

Special points of interest:

- Cancellation of Debt
- Maximum Rates of Interest
- Rescission
- Effect of Divorce on Planning

Cancellation Of Debt

Currently, taxpayers with outstanding debt may be subject to income tax on cancellation of debt (COD) income when all or a portion of such debt is cancelled or restructured. COD income can arise in a number of circumstances, including forgiveness of debt by the debtor, the repurchase of debt by the issuer at a discount, the exchange of one debt instrument of the issuer for another, the modification of debt, and the exchange of debt for equity of the issuer.

Section 108(a) of the Internal Revenue Code (the “Code”) provides a number of exceptions to the taxation of COD income, including exceptions related to insolvency and bankruptcy, farm and business real property debt, and principal residence debt. In each case, the COD income

is permanently excluded from taxation.

New Deferral Under §108(i)

Under new IRC §108(i), if an issuer of a debt instrument or a related person reacquires the debt instrument certain taxpayers can defer the recognition of COD income in connection



with “reacquisition” and applicable “debt instruments” after December 31, 2008, and before January 1, 2011. IRC §108(i) defines reacquisition as: 1) acquisition of a debt instrument for cash; 2) exchange of a debt instrument for another debt instrument; 3) exchange of a debt instrument for corporate stock or a

partnership interest; 4) a contribution of a debt instrument to capital; and, 5) complete forgiveness of the indebtedness by the holder of the debt instrument. IRC §108(i) defines a debt instrument to generally include all forms of indebtedness within the meaning of the Code. However, certain annuity contracts are not included.

The deferral period is five
Cont'd on Page 2

Texas Usury: Maximum Rates of Interest

Texas usury laws can become a nasty surprise to any business. Texas has not established specific usury caps for consumers, however, certain restrictions in Texas govern lending practices and interest rates.

In fact, working your way through the lending laws and interest rate regulations in Texas can be akin to walking through a mine field. Those interested in extending a loan or financing to someone (including the sale of goods or services on credit), or borrowing

money, are well served to obtain the assistance of legal counsel.

In general, the maximum legal rate (“ceiling rates”) of interest in Texas is 18%. However, to add to the confusion, some transactions require a lower rate. There are different ceiling rates for verbal loan contracts (10%), contracts that do not specify a rate (6%), judgments (variable), installment loans (variable), and loans for personal, family, or household use (variable). Some institutions are entitled to special

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Cancellation of Debt (Cont'd from page 1)

"Section 108(i) applies when either the issuer or a person related to the issuer reacquires the debt instrument"

taxable years in the case of COD income generated in 2009 or four taxable years for COD income generated in 2010 and applies only to the debts of C corporations or, in the case of all other taxpayers, trade or business debts; however, a non-corporate taxpayer carrying on investment activity is not included. At the end of the deferral period, the taxpayer must include the COD income ratably over the next five years. The taxpayer's death, dissolution, liquidation, or other similar event will accelerate deferred COD income.



Special Rules for Partnerships.

Any income or deduction deferred under Section 108(i) must be allocated to partners in the manner such amounts would have been included in their distributive shares if the income were recognized immediately before the reacquisition. Any decrease in a partner's share of partnership liabilities is not taken into account under Section 752 to the extent it would cause a partner to recognize gain under Section 731 from the deemed distribution. However, any decrease in partnership liabilities deferred

under Section 108(i) is taken into account when the deferred COD income is recognized.

Considerations

Section 108(i) is not an unfettered boon to taxpayers realizing COD income. The complexity and qualifications of IRC §108(i) force taxpayers to carefully consider its benefits and burdens prior to making an election, but it certainly provides some welcome relief. In addition, while the ability to defer COD income is welcome news for many taxpayers, the taxpayers' professionals must carefully review the taxpayer's current and future projected income and loss situations to determine if the Section 108(i) deferral is worthwhile.

