To ensure receipt of our emails, please add JudyWestCPA@e.mycpanewsletter.com to your Address Book.
For instructions on how to add, please click here. Thank you!

This issue has been provided to you by **Main Street Tax Advisors**

Client Bulletin

Smart Tax, Business & Planning Ideas *from your* **Trusted Business Advisor**SM

The Risks of Riskless Investing

After experiencing volatility in stocks and real estate during this century, some people are reluctant to take risks with their money. However, when you avoid risk, you also reduce your chance of enjoying portfolio growth.

U.S. Treasury bills are considered a nearly risk-free investment. If you put money into bills maturing in 30 days, you'll get a return of your capital then, plus a market interest rate. Ibbotson Associates, a Morningstar subsidiary, recently reported that $1 invested in Treasury bills at the end of 1925 would have grown to more than $20 at the end of 2013, assuming continual reinvestment of interest income. That's impressive, and it would have kept this hypothetical investor ahead of inflation: you need $13 today to buy the current equivalent of what a dollar bought in 1925.

However, these Ibbotson numbers don't take transaction costs or income taxes into effect. Over such a long term, the taxes from continual investments in Treasury bills would have depressed net returns to around, or even below, the inflation rate.

Better choices

In hindsight, other investments would have produced much higher returns. Intermediate-term Treasury bonds (with maturities around five years) aren't riskless, but they are relatively low risk. Under the same assumptions (reinvested interest, no taxes or transaction costs), that dollar invested at the end of 1925 would have grown to $93 at the end of 2013. There were few yearly losses and those losses tended to be modest (Ibbotson puts the steepest calendar year loss at -2.3% in 2009).

Concurrently, $1 invested in large company U.S. stocks would have grown to more than $4,600! Some steep losses occurred during those 88 years, however, such as the 37% decline in 2008.

Long-term lessons

All of the stock and bond categories tracked by Ibbotson have handily outperformed Treasury bills—and beaten inflation—over the time period being reviewed. That doesn't mean you should avoid riskless, cash-like holdings altogether, but it does mean that taking some risks can pay off over many years. Considering today's negligible yields on low-risk vehicles, such as T-bills and money market funds and bank accounts, you'll need to take some investment risks today to get any meaningful return.

What's Inside
June 2014

- The Risks of Riskless Investing
- How Inherited Assets Differ From Gifts
- Prime Points for Your Buy-Sell
- Tax Calendar

Philanthropy Peak
In 2013, U.S. charitable giving reached a record $416.7 billion—that was $100 billion more than donations in 2009.

Main Street Tax Advisors
1101-K W Main St,
League City,
TX 77573
281.332.2555

Click here to contact us.

Trusted Advice

Second Look

- The basis of inherited assets may be affected by the so-called "alternative valuation date."
- An estate's executor can choose to have all the estate assets valued as of six months after death, rather than the date of death, if that will reduce estate tax or the generation-skipping transfer tax.
- In that case, the valuation six months after death will be the basis of all inherited assets, on future sales by the heirs.

Did You Know ?

Many workers (58%) age 60 or older are putting off retirement.

For the highest long-term return, you might consider a 100% allocation to stocks, combined with ongoing outlays in this asset class. However, few people have the temperament to buy stocks, hold them, and keep investing even in bleak times. Therefore, many professionals advocate holding a mix of investments that aren't linked to each other so that some may rise while others fall.

Example: Ibbotson shows the long-term results from various hypothetical portfolios. A 50-50 allocation, stocks to bonds, would have produced about 80% of the return of stocks with only 50% of the volatility that an all-stock portfolio would have generated. By working with a financial advisor, you may be able to develop a diversified asset allocation with an acceptable mix of risk and potential reward.

Beyond diversification, the Ibbotson results reinforce basic points about managing your money. Reinvesting interest and dividends will help you maximize your compounded returns. Similarly, making an effort to minimize taxes and transaction costs will pay off over an extended time period.

As the economy has recovered, the percentage has dropped from 66% in 2010 and 61% in 2013. Women (71%) are far more likely to delay retirement than men (49%).

Source: CareerBuilder

Back to Top

How Inherited Assets Differ From Gifts

When someone gives you cash or other valuable assets, do you owe income tax? No. The same is true if you receive an inheritance. The giver may owe gift tax and the decedent's estate may owe estate tax but you, as the recipient, won't owe income tax.

