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Divorcee seeks tax relief under innocent spouse rules

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GREAT UNCERTAINTY

SAVVY TAX PLANNING CALLS FOR AN EARLY START THIS YEAR

Two words that frequently appear before the phrase “tax planning” are “year end.” But, for a variety of reasons, 2012 will likely bring great uncertainty when it comes to taxes. So if you want to prepare an effective tax plan this year, you need to start now by looking ahead at the many issues in flux and see where you might be able to lay the groundwork for some smart moves.

Why the ambiguity?

The vast amounts of ambiguity spring, at least in part, from the federal government’s recent struggles to deal with the economic downturn and our slow recovery from it. Tax rates that were lowered to boost the economy are set to go back up, and breaks designed for the same purpose are headed for expiration.

For example, both ordinary income and capital gains tax rates are scheduled to increase in 2013. (See “Tax rates scheduled to increase” at right.) Meanwhile, a number of tax breaks have been designated for elimination in 2013. These include the personal exemption and itemized deduction phaseout repeal, the higher contribution limits for Coverdell Education Savings Accounts and the American Opportunity education credit.

What’s the big deal?

If you’re the optimistic sort, you might respond to all of this uncertainty by saying, “What’s the big deal? Congress will just extend all of these rates and breaks as usual.”

Tax rates scheduled to increase	
2012	2013
Regular income tax rates	
10%	15%
15%	15%
25%	28%
28%	31%
33%	36%
35%	39.6%
Long-term capital gains rates*	
15%	20%

* Different rates apply in some situations.

Granted, they might. Or there could be another significant tax bill on the way.

But it’s even harder than usual to predict what will happen in the coming months because of the increased focus on the budget deficit and the fact that it’s an election year.



New Medicare tax could shock higher income households

The Patient Protection and Affordable Care Act of 2010 (PPACA) is bringing many changes to the health care landscape. But some people may be in for a shock when they learn that, starting in 2013, the act could drive up their tax liability as well. Under PPACA, higher-income taxpayers will be subject to two new Medicare taxes:

1. An additional 0.9% tax on wages and self-employment income that exceed specified thresholds, and
2. A new 3.8% tax on net investment income to the extent their modified adjusted gross income (MAGI) exceeds those same thresholds.

Feeling the effect of these two new taxes will be single filers and heads of households earning \$200,000 or more, married taxpayers filing jointly earning \$250,000 or more, and married taxpayers filing separately earning \$125,000 or more. As you can see, a “marriage penalty” appears to be in place for some couples.

Up until now, Medicare taxes have never applied to investment income or other “unearned” income. So this is definitely something new to prepare for if you’ll likely exceed these income thresholds in 2013.

But keep an eye on the Supreme Court, as well as Congress. The Court has agreed to review a case regarding the constitutionality of PPACA, and Congress might also again try to repeal the act, or at least some of its provisions.

And, while the advantageous rates and breaks we’ve discussed don’t expire until after 2012, a wide variety of tax planning strategies depend on looking ahead at not only the rest of the *current* year, but also the *next* year. Your goal is to time income and deductions to your advantage. Yet doing so is more difficult when there’s so much uncertainty about what tax rates will apply and what breaks will be available either this year or next.

After all, traditional tax planning often calls for deferring income to the next year and accelerating deductions into the current year in order to defer tax. But these steps could be costly if rates go up, because you’ll be pushing taxable income into a year when it will be subject to a higher tax rate. In addition, deductions are more valuable when your rate is higher.

How can you cope?

Although there’s no tax-savvy crystal ball that can tell you precisely what’s going to happen, you do

have plenty of coping measures worth discussing with your tax advisor:

Sell long-term appreciated assets before the favorable 15% capital gains rate jumps to 20%. This could be an especially beneficial move if you’ll also likely be subject to the new Medicare tax on gains next year. (See “New Medicare tax could shock higher income households” above.)

A wide variety of tax planning strategies depend on looking ahead at not only the rest of the current year, but also the next year.

Accelerate income into 2012, where possible.

