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TAX AND BUSINESS ADVISOR

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TAX AND BUSINESS Alert™

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New Business Tax Saving Opportunity

Individuals are opting to start new businesses at a rapid pace. This phenomenon is likely the result of various reasons including the slow economy, early retirement, and folks just wanting to get away from the everyday grind of working for someone else. If you are considering fulfilling the dream of owning your own business, you might consider a tax planning opportunity that exists if you own and operate that new business through a corporate entity.

As you may be aware, gains and losses on sales of corporate stock generally are treated as capital gains and losses. Although capital gains are potentially taxed at preferential rates, capital losses are usually unattractive because the losses can only offset capital gains plus $3,000 ($1,500 if married filing separate) of ordinary income (from wages, dividends, interest, etc.). Any remaining balance is carried over to future years. Thus, if you realize large capital losses but no capital gains, the tax benefit of the capital losses may have to be spread over many years.

There is a tax provision, however, that allows you to treat losses incurred from the sale of qualified corporate stock as ordinary (rather than capital) losses. That is beneficial because an ordinary loss offsets ordinary income. The deductible ordinary loss for this provision is subject to an annual limitation of $50,000 ($100,000 if you file a joint return).


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Of course, you don't intend for your new business to generate a loss. However, this tax provision (known as the Section 1244 stock provision) is like insurance—you hope you will not need it but it is nice to have just in case. Any gain realized on the sale of Section 1244 stock is considered capital gain. However, losses realized are characterized as ordinary losses. Thus, there is really no downside to qualifying for Section 1244 treatment if your initial capital structure can be set up to meet the requirements.

Only original owners of the corporate stock are eligible for Section 1244 treatment. To qualify as Section 1244 stock, your new business must be

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Tax Calendar

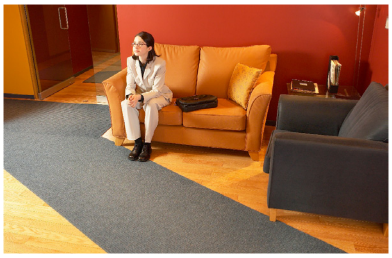
October 15—Personal returns that received an automatic six-month extension must be filed today, and any tax, interest, and penalties due must be paid.

—Electing large partnerships that received an additional six-month extension must file their Forms 1065-B today.

December 15—Calendar-year corporations must deposit the fourth installment of estimated income tax for 2010.

Deducting Job Search Expenses

In this economy, many individuals are looking for jobs and will likely incur some expenses along the way. Fortunately, some job-hunting expenses can be deducted on your tax return.



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While it may seem unfair, you can only deduct expenses to search for a job that is in the same occupation as the last one you had (or the one you still have if you're looking for a better position). If you pass this "same occupation test," you can potentially deduct the expenses (subject to the following limitations). You can also deduct expenses to look for a new job in the same occupation even if you are *temporarily* working in another field. And you can deduct expenses to look for full-time work in your existing occupation while you're working part-time or sporadically in the same line of work.

Some examples of deductible job-hunting expenses include employment agency or headhunter fees, travel costs, resume preparation, copying, postage, and long-distance calls (but only if you have to pay extra for them). If you drive in connection with your search, you can deduct the IRS business mileage allowance. But keep this in mind: transportation expenses to go out of town are only deductible if the primary reason for your trip is the job search. You cannot deduct expenses that are reimbursed by a prospective employer or a future or past employer.

There is a catch: you must classify the amount of your allowable job search expenses as a miscellaneous itemized deduction item. Therefore, you receive no tax-saving benefit at all unless you itemize. If you do itemize, miscellaneous itemized deduction write-offs are only allowed to the extent they exceed 2% of your adjusted gross income (AGI) when combined with certain other miscellaneous deduction items. And, no deduction is allowed under the alternative minimum tax (AMT) rules.

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a U.S. corporation (including an S corporation) and it must have no more than $1 million in capitalization at the time the stock is issued. The stock must be issued to an individual or partnership in exchange for money or property (other than stock or securities). Stock issued in exchange for services will not qualify. In addition, the corporation generally must derive more than half of its gross receipts from noninvestment activities for a specified period (generally, five years) before the year the stock is disposed of at a loss.

Note that individuals purchasing the stock of an existing corporation are not entitled to Section 1244 treatment since they are not the original owner of the stock. In this situation, investors can purchase the corporation's assets and transfer them to a new corporation that is eligible for Section 1244 treatment.

Please contact us to discuss Section 1244 stock benefits and requirements.

Retirement Account Catch-up Contributions Can Really Add up

Tax law changes made back in 2001 established the right to make additional catch-up contributions to certain types of tax-advantaged retirement accounts. For 2010, this opportunity may be available to you if you will be age 50 or older as of year-end.