Effect of Divorce on Will, Powers of Attorney, and Beneficiary Designations

One event that should prompt your client to update his or her Will is filing for or finalizing a divorce. Divorce has the effect of treating the divorced spouse AND those related to the divorced spouse as if he or she predeceased the testator (Will) or Principal (Powers of Attorney). This law is particularly problematic where the surviving spouse is the sole agent ap-

pointed under a Durable Power of Attorney or Medical Power of Attorney. Lack of an agent under a Durable or Medical Power of Attorney is the same as not having a Durable or Medical Power of Attorney, which means that a qualified person must apply for a guardianship (an inefficient, timely and costly process) so that the court can appoint someone to make those decisions. In addi-

tion, if your client still wants to provide for a member of the divorced spouse's family under his or her Will, the Will must be updated AFTER the divorce to reflect such a desire. This same law applies to beneficiary designations that transfer property at death. Therefore, it is a good practice to remind your clients to seek our guidance as to all estate and wealth transfer planning

Maximum Rate of Interest (Cont'd from Page 1)

rules. State chartered financial institutions (banks, savings and loans, credit unions), pawn shops, and credit cards have their own restrictions when it comes to interest rates and lending practices.

The penalties for violating usury laws are severe. The creditor can be liable to the debtor for a

range of harsh penalties, including, among other things, 1) the forfeiture of the principal amount; 2) a penalty of three times the excessive interest contracted for charged or received; 3) the court can re-write the contract; or, 4) void

the contract all together. In some cases, usury may even be a crime.

If you think you may have a problem, have any questions about your particular credit situation, have clients that regularly extend or borrow on credit, or someone accuses you of usury, call Stone and Associates.





Rescission

A very useful way of fixing a tax mistake is to rescind it. The rescission doctrine allows a taxpayer to unwind a tax transaction as long as it is unwound in the same taxable year in which it occurred, and as long as the parties are restored to their status quo. Thus, subject to certain exceptions and IRS nuances, a taxpayer can ignore and treat a transaction as if it never existed for federal income tax purposes.

For example, in March, Homeowner X sells real estate to buyer Y. The contract required the seller, at buyer's request, to accept reconveyance of the land from the buyer if, any time within nine months, the buyer is unable to rezone the land. If buyer, within that same year, determines that he cannot rezone the land, he can reconvey the land to X without any tax consequences. X recognizes no gain on the sale

because Buyer and Seller rescinded the transaction; to the IRS, a sale never took place. The contract in the above example actually provided for reconveyance or some kind of rescis-



sion; however, the IRS does not require prewritten rescission language to apply the rescission doctrine.

In addition, the doctrine is not limited to real estate sales. The following is a list of examples where rescission may be benefi-

cial: 1) the payment of compensation; 2) conversion of partnership into corporation; 3) corporate distribution of stock appreciation rights; 4) stock options and other compensation; 5) contribution of stock to another corporation; 6) compensatory transfer of stock and section 83 (b) elections; 7) distributions of earnings and profits by S-corporation; 8) termination of sale/leaseback; and 9) improper or excess gifts.

If a Client enters into a transaction which you later realize has serious, unintended tax consequences, you may be able to undo it. Everyone has "Oops, what have I done" moments and the IRS allows relief for just such moments with the doctrine of rescission.

"The rescission doctrine allows a taxpayer to unwind a tax transaction as long as it is unwound in the same taxable year in which it occurred, and as long as the parties are restored to their status quo"

Featured Attorney

Brent Stanfield is a native of Omaha, Nebraska, and joined Stone & Associates, LLP in September 2006 after completion of his last year of law school at the University of Houston as a visiting student.

In 2003, he earned his Bachelor of Sciences in Economics from The University of Nebraska-Lincoln. In 2006, he earned his law degree (Juris Doctorate) from the University of Nebraska-Lincoln, where he graduated cum laude.

Brent's practice concentrates on civil litigation with an emphasis on business litigation, including contract disputes, fraud, landlord-tenant disputes, DTPA, debt collection, and shareholder disputes. Brent also handles a wide range of other legal matters including personal injury, negligence, probate, and drafting contracts.

Entering his fourth year in practice, Brent has substantial courtroom and litigation experience, regularly negotiates deals, mediates and arbitrates, and resolves disputes. Regardless of the resolution method, Brent's and Stone and Associates, L.L.P.'s highest priority is to obtain the best and most cost effective result for the client.

In addition to his career as an attorney, Brent, and Jessica, his wife of four years, attend the Woodlands Point Community Church. He is also a member of the Montgomery County Young Republicans and the Montgomery County Chamber of Commerce.



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*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 Certified Public Accountant (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 newsletter has four articles that discuss hot topics in estate planning, taxation, and business law. The articles give you an overview on these topics so that you can better assist your clients and their needs. 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.



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