

Special points of interest:

- Requesting a Late S-Election
- Non-Compete Agreements
- Gifts to Children
- Conversions

Requesting a Late S-Election

Many corporations elect “S corporation” status so that the profits and losses flow through to the shareholders individual income tax returns, thus avoiding double taxation. Normally, if a corporation files Form 2553 after the 15th day of the third month of its tax year, then the IRS considers the S-Corporation election to be valid for the following tax year and not valid for the preceding tax year. However, under special circumstances a corporation can file Form 2553 after March 15th and the IRS will approve the election retroactive to the beginning of the corporation's tax year. Here are the rules to follow.

Eligibility Criteria for Late S-Corporation Elections:

To qualify for relief from the late filing of Form 2553, the

corporation must meet all the following criteria:

- (1) the corporation meets the S-Corporation eligibility criteria;
- (2) the corporation intended to be classified as an S-Corporation as of the intended effective date of the S-Corporation election;
- (3) the corporation failed to qualify as an S-Corporation solely because it did not timely file Form 2553 ;
- (4) less than 24 months have passed since the original due date of Form 2553;



- (5) the corporation either has reasonable cause or inadvertently failed to file Form 2553 in a timely manner;
- (6) the corporation has not yet filed tax returns for the first tax year for which it intended to file as an S-Corporation, or the corporation has filed its first tax return using Form 1120S and the shareholders properly reported their share of income in a manner consistent with the corporation's intention to be an S-Corporation;
- (7) form 2553 is filed not later than 6 months after the due date (without regard to extensions) of the first tax return for which

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Non-Compete Agreements

Non-Compete Agreements (“NCA”) are an effective tool to protect a business from unfair competition. While not for everyone, and sometimes difficult to enforce, recent changes to the law make it easier to enforce an NCA as long as it is clear, complies with certain principals, and is generally fair.

Texas courts generally consider NCAs a “restraint on trade”. Since public policy encourages competition, restraints on trade are disfavored. Three clear exceptions ap-

ply to the general rule that NCAs are not enforceable.

First, NCAs are easiest to enforce when part of the sale of a business. The reason is simple, Texas courts realize that no purchaser would buy a business if the prior owners could simply compete against the buyer under a new name. For that reason, courts are quick to enforce NCAs that are entered into during the sale of a business.

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Late S-Elections (Cont'd from page 1)

the corporation intended to file as an S-Corp.; and (8) shareholders and other taxpayers have not reported their income in a manner inconsistent with the corporation's intention to file as an S-Corp. If the company meets the above requirements, then the company should file IRS Form 2553 by writing at the very top of the form the following words: "FILED PURSUANT TO REV. PROC. 2003-43" and attach a statement indicating that the corporation either had reasonable cause (and explain the circumstances) or inadvertently failed to timely file Form 2553. Both Form 2553 and the attached statement must be signed by each and every shareholder. In addition, Revenue Procedure 2007-62 allows small businesses

that missed filing Form 2553, before filing their first Form 1120S to file both forms simultaneously. The change is effective for taxable years on or after Dec. 31, 2007; however, the requirement for filing Form 2553 to establish the election in advance of filing the initial Form 1120S remains in effect. Yet, the new process will save time and effort for those clients who

can establish reasonable cause. Eligibility for this type of late S-election are the same as those listed above.

Some states have a separate filing requirement and many do not allow a late S-election. Texas, fortunately, is not such a state, but for those doing business nationwide, be wary of state guidelines. The IRS provides a myriad of options for those clients who fell behind or inadvertently forgot to elect S-corporation status. However, the taxpayer must follow specific procedures outlined in the IRC.

"The IRS provides a myriad of options for those clients who fell behind or inadvertently forgot to elect S-corporation status."

Form 2553 Election by a Small Business Corporation
OMB No. 1545-0047

Instructions: See instructions on the back of this form. See page 1 of the instructions.

Part I Election Information

1. Name and address of the corporation (if a P.O. box, see instructions): _____
 2. State or other jurisdiction: _____
 3. Date of incorporation: _____
 4. Taxpayer identification number: _____

5. Check the appropriate boxes if the corporation, after applying for the SBA shown in 6 above, changed its name: or address:

6. Election to be effective for the year beginning on: 1/1/____ 1/1/____ 1/1/____

7. Name and title of officer or signatory representative who the IRS may call for more information: _____

8. If the election takes effect for the first time for the corporation, enter month, day, and year of the earliest of the following: (i) date the corporation had its shareholders; (ii) date the corporation had its assets; or (iii) date the corporation began doing business: _____

9. Indicate the year, month, and date when the election will be effective for the first time for the corporation: _____

10. If the tax year ends on any date other than December 31, except for a calendar year ending with reference to the month of December, complete Part 10 at the top of the page. If the date you enter in the ending date is 12/31, use the year after 12/31 ends for the year of the date.

11. Shareholder Consent Statement: Yes, I consent to the election. No, I do not consent to the election. (See instructions.)

12. Social security number or other identification number: _____

13. Date of preparation: _____

14. Signature of officer: _____ Title: _____ Date: _____

For Preparation Instructions and Notes, see page 4 of the instructions. U.S. GOVERNMENT PRINTING OFFICE: 2003 Form 2553 (Rev. 1/2003)

Gifts to Children



In 2010, an individual may gift up to \$13,000 annually (or \$26,000 if one gives jointly with a spouse) to as many people as desired in cash, investments, and/or property without triggering mandatory filing of Form 709 and possible gift tax payments. The tax break associated with gifts benefits parents and grandparents, as well as the children on the receiving end, by

diminishing the overall contribution to Uncle Sam. The donor can gift property via the Uniform Gift to Minors Act (UGMA), the Uniform Transfers to Minors Act (UTMA), or a special trust created by the donor for the recipient. An UGMA/UTMA account allows you to establish a savings or investment account in a child's name, with one adult (different

than the donor) named as custodian. In certain instances, a trust may be more appropriate than a UGMA/UTMA account. Depending on how the donor transfers the property, the child may use these funds to help secure the child's future—whether for college, marriage, or other financial challenges.