Specifically, you can potentially make additional salary reduction catch-up contributions to a 401(k) plan, 403(b) plan, 457 plan, or SIMPLE plan (assuming you participate in a plan that allows catch-up contributions). These contributions reduce your taxable income and therefore result in lower income tax bills. You can also make catch-up contributions to a traditional IRA (which may or may not be deductible depending on your circumstances) and to a Roth IRA. (Roth IRA contributions are always nondeductible, but they can be a good idea if you expect higher future tax rates.)

These catch-up contributions are above and beyond the "normal" annual contribution limits that otherwise apply to your tax-advantaged retirement accounts. The maximum allowable catch-up contribution for 2010 is $5,500 for 401(k), 403(b), and 457 plans. It is $2,500 for SIMPLE plans and $1,000 for traditional and Roth IRAs. However, depending on your salary level and the terms of your salary reduction plan, maximum allowed catch-up contributions to the plan could be less than the amounts shown here.

How much are the catch-up contributions worth? The beneficial long-term impact of making catch-up contributions is illustrated below. Remember, allowable catch-up contributions are now much bigger than back in 2002 when first allowed. For example, the maximum catch-up contribution to a 401(k) account for 2002 was only $1,000 versus $5,500 for 2010. The maximum catch-up contribution to a traditional or Roth IRA for 2002 was only $500 versus $1,000 for 2010. Therefore, you should now give catch-up contributions more respect than you might have earlier.

The following analysis proves the point.

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Assume you turn 50 during 2010 and make the maximum catch-up contribution for this year and then do the same for the following 15 years, up to age 65. Here's approximately how much extra you could accumulate by that age in the various types of retirement accounts, assuming the indicated annual rates of return:

Type of Account	Annual Catch-up Contribution	4% Rate of Return	6% Rate of Return	8% Rate of Return
401(k), 403(b), or 457 plan	$5,500	$120,000	$141,000	$167,000
SIMPLE Plan	2,500	55,000	64,000	76,000
Traditional or Roth IRA	1,000	22,000	26,000	30,000

The numbers prove that taking advantage of the opportunity to make additional annual catch-up contributions is not a trivial exercise. If your spouse can also make catch-up contributions, so much the better. Of course, the favorable impact is somewhat less than illustrated if you turned 50 before this year, but it is generally still a good idea. On the other hand, if you are disciplined enough to also save and invest the annual tax savings resulting from salary reduction contributions and any deductible IRA contributions, the dollars accumulated from making catch-up contributions could be even more than illustrated.

Please think about the extra retirement savings you could accumulate and contact us if you have questions or want additional information on how to make catch-up contributions.

Revocable Living Trusts

Living trusts remain a popular and affordable estate planning vehicle. A revocable (or living) trust is a trust that is funded with part or all of the property of the creator (grantor) of the trust. By serving as trustee, the grantor retains control of the property and also has the right to revoke the trust and reclaim ownership of the trust's property. By itself, the trust does not offer any estate tax savings, since the trust assets remain in the donor's taxable estate. However, if it is properly set up and funded, it can provide several advantages, including the following:


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Avoiding Probate. In states where executor fees and attorney fees are based on a percentage of a person's estate that goes through probate, a living trust can cut costs significantly because assets owned by the trust are not subject to the probate process.

Asset Administration. Another benefit of a living trust is that it can help avoid a court-supervised guardianship in the event the trust creator becomes unable to manage his or her own affairs. Of course, if the only reason for creating the trust is to avoid a guardianship proceeding, it may be simpler (and cheaper) to grant a durable power of attorney over all of one's assets to a trusted relative or friend, rather than to establish the trust.

Multi-state Administration. An ancillary administration (meaning administration of a person's estate in more than one state) is necessary when individuals own real property outside their state of residence. In some situations, this process is fairly simple; other times it is not. As an alternative to an ancillary administration, a living trust can be established to hold title to the property located in another state.

Privacy. An inventory of assets generally must be filed in a probate administration. This document becomes a matter of public record, subject to inspection by anyone. Thus, individuals who are concerned about the privacy of their financial affairs can use a fully funded living trust to prevent a public record of their assets at death.

Although a revocable living trust can be a valuable planning tool, it's certainly not for everyone. For example, the benefits of the trust normally are not fully realized unless all of a person's assets are placed in the trust. Some people will find the inconvenience of having assets such as cars, boats, homes, and checking accounts titled in the name of the trust rather than their own name too much to deal with on a day-to-day basis. Thus, they'll either not bother to properly fund the trust when it is set up, or as the years go by, they'll become remiss in maintaining the proper paperwork.

Please do not hesitate to contact us if you have questions concerning a living trust.