Anchin Advantage

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Tax Strategies: Planning Helps Protect Your Wealth

The volatility in the current economic and business environment makes strategic tax planning now more important than ever. Considering the likelihood that there will be significant tax increases to cover healthcare reform legislation and other government expenditures, formulating an effective tax strategy is a critical step in protecting your wealth. There is a range of tax planning opportunities that can enable you to shield your assets from taxation, defer income into a lower tax bracket, and potentially reduce your overall liability. Your Anchin relationship partner can review with you the best mix of tax planning techniques that can have a direct positive impact on your bottom line.

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Businesses Experiencing Losses Have Tax-saving Options

The Worker, Homeownership and Business Assistance Act of 2009 (WHBAA) recently signed into law extended unemployment benefits for millions of Americans, enhanced the homebuyers credit, and extends and expands a popular tax break for businesses: the five-year net operating loss (NOL) carryback election. This article provides an in-depth look at the NOL carryback election, summarized in a recent email to our clients.

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Valuable Tips for Tax-smart Intra-family Loans

At one time or another, you may wish to provide financial assistance to your children or other family members, whether it's to help them pay for college, buy their first home, or get out of debt. Often such assistance is offered in the form of a gift, but in many cases a loan may be more desirable.

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Tax Tips *(continued from page 1)*

Here are a few opportunities to discuss with your Anchin partner:

Roth Conversions: Change in AGI Requirements

Roth IRAs are a unique way to shield and grow your wealth tax-free. Instead of taking an upfront deduction on contributions into a traditional IRA and then paying taxes in future years on the distribution, a Roth IRA allows your assets to appreciate tax-free. Roth IRAs also have no minimum required distributions in comparison to a traditional IRA.

While annual contributions to Roth IRAs are capped at a low amount, converting your assets from a traditional IRA to a Roth enables you to jump start your growth. A conversion creates a taxable event at the date of conversion and must be recognized as income equal to the fair market value of your converted assets. Previously, only people with an adjusted gross income of $100,000 or less could participate in such a conversion. However, that rule will change after December 31, 2009 allowing anyone to do a Roth conversion.

For conversions completed before December 31, 2009 and after December 31, 2010, 100% of the converted amount is counted as taxable income. For conversions completed in 2010, taxpayers can report that income on 2011 or 2012 returns, delaying the tax payment. Depending on your financial position, it may make sense to convert in 2009 under the old rules, or have your income recognized in 2010 to avoid potentially higher rates in 2011 and 2012. Numerous factors come into play when making a conversion decision and your Anchin partner can advise you on the best approach.

Timing of Income and Deductions

Smart timing of income and deductions can reduce your tax liability, and poor timing can increase it. Generally speaking, it is preferable to defer income into a year in which you expect to be in a lower tax bracket. For example, you may want to consider deferring income to 2010 and accelerating deductible expenses into 2009. This will allow you to defer tax, which is usually beneficial. But if you think you'll be in a higher tax bracket next year, the opposite approach may be beneficial.

Bonuses and self-employment income, U.S Treasury bill income, real estate or non-publicly traded property sales, and non-mandatory retirement distributions are all examples of income that can be deferred.

On the expense side, you might be able to accelerate payments of state and local income, real estate taxes, mortgage interest, and margin interest.

"Converting your assets from a traditional IRA to a Roth enables you to jump start your growth."

You could also time your charitable contributions when it's most favorable for you tax-wise. One must consider the affect of the alternative minimum tax on accelerating deductions into the current year.

Higher State Tax Rates Trigger Alternative Minimum Tax

The Alternative Minimum Tax (AMT) is a distinct tax system that must be computed separately from the "regular" tax system, with taxpayers being liable for the higher amount. Accounting for the AMT can be quite complex as you must re-compute your taxable income under special rules: the AMT does not allow many deductions and has a generally broader definition of taxable income.

Because many deductions used to calculate regular income tax are not allowed under the AMT system, they can trigger AMT liability. For example, state and local income taxes are not deductable under the AMT. Tax rate increases in New York, New Jersey, and Connecticut are currently having the effect of pushing more people into the AMT.

