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Don’t underestimate the power of giving

Starting in 2009, the annual gift tax exclusion has been increased to $13,000 per recipient to keep pace with inflation. In light of this increase, now’s a good time to review your gifting strategies. If your wealth is substantial enough that gift and estate taxes are a concern, a well-designed gifting program can help you slash your potential tax bill, even while the gift and estate tax rules remain in limbo.

Deceptively effective

It’s easy to overlook the annual exclusion. After all, $13,000 isn’t a significant portion of your net worth. But a gifting plan that includes regular annual exclusion gifts to your children and other loved ones can be surprisingly effective. If you’re married, and you and your spouse elect to “split” your gifts, you can give up to $26,000 each year to an unlimited number of recipients without having to pay gift tax and without using up any of your $1 million lifetime gift tax exemption. This can be done even if the funds come entirely from just one of you.

Suppose you have three children and six grandchildren. If you and your spouse “split” your gifts by giving each of them $26,000 per year, in only five years you will have transferred $1.17 million (9 x $26,000 x 5) without paying a cent of gift tax or using up any of your lifetime exemption.

One thing to keep in mind: If you make noncash gifts, such as stock, the tax basis in the gifted property — unlike property transferred at death — won’t be “stepped up” to fair market value. Instead, the recipient will inherit your original cost basis in the property, which may result in a significant income tax liability if he or she sells the property. Your tax advisor can help you weigh the potential gift and estate tax savings against the potential income tax cost so you can choose the best assets to give away.

Better than the lifetime exemption

There’s a common misconception that annual exclusion gifts are unnecessary because you can use your lifetime exemption to reduce gift taxes and avoid spreading gifts over several years. But the annual exclusion offers several advantages.

For one thing, it allows you to insulate more of your wealth from gift and estate taxes. Gifts that deplete your lifetime exemption reduce the amount of wealth you can transfer tax free at death. As of this writing, the estate tax exemption is $3.5 million. But if you use up all of your lifetime gift tax exemption, that amount drops to $2.5 million.

A regular program of annual exclusion gifts allows you to remove substantial amounts of wealth from your estate while preserving your full estate tax exemption. Annual exclusion gifts also allow you to take advantage of valuation discounts for minority interests in a closely held business or fractional interests in real estate.

Typically, these interests are entitled to significant discounts for lack of control and lack of marketability, which enables you to leverage your annual exclusion gifts to transfer more value over time than you could with a larger, one-time gift of the entire asset.

Give early and often

Annual gifting is a great way to transfer stock, business interests or other assets you expect

to appreciate in value. By removing these assets from your estate as early as possible, you avoid gift or estate taxes on any future appreciation. And by gifting business or real estate interests gradually over time, you can minimize the transfer-tax impact while retaining control as long as possible.

If you're already giving away as much as you can using the annual exclusion, consider making additional gifts within your $1 million lifetime exemption. The earlier you transfer assets, the more appreciation you'll hopefully shelter from gift and estate taxes. A drop in stock market or real estate values presents an opportunity to make gifts at lower values. If you wait until your death to transfer these assets to your family, their appreciated value will be included in your estate.

If you give closely held stock or other property whose value isn't readily determined by market prices, it's a good idea to have the property appraised by a qualified appraiser in case the IRS challenges your valuation later.

Consider taxable gifts

If you expect your wealth to exceed the estate tax exemption amount, consider making lifetime gifts even if you've used up all of your exemptions and exclusions. There are two reasons for this: First, if assets are expected to appreciate dramatically in value, you may be better off paying gift tax on their current value instead of estate tax on their appreciated value down the road even though you're paying the tax earlier. Your tax advisor can help you determine which approach is best.

Second, all other things being equal, gift tax is cheaper than estate tax. Suppose you've set aside $2 million for your daughter and that none of your gift or estate tax exemptions are available. If you leave the money to your daughter in your will, $900,000 will go to estate taxes (assuming a 45% marginal rate), leaving $1.1 million for your daughter.