The situation will change, however, if you receive a noncash asset as a gift or inheritance and subsequently sell that asset. You'll incur tax consequences, which will depend on your so-called "basis" in the asset. In this context, your basis can be considered your cost for tax purposes.

Carryover basis

When you receive an appreciated asset as a gift, you also receive the giver's basis in that gift. In tax parlance, the former owner's basis "carries over" to you.

Example 1: Mike Owens invested $10,000 in ABC Corp. stock many years ago. Mike always receives the dividends from ABC, rather than reinvesting them. When the shares are worth $19,000, Mike gives those shares to his niece Pam. In this scenario, Pam retains Mike's $10,000 basis in the shares. If she sells the shares for $22,000, Pam will owe tax on a $12,000 gain, because of the carryover basis, rather than owing tax on the $3,000 gain since the gift.

For gifts of appreciated assets, the donor's holding period also carries over. Here, Pam will have a favorably taxed long-term gain because Mike held the shares for many years. In another situation, where Pam's sale takes place one year or less since Mike's purchase, her $12,000 gain would be taxed at higher ordinary income rates. (The carryover basis rules on gifts of depreciated property are more complex. If you have received such a gift, our office can explain the tax consequences of a future sale.)

Stepped-up basis

Different rules apply to inherited assets. Here, the heir's basis typically is the asset's value on the date of death.

Example 2: Rebecca Smith dies and leaves $200,000 worth of XYZ Corp. shares to her nephew Tom. Even if Rebecca's basis in the shares was only, say, $90,000, Tom's basis in the shares is $200,000, their value when Rebecca died. Tom will have no taxable gain on a subsequent sale for $200,000, a $10,000 gain on a sale for $210,000, and a $5,000 capital loss on a sale for $195,000. Depreciated assets are stepped down: if Rebecca had bought the shares for $200,000, but they were worth $90,000 when she died, Tom's basis would be $90,000.

After an inheritance, sales generally are taxed as a long-term gain or loss, regardless of the heir's or the decedent's holding period.

In some cases, special rules apply to the basis of inherited assets. For property held jointly with right of survivorship (JTWROS), the survivor generally gets a basis step up for half of the asset value.

Example 3: Victor and Wendy Young hold shares of DEF Corp. in a brokerage account. The account is titled as JTWROS, so the surviving co-owner will be the sole owner. Victor dies first, when the couple's basis in the shares is $60,000 and the current value is $88,000.

Going forward, Wendy owns those DEF shares. Her basis is stepped up to $74,000: $30,000 for her half of the previous $60,000 basis plus $44,000 for Victor's half of the current $88,000 value, which is stepped up at his death. If Wendy sells the DEF shares a week later for $89,000, she will have a $15,000 long-term capital gain, considering the basis increase to $74,000 at Victor's death. (Different rules may apply to property held by married couples living in community property states.)

Basis backup

As you can see, documenting your basis in gifted or inherited assets is vital. When you get a gift, find out the giver's basis in that asset; after an inheritance, document the date of death value (or the value on the alternative valuation date, as explained in the "Second Look" Trusted Advice column herein).

Putting a value on listed securities or other assets held in an investment account may be relatively easy. Such information should be available online or from the financial firm holding

the assets. If you receive a gift of stock from Uncle Joe, who dimly recalls buying the shares "in the 1980s," make every effort to find a number that can be justified by hard evidence.

Illiquid assets present more of a challenge. Again, try to get a valuation you can support for the basis of assets you receive as a gift. For inherited assets, hire a reputable professional as soon as possible to appraise assets, such as real estate, collectibles and shares of a closely held company. Our office can help you accumulate the necessary documentation for gifts and inherited property. ■

Back to Top

Prime Points for Your Buy-Sell

Businesses with more than one substantial co-owner should have a buy-sell agreement. This agreement can help all parties when the inevitable happens, and one of the owners no longer can or will participate in the company as they had been. For the best result, your buy-sell should include a plan for what will happen when the following so-called "trigger events" occur.

Owner's death

Assume a company is owned equally by Lynn Jones and Greg Harris. They both work full time, contributing to the company's growth, until Greg dies unexpectedly.

A buy-sell can set the stage for Lynn to buy the company shares that Greg's wife will inherit. A predetermined formula can set the buyout price, which Lynn will pay, and some life insurance can provide the funds she'll need. Alternatively, the company might receive the insurance proceeds and buy in Greg's shares, leaving Lynn as the sole owner.

