities. Coordinate all college savings aspects into a comprehensive plan of action.

This Type of Trust Succeeds at “Failure”

Benefits of intentionally defective trusts

Depending on your situation, it may be advisable to set up a trust to fail certain tax law requirements. Actually, it is not as drastic as it sounds. An “intentionally defective trust” (known as an IDT, for short) can be a valuable estate-planning tool, especially in this current interest rate environment.

But IDTs are not for everyone or at every available opportunity. Here is a brief review of this sophisticated estate-planning technique.

How it works: Usually, you transfer assets such as cash or securities to the trust, which then pays annual income to the designated beneficiaries. By giving up all rights to the assets, you are not responsible for any federal income tax on the earnings. This can be particularly beneficial if you are in one of the top income tax brackets. (The current top bracket is 35%.) The income tax is generally paid by the trust under a graduated tax rate structure, beginning at a 15% rate.

But be aware that the income tax brackets for trusts are highly compressed. In other words, the dollar amounts for each bracket are relatively small compared with the



tax brackets for individuals, so the higher tax rates are reached relatively quickly.

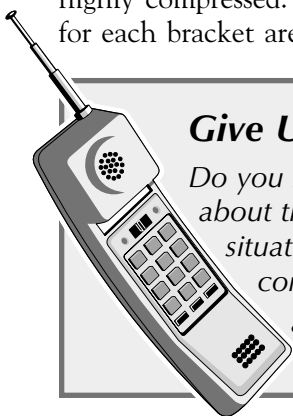
Bottom line: The trust could end up paying more tax than you would have been assessed in your usual individual tax bracket. In that case, you are defeating one of your own objectives.

This is where an IDT can provide some much-needed relief. Assuming the trust document is properly structured, the trust will be treated as a “grantor trust” if it permits you to retain certain rights or interests. This means that the income will be taxed to you as the grantor rather than the trust—even though you are not receiving any of the annual income.

In addition to the income tax savings, current interest rates make it conducive to establish an IDT. **Reason:** The resulting gift-tax liability for the remainder is based on the assumed IRS interest rate at the time the trust is created. When interest rates are on the low side—as they have been through the beginning of 2011—the gift-tax consequences are favorable to the grantor.

Note, however, that an IDT could lead to estate-tax complications. That is because your taxable estate includes assets you have transferred to trusts and individuals where you retain possession or enjoyment of the transferred property. Essentially, you must give up complete control over the assets. Nevertheless, negative estate-tax consequences can be avoided with proper planning.

Caution: This is not a do-it-yourself proposition. Consult an experienced estate-planning adviser to determine if an IDT makes sense for your situation.



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.

How to Guard Against Supervisory Bias

New case points out hidden danger

Say that one of your company's top managers comes to the owner with a complaint about a particular worker. You are well aware that there have been ongoing problems between the manager and the worker for the last few years. But the manager requests that the worker be fired and presents some valid reasons for doing so. Based on the request, your company terminates the worker's employment.

Surprisingly, your company may have just landed in some hot legal water. As evidenced by a new ruling handed down by the U.S. Supreme Court, an employer may be held liable for the discriminatory intent of supervisors who influence hiring and firing decisions. If there is an element of bias involved, it does not matter whether those decisions are made by somebody other than the owner.

Facts of the new case: Mr. Staub worked for a hospital in Illinois. He was fired because of a supervisor's complaint that Staub left his workstation in violation of hospital rules. But the supervisor didn't tell the human resources (HR) department that Staub had been taking military leave for reserve training duty. This was a point of contention with the supervisor.

Staub sued the hospital for wrongful termination under the Uniformed Services Employment and Reemployment Rights Act (USERRA) of 1994. Eventually, the case worked its way up to the nation's highest court. Now, the

Supreme Court says that the hospital could be held liable even though the HR department was not aware of the supervisor's bias. **Reason:** The hospital management staff made no effort to examine the reasoning behind the firing.

To avoid this result, the hospital managers could have conducted an independent investigation about the firing and then followed up on the results. At the very least, it would have helped to document the reasons for firing Staub.

What can you learn from this new case? Employers should take these steps to avoid liability in comparable situations:

- ◆ Make sure that the final decision-maker for a termination is not merely "rubber-stamping" a supervisor's recommendation.
- ◆ Independently investigate the incident or behavior that resulted in the firing. Verify that the incident or behavior actually occurred and that termination is warranted based on the facts, not bias.
- ◆ Train all employees, especially supervisors, about non-discrimination policies in your workplace. Also outline the reporting procedures so all employees understand them.
- ◆ Periodically review the relationships between supervisors and their workers. Determine whether a past history of confrontation warrants changing the line of command.
- ◆ Do not rely solely on recommendations from a supervisor who may have ulterior motives or has had confrontations with a particular employee in the past.