Your Anchin partner can work with you to determine when you could be subject to this tax and how best to plan to minimize your total liabilities. One option is to accelerate income and short-term capital gains into 2009. This may allow you to benefit from the lower maximum AMT rate. Deferring expenses that you can't deduct for AMT purposes until 2010 may allow you to actually retain those deductions. If you will be subject to AMT next year, you could take the opposite approach, deferring income to 2010 to take advantage of a probable lower AMT rate.

Self-directed IRA Withdrawals

For 2009, required minimum distributions (RMDs) from IRAs and other retirement accounts have been suspended for people age 70½ and older. For many, skipping this year's RMD is a good idea because investments might have to be sold at distressed prices to generate the cash needed to make the distribution.

If you have a self-directed IRA, however, you may be better off taking a distribution this year, even if it's not required. Why? Because you're permitted to make withdrawals from a self-directed IRA "in kind" — that is, by taking possession of the assets rather than converting them to cash. For example, if your self-directed IRA holds stock, it can simply transfer some of the stock directly to you rather than selling it and making a cash distribution. The amount of the distribution for tax purposes is based on the asset's depressed value; plus, you get to hold on to your investment.

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Tax Saving Options *(continued from page 1)*

More years, more types of businesses

Generally, when business deductions exceed gross income, the difference is an NOL for tax purposes and may be carried back two years to offset income. This generates a tax refund, providing a cash infusion in times of loss. Any loss that's not absorbed is carried forward up to 20 years. In the case of a flow-through entity, such as a partnership, limited liability company (LLC) or S corporation, the NOL flows through to the owner's tax return, but additional rules apply that affect the amount of NOL the owner can use to offset income.

The American Recovery and Reinvestment Act of 2009 (ARRA) allowed taxpayers to elect to carry back 2008 NOLs (NOLs for taxable years beginning or ending in 2008) from qualifying small businesses (businesses with average gross receipts of $15 million or less for the three years ending with the loss year) for three, four or five years instead of two. This year's law goes even further: WHBAA expands the longer carryback option to businesses that don't qualify as "small" and extends it to 2009 NOLs (NOLs for taxable years beginning or ending in 2009).

Because the biggest refund that taxpayers can get from carrying back an NOL is an amount equal to the taxes paid in the carryback years, having additional carryback years available can be particularly helpful if little or no income was earned in the two years immediately preceding the loss.

Under WHBAA, generally taxpayers can apply the longer carryback to only one tax year's NOL and to offset only 50% of income in the fifth year back, 100% in the other four. For qualifying small businesses, taxpayers can apply the longer carryback to both 2008 and 2009 NOLs, and the 50% limit applies only to 2009 NOLs.

Taxpayers also have the option to waive the carryback period and carry the entire loss forward. This may be beneficial if the marginal tax rate in the carryback years is unusually low or if the alternative minimum tax (AMT) in prior years makes the carryback less beneficial.

An NOL in action

So what does all this really mean? The following examples illustrate the potential benefit of the NOL carryback as well as the carryforward. Let's say your closely held C corporation experiences a $100,000 NOL in the 2009 tax year. Under WHBAA, you can elect to carry the NOL back five years:

- If your business's 2004 taxable income was $50,000, you can offset 50% of it, or $25,000, with the 2009 NOL, and your business will receive a refund of the $3,750 of tax paid on that income.

> **"Having additional carryback years available can be helpful if little or no income was earned in the two years preceding the loss."**

- If 2005 taxable income was also $50,000, you can offset 100% of it with the remaining $75,000 of 2009 NOL, and your business will receive a refund for 100% of the 2005 taxes paid, or $7,500.
- If 2006 taxable income was also $50,000, you can then use up the last $25,000 of the 2009 NOL and receive a refund of $3,750.

In this example, your total refund from carrying back the NOL will be $15,000.

But let's say you're adding a new product line in 2010 that you anticipate will significantly boost profits, pushing your company into a higher tax bracket. In that situation, if you can afford to forgo the current cash flow boost that an NOL carryback would provide, you may be better off carrying forward the entire NOL.