The earlier you transfer assets, the more appreciation you'll shelter from gift and estate taxes.

Alternatively, you could use that same $2 million to make a gift of $1.38 million with enough left over to pay the $621,000 gift tax ($1.38 million x 45%). Using a lifetime gift instead of a bequest saves you $279,000 in taxes, because the gift taxes are paid only on the net gift while estate taxes are paid on the gross amount.

Do the math

A gifting program can provide significant tax benefits, depending on your situation. To determine the right strategy, you need to compare the potential transfer tax savings against the potential income tax costs, taking into account the time value of money. ◈

THE R&D TAX CREDIT

Are you overlooking this tax-saving tool?

Among all the deductions and credits that Uncle Sam has to offer businesses, the research and development (R&D) tax credit is perhaps the most overlooked. The purpose of this tax break is to provide companies with an incentive to increase their R&D activities. Yet many eligible companies still don't claim the credit, don't take full advantage of it, or aren't implementing the relatively simple procedures that would substantiate the credit and minimize IRS scrutiny. Why is that?

Permanence eludes it

One reason that businesses may not be tapping into the R&D credit is that, since 1981 when the credit was first established, it's never been made permanent. Instead, the credit has been allowed to expire and then reinstated multiple times since its inception.

Because these extensions often modified the way the R&D credit was calculated, companies didn't always understand how

to account for it properly or they chose not to consider it at all.

What's its status now? Well, after having expired at the end of 2007, the Emergency Economic Stabilization Act of 2008 extended the R&D credit through 2009. And it's possible that, by the time you're reading this article, the credit will have been made permanent. Talk to your tax advisor for the latest information.

It's hard to define

Many companies may not have understood what activities qualify for the credit. Under the Internal Revenue Code, "qualified research" is defined as research undertaken for the discovery of technological information that will aid in the development of a business component relating to a new or improved function or better performance, reliability or quality, and it must relate to a process of experimentation. The new development need not be patentable or entirely new to the world, or even be successful, to qualify.

Accounting and financial staff are often unsure how to determine whether the activity being performed or expenses incurred qualify for the tax credit because they lack the necessary technical knowledge of processes and procedures. Consequently, management must consult with the engineers and technicians who are directly involved with the research to identify qualifying activities.

Many companies that have proven or attempted technological advances may be eligible to claim the R&D credit.

Work with someone who understands it

If your company has never tapped into the R&D credit, you may be missing out on significant tax savings. In many instances, tax returns can be amended to claim this credit for up to three years, and those refunds can far outweigh the costs of gathering the proper data and documentation.

Moreover, once you put the procedures in place, these credits can be calculated for future years with relative ease. Work with your CPA to first see whether your company qualifies and then to establish a strategy for capturing this tax benefit. ◈

The ins and outs of valuing a privately held business

You may think you have a fairly good idea of how much your company is worth. But formally appraising a privately held business goes far beyond guesswork. In fact, it's a fairly complex process that involves using professionally accepted methods to arrive at a well-reasoned and defensible estimate of value. The results, however, can serve a variety of purposes.

Why perform a valuation?

The reasons for performing a valuation are numerous: You may want to buy or sell a business, use gifts as a tax strategy in your estate plan, set up a buy-sell agreement or target some strategic goals. You may also want to invest in a valuation to:

- Establish an employee stock ownership plan,
- Secure financing and credit,
- Comply with Financial Accounting Standards Board requirements for a business merger or acquisition,

- Assess life insurance policy needs for succession and estate planning,
- File an estate tax return as an owner's estate executor, or
- Resolve disputes related to gift and estate taxation, shareholder agreements, or divorce litigation.