Finally, be aware that the new Supreme Court ruling could open the floodgates to litigation, or the potential threat of litigation, in cases where supervisors may have suspect motives.

Best approach: Have all disciplinary actions properly documented by your staff. It can help protect your company against potential liability.

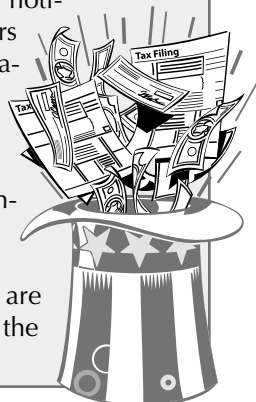


Pay the IRS First

The courts often deliver this message to employers: Pay the IRS before everyone else.

Latest example: Owners of a trucking firm relied on their bookkeeper to make payroll tax deposits. They were not aware that the bookkeeper had embezzled funds set aside for taxes until the IRS notified them of the problem. But the owners then paid more than \$5 million in salaries to employees and made payments to other creditors without giving anything to the IRS.

Result: The Eighth Circuit said the owners should have paid the IRS first. Under the "100% penalty" assessed against the responsible parties, they are personally liable for the full amount of the unpaid taxes.





Debt Forgiven? You Are Not Home-free

Tax may apply to cancellation-of-debt income

Typical situation: An individual owes money to a third party relating to a loan for business or personal reasons. Due to extenuating circumstances, the lender agrees to a settlement of an amount less than the amount the borrower owes in principal and interest. So the full amount of debt is effectively wiped off the books.

Case closed ... right? Not exactly. The individual still faces potential federal income tax liability when a debt is completely or partially forgiven. In other words, you must pay tax on the reduction of the debt you benefit from. This is commonly referred to as cancellation of debt (COD) income in tax circles.

Background: If a debt is forgiven or canceled, the benefactor must report the amount as taxable income on his or her personal tax return. A business debt is reported on the appropriate return for the business entity or sole proprietorship. For this purpose, a debt includes any indebtedness for which the party is legally liable or indebtedness that attaches to property owned by that party.

Similarly, the debtor is required to report any interest attributable to the debt that is being forgiven or canceled. It's a double whammy.

New case: A taxpayer who attended college in the 1980s borrowed money from the Connecticut Student Loan Foundation (CSLF) to help pay for school. At some point, the taxpayer became delinquent in the payments.

Eventually, he settled the debt with CSLF by paying \$45,000 of the \$73,000 he owed, at a discount of \$28,000. **Result:** The Tax Court says the taxpayer now owes tax on \$28,000 of COD income.

Be aware, however, that there are several key exemptions to the rules for COD income, including student loans requiring the student to work after school for a specified time in a designated profession and certain student loans issued by tax-exempt organizations. Also, COD income does not have to be realized if the payment of debt would have been tax-deductible. (This exemption only applies if the cash method of accounting is used.)

Furthermore, the rules for tax on COD income generally do not apply to insolvent taxpayers or those in bankruptcy proceedings. Other special rules apply to indebtedness of farms.

Finally, there is a specific exclusion from COD income for debt of a principal residence. The exemption, which was established by a recent tax law in the wake of the mortgage foreclosure crisis, is capped at \$2 million of qualified principal residence debt. Technically, this tax break is currently scheduled to expire for debts discharged after 2012.

Final words: Do not simply assume you are in the clear. Obtain professional assistance regarding the tax consequences of debt forgiveness or cancellation.

Facts and Figures

Timely points of particular interest

Pumped-up Deduction—The standard mileage rate for qualified business drivers was set at 51 cents per business mile (plus tolls and parking fees) for 2011. Now the IRS has announced that the rate is jumping to 55.5 cents per mile for the second half of the year. For the same six-month period, the standard mileage rate for medical and moving expenses increases from 19 cents per mile to 23.5 cents per mile.

Cosmetic Changes—Generally, the cost of cosmetic surgery is not deductible as a medical expense. But certain expenses, such as the cost of reconstructive breast surgery, may qualify for deductions if they result from a congenital abnormality or an accident, trauma or a disfiguring disease. **Reminder:** Medical deductions are deductible only to the extent that the annual cost exceeds 7.5% of adjusted gross income (AGI).

This newsletter is published for our clients, friends and professional associates. It is designed to provide accurate and authoritative information with respect to the subject matter covered. It is distributed with the understanding that the publisher is not engaged in rendering accounting, legal or other professional services. Before any action is taken based upon this information, it is essential that competent, individual, professional advice be obtained. In accordance with IRS Circular 230 any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of 1) avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions, or 2) promoting, marketing or recommending to another party any transaction or matter addressed herein. © 2011