BUSINESS MATTERS

SPRING 2012

CHANCE OF A LIFETIME

Don't miss the temporarily high gift tax exemption

If you haven't put much thought into minimizing potential estate tax exposure, now's a great time to do so. Thanks to 2010's Tax Relief act, you may transfer up to a lifetime maximum of $5.12 million to family members or others free of gift taxes. But this window of opportunity may close soon.

TIMING IS EVERYTHING

Without congressional action, on Jan. 1, 2013, the lifetime gift and estate tax exemptions will fall to $1 million. In addition, the top gift and estate tax rates will increase from 35% to 55%.

Why would you want to give away $5.12 million? If you're a business owner or someone with significant wealth, making gifts in 2012 allows you to 1) transfer business interests or other assets while you're still alive and can see your heirs enjoy them, and 2) reduce the size of your estate, thus potentially minimizing eventual estate taxes.

Future appreciation on gifted assets won't be included in your taxable estate, so you can leverage your exemption by transferring assets you expect to appreciate significantly. Gifting can be even more advantageous if your spouse also uses his or her exemption now — for a tax-free maximum amount per couple of $10.24 million.

This limited-time exemption increase is available even if you used up your exemption when it was $1 million. In this case, you can give away an additional $4.12 million gift-tax-free this year (less any taxable gifts you made in 2011).

Business owners can transfer even more tax-free if their gifts of business interests qualify for

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HIRING TIME

Options for owners who need a hand

In January, the U.S. unemployment rate fell to a three-year low of 8.3%. Although many business owners remain uncertain about the economy's recovery, some have decided to bring new staff on board to take advantage of any potential economic upswing. Also, the talent pool is unusually rich right now.

How do you know if it's time to hire? Consider your business's current productivity and revenue — as well as projected growth.

AFFORDING NEW STAFF

Whether you're thinking about adding your first or fiftieth employee, hiring is an important decision with long-term consequences. As many business owners learned in recent years, laying off good, loyal employees can be heartbreaking. So before you add more people to the payroll, ensure you have the resources to pay them.

Employees cost more than an annual paycheck; benefits, payroll taxes and workers' compensation insurance typically add another 20% to the total. Keep in mind, however, that current tax incentives may reduce your hiring costs. For example, if you hire a military veteran who's been unemployed for more than six months, you may be eligible for a Work Opportunity credit as high as $5,600 — and up to $9,600 for hiring qualified "wounded warriors."

OPPORTUNITY COSTS

Need more incentives? Perform a cost-benefit analysis. For example, if you're picking up the slack by performing administrative and bookkeeping tasks yourself, you may have little time left over to manage customer relationships and solicit new business. Consider the cost of lost growth opportunities vs. the cost of hiring a new employee.

Also consider your business's near-term future — say, six months to a year out. Depending on the industry and position, it can take several months to find qualified candidates — not to mention the fact that, if you drag your feet, your forward-looking competitors may beat you to the best talent.

Leading economic indicators such as retail sales and durable goods orders, as well as sector-specific measures, can help guide your growth and productivity projections. But it may be necessary to take a leap of faith and hire new workers before you're certain you have enough work to keep them busy.

WILL A TEMP WORK?

One option for gun-shy owners is to hire part-time employees. For example, you might start someone at 20 hours a week with the possibility of full-time employment when work picks up. If you're wary of adding an employee to your payroll, employment agencies can be excellent sources of part-time and temporary staffers — particularly administrative, accounting and creative personnel. Keep in mind, however, that you may have to pay a finder's fee if you later decide to hire one of these temps.

Be careful, too, when working with independent contractors. Although they can be lifesavers when you have a short-term project that requires specific skills such as IT or graphic design expertise, these relationships are scrutinized by the IRS. To avoid possible back taxes and penalties, talk with your accountant about how the IRS defines contractors vs. employees.

