HISTORIC TAX LEGISLATION IMPACTS EXIT, ESTATE AND GIFT CONSIDERATIONS

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. For the next two years, 2011 and 2012, the gift, estate and generation skipping (GST) tax exemptions are unified, with the exemption set at $5 million and the tax rate at 35%.

It is important to remember that these changes are effective only for the next two years. On January 1, 2013, if Congress fails to act, the estate, gift and GST exemptions will be $1 million (adjusted for inflation) and the top tax rate will be 55%.

Estate tax exemptions are now portable. The executor of an estate may elect, on a timely filed estate tax return, to transfer any unused exemption to the surviving spouse. Despite the simplicity of portability, there are strong reasons to continue to use credit shelter trust planning, which include the following:

- Asset protection for the surviving spouse.
- Deceased spouse's unused exemption will be lost if the surviving spouse remarries and survives next spouse.
- Appreciation of assets excluded from surviving spouse's gross estate.
- No portability of deceased spouse's unused GST exemption.
- Assets in a credit shelter trust are managed and distributed in accordance with the wishes of the deceased.

President Obama's 2012 budget proposals include permanent estate and gift tax reforms, which include the following:

- Restoring the 2009 estate, gift and GST tax rules on January 1, 2013. These would include a top estate, gift and GST tax rate of 45%, a $1 million gift tax exemption and a $3.5 million estate and GST exemption.
- . Make portability of the deceased spousal unused exemption amount permanent.

- Beneficiaries receive a step-up in basis of inherited assets.
- Expansion of regulations to ignore the use of valuation discounts on business entities.

Given the impact of recent and continuing economic conditions on the automotive industry as a whole and the decrease in value of many companies related to the industry, now is the time to consider a company valuation in conjunction with exit, gift and estate tax planning.

Many companies within the automotive industry are closely-held, family-owned businesses. As owners approach retirement age and older, there becomes a need for exit planning to both insure an orderly transition and to minimize gift and estate taxes.

Gifting of an interest in a closely-held, family-owned business to the next generation accomplishes two goals. First, use of the annual and lifetime gift exclusions to transfer a business interest to heirs with no gift or estate tax consequences. Second, by transferring the interest in the business, future appreciation in the gifted interest is removed from the donor's estate.

The economy and business conditions have not been kind to the automotive industry. Contracts and profits are as low as they have been in recent history. This translates into lower overall company values. When values are low, a larger interest in the business may be gifted without paying gift taxes.

When valuing an interest in a closely-held, family-owned business for gift and estate tax purposes, IRS regulations require an independent valuation of the company by a business valuation analyst to determine the value of the interest being gifted. The valuation analyst must be credentialed by the American Institute of Certified Public Accountants, the National Association of Certified Valuation analyst or other qualified organization. The valuation report will be attached to the gift or estate tax return that is filed with the IRS.

In performing the valuation of a business, premiums and/or discounts will generally be applied to the estimate of value. For gift and estate tax purposes, fair market value must be used as the standard of value. If a minority interest is being gifted, a minority interest discount will be applied. A discount for lack of marketability is taken when valuing closely-held businesses.

For the majority of business owners, the business constitutes their largest asset, albeit illiquid. Given the current environment of low company values and the continued availability of discounts, steps should be taken to evaluate exit, estate and gift plans to take advantage of the current window of opportunity.

TAX TIP

WORKER MISCLASSIFICATION

Employers who misclassify employees as independent contractors may find themselves under audit by the US Department of Labor (DOL) and the Internal Revenue Service. These agencies have announced that they will aggressively go after these employers for non-payment of unemployment, disability or Social Security taxes or pay workers' compensation premiums for independent contractors. Employers should be careful as the states and federal government have strict rules regarding who can be classified as an independent contractor and who needs to be treated as an employee. If the employer gets the classification wrong, he may be subject to stiff penalties, fines and work stoppages.

In Announcement 2011-64, the IRS outlined its Voluntary Classification Settlement Program (VCSP). This program will enable many employers to resolve past worker classification issues and achieve certainty under the tax law at a low cost by voluntarily reclassifying their workers. Under the VCSP, an employer can become compliant by making a minimal payment covering past payroll tax obligations rather than waiting for an IRS audit.
To be eligible for VCSP, an employer must not be currently under audit and must:

1. Have consistently treated the workers as nonemployees;
2. Have filed all required Forms 1099 for the workers for the previous three years;
3. Not currently be under audit by the IRS, the Department of Labor or a state agency concerning the classification of these workers.

Interested employers can apply for the program by filing Form 8952, voluntarily reclassify their workers as employees for future tax periods with limited federal employment tax liability for the past nonemployee treatment (10% of the employment tax liability due for the most current tax year not subject to any interest or penalties), and enter into a closing agreement with the IRS.

If you have any questions consult your ATA representative.