Doing so will help you take advantage of the lower ordinary rate — again, particularly if you’d

also be subject to the new additional Medicare tax noted above. If you'll be subject to deduction phaseouts in 2013, consider whether it would make sense to also accelerate deductible expenses into 2012 while the phaseout is repealed.

We do have a couple of caveats to these tips and others you may ponder. First, beware of the alternative minimum tax (AMT). Actions that are advantageous for regular income tax purposes could trigger it.

Also, as contradictory as this may sound to this tax-focused discussion, don't think only about

taxes. It's important to consider other factors as well, such as your degree of financial security, your financial needs and goals, and your risk tolerance.

Who can help?

In many years, economic uncertainty and market volatility can make it difficult to predict your financial situation. But this year brings notable tax uncertainty as well. Work closely with your tax and financial advisors throughout the year to stay apprised of the latest tax law developments and for help determining how any changes may affect your specific situation. □

THE POWER OF MENTORING

UNITE BUSINESS PLAN WITH SUCCESSION PLAN

The owners of many companies launch their enterprises with a *business plan* — a written document outlining the company's strategic objectives and practical means of accomplishing them. Likewise, many owners leave their businesses via a *succession plan*, a written document outlining how the company's ownership should transition.

Often, however, these two documents never cross paths, much less join toward a common goal. If this is the case with your business, and you've already identified your likely successor, effective mentoring can enable you to unite your succession plan with your business plan to great effect.

Regular meetings

As your company evolves and its objectives change, you need to update the transition strategy to ensure your successor is learning the skills and gaining the knowledge he or she will need to keep your business competitive and, ideally, take it to higher levels of success.

Let's say, for example, that your company has always just sold widgets and is now expanding to help clients service the widgets. You'll need to make both strategic and operational changes so that your successor and staff can handle a diversified business



that's both product- and service-based. In addition, your successor will need to understand the differences between managing the costs of distributing a tangible product and providing an intangible service.

Meet with your successor often. The first days of running a company are particularly stressful. But coaching during the period leading up to the transition can help successors manage the pressures. This is your opportunity to leverage your experience and help your replacement develop the skills to run the business.

During this time, you can provide a secure environment for him or her to apply these new abilities and assume more of your responsibilities. To maximize your mentoring efforts, have your successor meet monthly with key personnel to discuss current matters, growth and operations strategies, your and your competitors' products and services, and industry trends.

Outside help

Also have your successor join industry trade associations and community organizations to meet other executives and successors in diverse industries. And require him or her to review and,

if necessary, help update your company's business plan.

To encourage your successor to develop relationships with key players inside and outside your company, include him or her in meetings with managers and trusted advisors, such as your accountant, lawyer, banker and insurance agent.

Key information

Find ways to continuously pass on your knowledge. Too often, vital business knowledge is lost when leadership or ownership changes — causing a difficult and chaotic transition for the successor. Although you can impart a great deal of expertise by mentoring your replacement, you need to do more. For instance, create procedures for you and other executives to share your wisdom.

Include your successor in meetings with managers and trusted advisors, such as your accountant, lawyer, banker and insurance agent.

Begin by documenting your business systems, processes and methods through a secure online employee information portal, which provides links to company databases. You also could set up a training program around core business methods and practices — workers could attend a class or complete a computer-based course — and create an annual benchmarking report of key activities and results for internal use.

New challenges

Prepare your company to adapt and grow. With customer needs and market factors continually changing, your successor will likely face challenges that are different from what you encountered.

To enable your company to adapt to an ever-changing business world, ensure your successor understands how each department works and knows the fundamentals of key areas, including customer service, marketing and accounting. One way is to have your successor work in each business area.

Plenty of time

The points we've made emphasize the importance of choosing your successor as early in the ownership transition process as possible.

Clearly, it's not always feasible to find someone quickly. But, when it is, giving yourself plenty of time to mentor your successor — and integrate the key objectives of your business plan — will increase the likelihood of a smooth transition and make his or her job much easier after you've left. □

MONEYLINES: NEWS BRIEFS FOR BUSINESSES

How strong is your business confidence heading into 2012? The Sage Business Index measures the confidence of small to midsize business owners regarding their business prospects in the upcoming six months. Responses are graded on a scale of 0 to 100, with values above 50 reflecting optimism and those below 50 reflecting pessimism. Regarding expected prospects in the latter part of 2011 through early 2012, respondents had a confidence index of 57.88. Do you share this feeling of cautious optimism regarding your company's likelihood of success this year? If not, perhaps revisit your strategic plan.