If, for instance, your business is projected to have a $100,000 profit in 2010, and presuming the tax rates don't change, carrying forward the NOL may save $22,250 in taxes — $7,250 more than if you carry it back. The savings may be even greater if your business expects a higher profit in 2010.

Year end tax planning tips

If you expect that your business will experience a 2009 NOL, consider strategies for maximizing it. For example, if you need to make equipment or other asset purchases within the next few months, you may want to do so before year end. You could take advantage of 50% bonus depreciation (generally available only for purchase of qualified assets placed in service this year) to maximize your expense deduction and increase your NOL.

If your business uses the accrual method of accounting for tax purposes, you also can increase this year's NOL with inventory write-downs, bad debt write-offs or a reduction of accrued expenses. Cash basis businesses may be able to increase an NOL by accelerating depreciation deductions, maximizing retirement plan funding, selling off devalued assets, or prepaying deductible expenses before year end.

Don't wait

You may need to take steps before year end to maximize the benefit of the five-year NOL carryback option. So if your business has suffered operating losses, don't wait to explore how you might turn them into a tax advantage.

Your Anchin relationship partner is ready to work with you to determine the best strategy for utilizing an NOL, as well as other strategies to consider in your 2009 year end tax planning.

Intra-family Loans *(continued from page 1)*

Maybe you're concerned about gift taxes or feel that a loan is the best way to teach your children financial responsibility. Perhaps you simply can't afford to give the money away. Whatever your reasons for lending to a family member, it's important to structure and document the loan carefully. You may trust these loved ones implicitly but, if you handle things too informally, you may bring about some unpleasant tax consequences.

Here are three tips for making tax-friendly family loans:

1. Put it in writing. Have the borrower sign a promissory note that details the payment terms and interest rate. If you don't, the IRS may assume the loan is a gift, which can trigger gift taxes or reduce your lifetime gift tax exemption (currently $1 million).

2. Charge appropriate interest. When family is involved, your first thought may be to charge low or even no interest. But generally it's best to charge at least the "applicable federal rate." If you charge less, the IRS will treat the difference as "imputed interest," which means you'll pay income tax on that amount whether you collect it or not. What's more, forgone interest will be treated as a gift to the borrower for gift tax purposes.

If you do choose to charge low or no interest, in most cases a "demand loan" is your best bet for minimizing gift taxes. A demand loan — as opposed to a "term loan" — is one with no fixed maturity date or payment schedule; it can be called for repayment whenever the lender chooses.

3. Understand the exceptions. There are two exceptions to the imputed interest rules. First, you can make a low- or no-interest loan of up to $10,000 to a family member without creating tax problems, provided the borrower doesn't invest the proceeds in income-producing assets (such as securities or rental real estate). Second, imputed interest on loans up to $100,000 is generally limited to the borrower's net investment income.

However you decide to structure a family loan, follow and enforce its terms to be sure the IRS doesn't challenge the transaction as a disguised gift.

Tax Tips *(continued from page 2)*

A Good Time for a QPRT

A qualified personal residence trust (QPRT) allows you to transfer a principal residence or vacation home to loved ones at a reduced tax cost and retain the right to live in the home for a specified term. The home is removed from your estate, so any future appreciation in value goes to your beneficiaries' estate tax free, provided you survive the trust term.

Typically the best time for a QPRT is when interest rates are high. That's because when you transfer your home to the trust you make a taxable gift equal to the present value of your beneficiaries' future interest. The higher the interest rate, the lower the present value and, therefore, the lower the gift tax.

Even though interest rates are relatively low, you may still be better off establishing a QPRT now, while real estate values are depressed, because that will also reduce your gift's value.

The right timing depends on your particular situation but, in many cases, if you wait for interest rates to rise, the tax advantages of a higher interest rate may be erased by rising home prices.

These represent just a few key tax planning strategies to consider. For a more detailed explanation of these and many other tax ideas, refer to the Anchin 2009 Year-End Tax Planning Guide that was recently mailed to you. If you did not receive a Guide, you may request one at info@anchin.com.

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