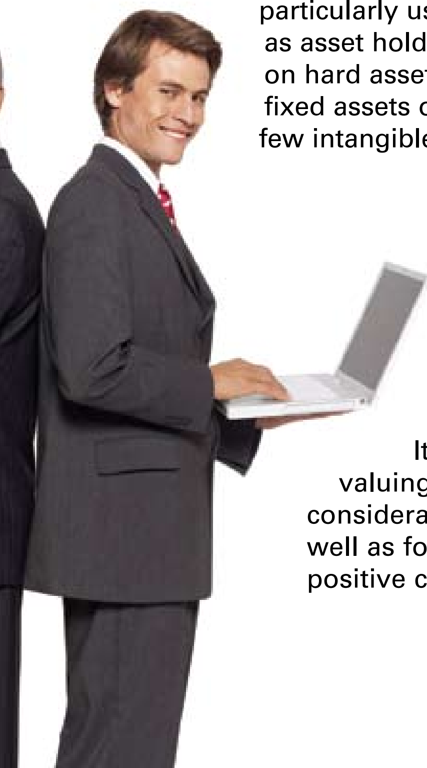
Moreover, if you're converting your C corporation to an S corporation, a valuation will help establish a basis for the company's common shares of stock and its potential "built-in gain," which may be subject to taxes if the business (or portion thereof) is sold.

Why do valuation methods vary?

Financial statements provide a useful starting point for valuing a business, but they reflect only historic values and operating results. More meaningful are the economic benefits your business will provide in the future. To get a more complete picture of your company's worth, valuators consider several variables, including economic and market conditions, business circumstances, and the company's tangible and intangible assets.

Because the valuation process is so complex, it's critical to work with a valuation professional who is skilled in selecting relevant valuation methodology. Not all appraisal methods apply to every business valuation assignment. Three commonly used approaches include:

1. Asset or cost. Under this approach, business value is the difference between the combined value of assets and that of liabilities. It's particularly useful to businesses — such as asset holding companies — that rely on hard assets (for example, inventory, fixed assets or real estate) and possess few intangible assets.



2. Income. This approach determines the present value of a business's anticipated future cash flows, which are discounted at a rate of return commensurate with the company's risk. It's particularly useful when valuing service businesses with considerable intangible assets, as well as for businesses that generate positive cash flows.

Increase your business's worth through a USP

One strategic way of increasing your business's worth is to create a unique selling proposition (USP) that differentiates your business from the competition.

Competing on price alone is a risky leg to stand on. USP strategies that could help you stand out from the crowd might include:

- High-quality products and services with superior features and functions,
- Quality or satisfaction guarantees,
- Innovation in research and development,
- A broad variety of products and services,
- Specialized expertise in select products and services,
- Environmentally friendly materials sourcing, production, or packaging and distribution,
- Efficient and accurate delivery,
- Personalized delivery with specifically targeted customer marketing messages, product packaging and promotional gifts, and
- Length of time in business and depth of experience.

3. Market. This approach estimates pricing multiples from recent sales of similar private businesses or comparable public stocks. These multiples establish relationships between actual transaction prices and the comparables' economic performance, such as price-to-earnings or price-to-sales. To obtain a meaningful sample of comparables, valuators use various selection criteria, including standard industrial classification code, transaction date and size.

Within each of these three basic approaches, there are various valuation methods that may be applied depending on the availability of data, your company's distinct characteristics, and the specific purpose of the valuation.

Why do you need a pro?

When it comes to valuing a privately held business, the process is highly technical. That's why it's critical to retain a qualified valuation professional who possesses the necessary technical skills, professional accreditation and experience. ◈

It’s more important than ever to start thinking about taxes early

If you’re like most people, you don’t worry about tax planning in February or March. You wait until later in the year. But, to maximize your tax savings, you should begin planning earlier — especially this year. That’s because, starting in 2008, numerous tax relief provisions have been signed into law in response to the economic crisis — and even more changes will likely be enacted throughout 2009. Although it’s impossible to know exactly what tax law changes await, we can give you guidance on some important ones that have been made as of this writing.

First-time homebuyer tax credit

This is one of the biggest tax breaks included in the Housing and Economic Recovery Act of 2008 (HERA), and as of this writing it’s available only for homes purchased before July 1, 2009. “First-time homebuyer credit” is a bit of a misnomer, though, because it’s not just for first-time homebuyers, and it’s not a credit in the usual sense of the term.