Many companies are rushing into the cloud unprepared. Software security experts Symantec surveyed 5,300 IT and security managers in 38 countries late last year about cloud computing — the practice of storing and accessing critical business software via the Internet rather than on-site. The survey revealed that 19% of the respondents had moved at least some applications to a public cloud arrangement. Meanwhile, 17% were using a private cloud service. Chillingly, however, many respondents admitted to moving to cloud computing even though they were unprepared to do so. If you're considering cloud computing, make sure you know what you're getting into.

Small to midsize businesses also vulnerable to corruption. When the topic of corruption comes up, it's typically associated with large companies. But smaller businesses can suffer at the hands of these crimes, too. And many aren't addressing the danger. Results of a 2011 survey by the Deloitte Forensic Center found that smaller companies are almost 23% more likely than larger ones to have no documented anticorruption policies. Have you addressed this risk at your business — in writing? You'll be glad you did if a scandal strikes.



DIVORCEE SEEKS TAX RELIEF UNDER INNOCENT SPOUSE RULES

Roxanne and Steve were married for about five years and things didn't go well. About six months after their divorce, Roxanne received an IRS notice in the mail. Apparently, her ex-husband had failed to report thousands of dollars in income and the two owed the federal government a substantial sum in back taxes, interest and penalties. This was the last thing Roxanne needed as she tried to rebuild her life. So she visited her financial advisor to determine what recourse she might have.

Roxanne's advisor assured her that this wasn't an open and shut case in the IRS's favor: Her recourse could be found under Section 6015 of the IRS Restructuring and Reform Act of 1998, better known as the "innocent spouse rules."

Various conditions

According to these rules, applicants may qualify for either general, separate liability or equitable relief if they can meet the applicable IRS conditions. (Her advisor promised to explain further at a follow-up meeting.)

Conditions include whether the applicant received any significant direct or indirect benefit from the tax understatement. For instance, Roxanne's case could be weakened if she'd used unreported income to pay extraordinary household expenses.

The agency will also look at the distinctive personal aspects of her case. The fact that she has divorced her husband is significant. Whether she was abused physically or mentally by her former spouse will also play a role, as will whether she was in poor mental or physical health when the return(s) in question was signed.

In addition, the agency will consider whether Roxanne would experience economic hardship without relief from this significant tax debt.

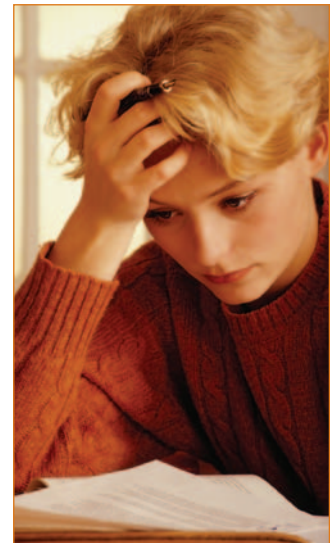
Important development

There has been an important recent development in the innocent spouse rules. Previously, applicants had to file for relief within a two-year period following receipt of a collection notice. This deadline has impeded many taxpayers from obtaining relief because their irresponsible spouse got to the notice first.

Last summer, the IRS announced that it was abolishing this deadline for applicants who file under the equitable relief provision of the innocent spouse rules. The change also applies to cases that are currently pending with the IRS. And taxpayers who were previously denied relief under the deadline may reapply.

Not easy

Roxanne's financial advisor warned her that winning relief under the innocent spouse rules isn't easy. The IRS grants fewer than half of the approximately 50,000 applications it receives annually, according to financial educators SmartPros. But he assured her he'd work hard to ensure she wouldn't have to pay for her ex-husband's misdoings. □





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Our extensive and practical experience assists our clients to operate and expand successfully, while minimizing taxes and retaining more of their profits.

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