MAKING THE CALL

Deciding to hire is a tough call in an uncertain economy. But if you've been short-staffed for a while and your revenue picture is finally improving, it's time to start considering it. ■

HOW TO AVOID — OR AT LEAST SURVIVE — AN IRS AUDIT

Nothing strikes fear into the heart of a business owner like the words "IRS audit." Although you can't always prevent an audit, you can take steps to reduce the IRS scrutiny that is likely to trigger one. And you can be prepared to defend your business if you still do receive an audit letter.

STRONG OFFENSE IS BEST

The IRS is more likely to scrutinize certain types of businesses, such as those that are primarily cash-based. You're probably not going to change your industry, so focus on things you can control, namely your tax returns. Minimize errors by keeping meticulous records and working with a reputable tax advisor.

Certain tax return items are likely to raise red flags with the IRS. These include:

- Significant inconsistencies with previous years' filings,
- Understated or overstated income,
- Errors related to employee compensation,
- Miscalculated or unusually high deductions compared with your income, and
- Expense and gross profit margin disparities compared with other businesses in your industry.

It's critical to have supporting material ready. The tax code generally requires businesses to maintain tax-related records for at least three years from the due date of the return — the normal statute of limitations for an IRS adjustment.

BUT MOUNT A VIGOROUS DEFENSE

If, despite your best efforts to file accurate returns, you receive an audit letter, don't panic. Contact your tax advisor immediately; then ask the IRS to postpone your audit to give you time to prepare.

Assemble the documentation you might need, including payroll records; contractor invoices; interest and dividend income statements; cash receipts and disbursement records; credit card statements; proof of payment for cash expenses; property and equipment purchase documents; and salesperson logs. Generally, the IRS provides a detailed list of what it wants to review. Provide the investigator only with the documentation required to make your case. If difficult tax issues or conflict or fraud allegations arise, let your tax advisor take over.

A SMALL PRICE

Even if you prove any errors were unintentional, it's likely that you'll have to pay something. Typically, this means the tax amount you underpaid, plus interest and a 5% penalty. But if you've prepared for this day, any financial damage probably will be minimal. ■

HSAs CAN BE GOOD FOR YOUR FINANCIAL HEALTH

If you don't contribute to a Health Savings Account (HSA), you may be missing out on significant savings. Individual HSAs are similar to IRAs in that they enable you to deduct contributions on your income tax return. Or, if you participate in an employer-sponsored HSA, your employer's contributions are excluded from your taxable income and your payroll deduction contributions are pretax.

When you need funds to pay qualified medical expenses, you can withdraw them tax-free. And unlike Flexible Spending Accounts, HSAs allow you to roll over unused contributions from year to year. After age 65, you can withdraw funds for *any* reason. Such nonmedical withdrawals will be taxed, but they won't be subject to penalties.

To open and contribute to an HSA, you must participate in a "high deductible health plan" (for individuals in 2012, a minimum deductible of $1,200 and out-of-pocket maximum of $6,050). You also must be under age 65. The annual contribution limit for individuals in 2012 is $3,100, with an additional $1,000 for those who have reached age 55. For more information on HSAs, talk with your financial advisor.

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minority-interest and lack-of-control discounts. A professional valuator can help you determine your business's current market value and any applicable discounts. Be sure to include your valuator's report with your gift tax return.

BIG PICTURE

Before making gifts, look at your overall financial picture. It's important to make sure you'll retain sufficient assets after gifting so that you can maintain your own financial security and live your desired lifestyle. ■

RETAINING CONTROL WHILE TRANSFERRING WEALTH

If you aren't ready to fully relinquish control of your assets but want to take advantage of the current gift tax exemption, talk to your financial or estate planning advisor about:

GRATs. A grantor-retained annuity trust enables you to transfer wealth to your children while retaining some control over the assets and enjoying an income stream throughout the trust's term. You (the grantor) must, however, survive the term, or the trust assets will be included in your taxable estate.

FLPs. A family limited partnership can help you transfer business interests or other assets to your children, grandchildren and others. They receive limited partnership interests in the FLP, while you retain a general partnership interest — and control. FLPs are frequent IRS targets, so be sure to establish yours for bona fide, nontax business purposes and to adhere to other applicable rules.