

A One Minute Structuring And Tax Solution From Your Business Transaction Strategist

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**Your Business
Transaction Strategist**



**Helping clients draw
knowledge and
understanding from
the sea of business
confusion.**



**Which Vessel Would
You Rather Be In
During A Storm?**

Two vessels are about to

Federal Capital Gain Tax Rates:

Where are they headed?

Since 2003, the top tax rate on most capital gains has been 15% for people in the 25% or higher tax bracket. Although a lower level tax rate has also been in place since 2003 for people in the 15% or lower tax bracket, this rate is only applicable until a person has enough income to cause him / her to enter the 25% tax bracket. As a result, for people incurring a capital gain from selling a business, most of them are in at least the 25% tax bracket so the top 15% rate is generally the rate they experience.

The current capital gain rates are scheduled to expire effective December 31, 2010 due to a time lapse built into the regulations associated with the 2003 gain reductions. This time phase-in is known as a sunset provision. Thus, starting in 2011, the top 15% rate is scheduled to revert to its former pre-May 6, 2003 level of 20%.

President Obama made a pledge to the American people that he and his administration would not raise taxes. Well, he was able to make this pledge with confidence regarding the tax on capital gains because the sunset provision was already going to cause the rate to increase.

The big question now is; Will the top rate only rise to 20% or will congress raise it higher?

Background:

For the past 30 years, the top tax rate on long-term capital gains has been below 30%.

The top tax rate on most long-term capital gains was reduced from around 35 percent to 28 percent in 1978 and was further reduced to 20 percent in 1981. It was raised to 28 percent in 1987, reduced to 20 percent again in 1997, and further reduced to 15 percent in 2003.

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) extended the 15% rate through 2010. But, in 2011, the top long-term capital gain rate for most long-term capital gains is scheduled to revert back to the 20% rate that applied prior to the Jobs and Growth Tax Relief Reconciliation Act of 2003 (2003 Tax Act).

leave port. One is an inflatable dingy, the other a U.S. aircraft carrier. With a long journey ahead, you have the option to choose the vessel in which you travel. When making your decision, remember that major storms do occur at sea. Both vessels float and each will get you started on your journey. But...which vessel would you rather find yourself in during a storm? It's not whether a vessel can float at the start; it's which vessel will get you where you want to go that counts!

The Retirement Security Plan & Trust (RSPT) is the plan of choice to get you where you want to go. It is the most advanced plan platform available to small businesses!

The pending tax change is well within the range of changes experienced in the last 30 years.

What to Expect

On September 25, 2009, in a letter to Representative Brian P. Bilbray (R-CA), the Congressional Budget Office (CBO) stated that when assessing the impact of the increased tax rates on economic growth, it is important to keep in mind that taxable capital gains account for a small portion of all capital income. Much capital income is paid as dividends, interest, rent, and proprietors' profits. In addition, most capital gains are not taxable because they are held in tax-exempt accounts or are held until death. As a result, CBO does not anticipate that the pending increase in the capital gains tax rate alone will have a large enough impact on the rate of return to capital overall to change significantly the magnitude of saving and capital investment.

But the CBO did further state that higher capital gains taxes could have an additional effect by discouraging innovation and risk-taking, but there is insufficient evidence on which to base a quantitative estimate.

Congress depends on the CBO to help corroborate the financial and tax results of congressional decisions. In this case the CBO is uncertain as to the full impact to be realized by an increase in capital gain rates. This indecisiveness is exactly what Congress wants in order to support that an increase in capital gain rates will not be harmful.

Also it is important to keep in mind that with the pending Health Care Reform, people classified as wealthy will experience an additional tax levy or surtax. In the House Bill, the surtax will apply to families earning more than \$350,000 a year and individuals earning more than \$280,000. The surtax will start at 1 percent and rise to 5.4 percent on income exceeding \$1 million. In the Senate Bill, families of more modest wealth - over \$250,000 - will experience a payroll tax hike of 0.5 percent.

Take notice that the surtax in the House's Bill of 5.4%, when combined with the Year 2011 expiration of tax cuts enacted during the Bush administration, the surtax will drive the top federal tax rate to 45%, the highest level since lawmakers rewrote the tax code in 1986. That's right, in Year 2011, along with an increase in capital gain rates, the top federal tax rate returns to 39.6%.

As previously stated, the sunset provision on capital gains will cause the top capital gain rate to increase to 20% on January 1, 2011. When considering the financial impact resulting from the War on Terrorism and the overall increase in congressional spending, it is very likely that the issue of raising capital gain rates even higher will be introduced by some member of Congress.

Assuming a final Health Care Reform bill is submitted to the President, which it certainly appears will be happening, and likely before the end of January 2010, a person with a capital gain which causes his / her total income to be above \$280,000 will already pay more that 20% because of the surtax.

So, should a person trigger a capital gain in Year 2010, such as selling a business, if at all possible?

Since most business sales include a blend of capital gain and ordinary income, when considering the known capital gain rate increase, the potential for additional capital gain increases, the pending surtax and the fact that the top federal tax rate returns to 39.6% in Year 2011, a clear answer certainly emerges.

If an entrepreneur wants to experience the lowest tax impact possible from selling his / her business, selling before the tax rates increase is the way to go.

Based on current regulations, 2011 capital gain tax rates will be at least 20% with the health care surtax likely causing some people to exceed a 25% aggregate rate. If congress decides to implement further increases, anyone who waited until 2011 to sell a business will wish they could go back in time to 2010.

If you need additional information, have questions, or need assistance navigating the sea of business confusion, call your Business Transaction Strategist, Monty W. Walker at (940) 322-5086.

Sincerely,

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Walker Business Advisory Services