Dealing with disability

In another scenario, Lynn suffers a serious illness and cannot work. The buy-sell can spell out how disability will be determined, whether Lynn will receive a salary, how long such a salary will continue, and how an ultimate buyout will be structured. Disability insurance may help to provide the necessary funds.

Defending against divorce

Considering the U.S. divorce rate and the demands of running a small business, it's not surprising when a company co-owner has marital problems. However, if Greg is in a divorce negotiation, his wife may want a share of the company as part of the settlement—and Lynn might not welcome this additional partner.

Such a situation can be avoided if share transfers are restricted in some manner by the buy-sell agreement; the divorcing co-owner, the non-divorcing owners, or the company might be given the right of first refusal, so the divorcing spouse receives cash instead of shares. (Careful drafting is needed to avoid tax traps.) The buy-sell agreement should cover valuation, and the owners should have a plan to generate enough cash.

Ready for retirement

In yet another scenario, Lynn decides that she wants to retire while she is still young and healthy enough to enjoy her favorite pastimes. Greg intends to stay active in the business. A buy-sell can set up a plan in which Lynn steps down and is compensated for her interest in the company, perhaps over an extended time period. Some life insurance policies can be structured to fund such a contingency.

Changing directions

What if Lynn wants to leave the company at, say, age 55 in order to try another career? A buy-sell agreement may distinguish between retirement and "withdrawal" or "departure," perhaps based on age. A buy-sell could discount the purchase price if an owner leaves after relatively few years and could delay the payout until a certain time, if that's what the co-owners agree upon.

Personal bankruptcy

Suppose that Greg incurs a tremendous amount of debt, either from extravagant living or from poor financial decisions not directly related to the company. He might file for personal bankruptcy to get relief. Again, the buy-sell can set a procedure for Lynn or the company to buy Greg's shares so that his creditors get cash instead of interests in the business.

Time and money

Business owners commonly work long hours and need ample cash flow for company growth. Thus, owners of a small firm might not look forward to crafting a detailed buy-sell agreement, paying attorney fees, and committing to premium outlays for life insurance as well as disability insurance. That reluctance should be weighed against the outcome if one or more of the previously mentioned trigger events should arise without a buy-sell in place. A deceased partner's heirs may inherit shares without a procedure in place for an equitable buyout; an owner's divorce negotiations might spill over and affect company operations.

Our office can help you develop a buy-sell agreement that will protect you, your co-owners and your company from getting hurt when the trigger is pulled on these types of events. ■

Back to Top

TAX CALENDAR

JUNE 2014
June 16
Individuals. If you are not paying your 2014 income tax through withholding (or will not pay enough tax during the year that way), pay the second installment of your 2014 estimated tax.

JULY 2014
July 15
Employers. For Social Security, Medicare, withheld income tax and nonpayroll withholding, deposit the tax for payments in June if the monthly rule applies.

If you are a U.S. citizen or resident alien living and working (or on military duty) outside the United States and Puerto Rico, file Form 1040 and pay any tax, interest and penalties due for 2013. If you want additional time to file your return, file Form 4868 to obtain four additional months to file. Then, file Form 1040 by October 15.

Corporations. Deposit the second installment of estimated tax for 2014.

Employers. For Social Security, Medicare, withheld income tax and nonpayroll withholding, deposit the tax for payments in May if the monthly rule applies.

July 31

Employers. For Social Security, Medicare and withheld income tax, file Form 941 for the second quarter of 2014. Deposit any undeposited tax. If your tax liability is less than $2,500, you can pay it in full with a timely filed return. If you deposited the tax for the quarter in full and on time, you have until August 11 to file the return.

For federal unemployment tax, deposit the tax owed through June if more than $500.

If you maintain an employee benefit plan with a calendar year end, file Form 5500 or 5500-EZ for calendar year 2013.

888.777.7077 • taxinfo@aicpa.org

This *CPA Client Bulletin* has been provided as a complimentary service of your CPA. If you have any questions or would like to stop receiving this newsletter, please contact **Main Street Tax Advisors**directly.

The *CPA Client Bulletin* (ISSN 1942-7271) is prepared by AICPA staff for the clients of its members and other practitioners. The Bulletin carries no official authority, and its contents should not be acted upon without professional advice. Copyright © 2011 by the American Institute of Certifed Public Accountants, Inc., New York, NY 10036-8775. Sidney Kess, CPA, JD, Editor.

In accordance with IRS Circular 230, this newsletter is not to be considered a "covered opinion" or other written tax advice and should not be relied upon for IRS audit, tax dispute, or any other purpose.