HERA defines a “first-time homebuyer” as someone who didn’t own a principal residence for at least three years before the purchase. If you meet that definition, you can claim a credit up to $7,500 for most taxpayers ($3,750 for married individuals filing separately). The credit is phased out, however, beginning at $150,000 of adjusted gross income (AGI) for joint filers; $75,000 AGI for everyone else.

Unlike the typical tax credit, this one has to be repaid in equal installments over 15 years. So, in effect, it’s an interest-free loan from the government to help you buy a new home.

Bailout legislation

The Emergency Economic Stabilization Act of 2008 (EESA), commonly known as the “bailout” legislation, includes several tax benefits for individuals and businesses, including alternative minimum tax (AMT) relief for 2008. Although the law didn’t address this year’s AMT liability, it’s highly likely that AMT relief will be extended for 2009 — it may even have been extended by

the time you’re reading this article. Talk to your tax advisor for the latest information and about strategies for reducing or eliminating your exposure.

EESA also extended several energy incentives, including the tax credit for energy-efficient residential property, through the end of this year.

Other EESA incentives that may help you reduce your tax bill this year include:

- Extending the limited property tax deduction (up to $1,000 for joint filers) for nonitemizers,
- Providing increased relief to employees who exercised incentive stock options before 2008 and then found themselves with a large AMT liability on profits,
- Extending the option to deduct state and local *sales* taxes in lieu of state and local *income* taxes,
- Extending the above-the-line deduction for certain higher education expenses, and
- Enhancing the child tax credit.

Not all the tax news is good, though. For example, EESA makes it harder to exclude capital gains on the sale of property you converted into a principal residence. The exclusion is reduced in proportion to any preconversion period of nonqualified use (such as rental or vacation property) beginning Jan. 1, 2009.

Suppose, for example, that you buy a vacation home on April 1, 2009, for $300,000. On April 1, 2011, you move into the home full-time

and convert it to your principal residence. On April 1, 2013, you sell the home for $600,000. Under the old rules, you could have excluded your entire $300,000 gain. But under the new rules, because your use of the home is nonqualified for two of the four years you own it, your capital gain exclusion is limited to $150,000 (two years/four years x $300,000).

Note that this rule doesn't apply in reverse. In other words, if you convert a principal residence to a nonqualified use, such as rental, you can still take advantage of the full exclusion (provided you otherwise qualify).

Plan now

To take advantage of these and other tax-saving opportunities that are yet to come, start planning now. Many tax strategies require some lead time — if you wait until the end of the year it may be too late. ◈

Delivering employee feedback: Accentuate the positive

People often overlook or take for granted positive accomplishments and spend excess time dwelling on the negatives. In the workplace, this negative tendency can contribute to poor morale and costly workforce attrition.

The next time you or your supervisors provide employees with feedback on areas for improvement, remember to balance that feedback with positive comments. And the way to achieve the best results from this feedback is by delivering it:

1. Precisely,
2. Promptly,
3. Personally,
4. Publicly, and
5. Purposefully.

Also, avoid generalizations. If employees don't understand exactly what you're praising them for, they won't know what to focus on going forward. Make sure you cite the specific accomplishment.

Whenever possible, give informal praise as soon as possible following the accomplishment to capture and build on the employee's moment of glory. You may want to make small, but important, gestures, such as sending the employee a simple e-mail or handwritten thank you note, flowers, or a gift certificate to a favorite coffee shop.

For more significant accomplishments, follow up with *formal* public recognition in a company or department meeting as well as citing the employee's accomplishments in your company newsletter or in a companywide e-mail. Such public recognition honors the employee, while demonstrating to others that the company truly appreciates and rewards its employees for their good work. Just make sure the level of recognition fits the significance of the accomplishment.

Finally, factor employee accomplishments into formal annual performance and interim progress reviews. Explaining to employees how their accomplishments have supported overall company business goals — and then linking their performance to a promotion, raise or bonus — will help them better understand how their contribution served a larger purpose.

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