Non-Compete Agreements ... (Cont'd from Page 1)

Second, if reasonable with respect to time, geographic scope, and the scope of activity restrained, employers can have their employees enter into enforceable NCAs that bind the employee after terminating employment. As you can imagine, businesses interested in preventing unfair competition from

former employees value NCAs highly. Third, many businesses utilize proprietary and confidential information or provide specialized training to their employees. For such businesses, NCAs protect a business' investment and prevent former employees from using that confidential informa-

tion or special training obtained against their former employer unfairly. An employer cannot use an NCA simply to prevent fair competition; but, they can be an invaluable tool to protect a business from unfair competition.





Conversions

In today's legal environment, our clients are increasingly concerned with liability issues and asset protection. One particular concern regards the ability of a judgment creditor to seize corporate stock, thus allowing the judgment creditor to obtain the valuable assets of a corporation. Unlike a corporation, other entities such as LLCs, LLPs, and LPs have extra protection in the form of charging order laws that limit the judgment creditor to distributions from the LLC/LLP. Unfortunately, for shareholders in closely held corporations, charging orders do not apply; however, Texas law and the IRC provide a powerful solution: converting the corporation to an LLC or LLP in a tax free reorganization.

Practically, the charging order protections have benefited our clients several times. In one in-

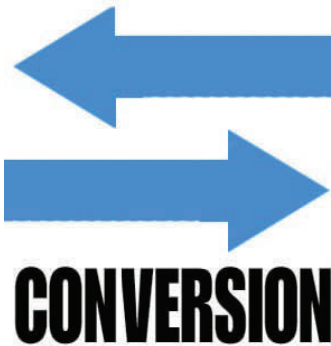
timely conversion from a corporation to an LLC prevented the judgment plaintiff from seizing millions by shielding a client's LLC assets from a \$4.0M judgment. Plaintiffs who understand the limits of charging orders also are more willing to settle complicated legal matters before facing the frustrations that charging order protections afford clients in collection.

Properly structured conversions require state law and Federal tax law compliance. An improper state law conversion fails to provide enhanced asset protection. An improper tax conversion results in a taxable

liquidation of the entity. Both results can be disastrous.

Good candidates for conversion are owners of closely held corporations with significant assets. Even entities selling significant amounts of real property can convert to avoid franchise taxes. Other benefits, our clients appreciate are: (i) the converted corporation keeps its employer identification number after the conversion; and, (ii) the taxation filings and book-keeping of the converted corporation does not change. As a result, the administrative costs of a conversion remain low.

Corporations may convert to LLCs or LLPs in order to obtain greater asset protection. Properly structured conversions require state law and Federal tax law compliance.



Featured Attorney

Thomas P. Stone, a native of Detroit, Michigan, formed Stone & Associates in 2001. Previously, he practiced law as a partner in a well-known Houston firm.

Tom earned his Bachelor of Accountancy in 1981 from Western Michigan University. He received his Certified Public Account (CPA) license in 1983. In 1987, he earned his law degree (Juris Doctorate) from South Texas College of Law.

Tom has 20 years of experience in estate planning and virtually all legal phases of the lifecycle of business organizations, including formation, operation, and dissolution. He utilizes his expertise and experience to effectively advise clients as to the best form of business structure for protecting assets and minimizing income and estate

taxes. Additionally, he is an experienced trial attorney who represents clients in business lawsuits. Tom assists the owners of closely held businesses in protecting the profits of their company from the Internal Revenue Service and plaintiffs of meritless lawsuits.

Tom often speaks at continuing education seminars for certified public accountants, certified financial planners, and licensed insurance agents. His seminars focus on the topics related to estate planning, probate, and income taxation.



Stone & Associates, LLP

2202 Timberloch Place, Suite 250
The Woodlands, Texas 77380

Phone: 281-681-3004

Fax: 281-681-3007

E-mail: Penni@stoneandassociates.net

*Business, Estate, and
Tax Planning for
Generations*



Stone & Associates, LLP's practice focuses on estate planning, probate and estate administration, business law, tax planning and controversies, and business litigation. Additional credentials such as Board Certification in Estate Planning and Probate by the Texas Board of Legal Specialization, CPA and Masters of Laws in Taxation (LLM), combined with years of practical experience, make our attorneys uniquely qualified to address the business and tax issues inherent in these areas of law.

Our clients desire to minimize taxes and protect their assets, with the ultimate goal of maintaining and preserving wealth for themselves and future generations. We lead our clients through the complex maze of Federal and State laws to this ultimate goal.

The four attorneys of Stone & Associates, LLP, frequently present continuing education seminars to certified public accountants, certified financial planners, realtors, and licensed insurance agents. We explain complicated business, estate, and tax laws in an understandable manner that our clients and other professionals appreciate. Not surprisingly, Stone & Associates, LLP, has quickly become the firm that professionals turn to for their clients' estate planning, taxation, and business law needs.

This issue contains four articles that you may find relevant to your clients throughout the year. As is customary in our past issues, we prepared a tax, estate planning, business structure, and general business article based on current issues our clients faced over the last few months. As always, we are here to serve as a resource to you and your clients, so please call or e-mail if we can help.



Stone and Associates, LLP

2202 Timberloch Place, Suite 250 • The Woodlands, Texas 77380

WWW.STONEANDASSOCIATES.NET