

Special points of interest:

- Rollovers As Business Start Ups
- Why Should I Create an Entity
- Taking Real Estate Out of a C-Corp
- The New Tax Bill

Retirement Plan Funds for Business (Rollovers As Business Start Ups)

Starting a small business is a dream for many people, and the tepid job market seems to encourage would-be entrepreneurs to think about pursuing that dream. To make that dream a reality, starting a new business requires capital, and in the current economic climate the search for capital can quickly turn the dream into a nightmare. Many traditional capital-raising options are either no longer feasible or deeply unattractive. The criteria for conventional loans in the current credit market make loans unobtainable for most people.

Into this funding void step promoters of a funding mechanism that promises to allow people to access their 401(k) or IRA accounts to start a business without incurring tax or a penalty for early withdrawal.

The Internal Revenue Service (IRS) repeatedly expresses some reservations about

these transactions, which effectively allow individuals to use tax-favored retirement funds for purposes other than retirement.

The IRS dubbed these transactions Rollovers as Business Start-ups, (“ROBS”). In a 2008 newsletter, the IRS expressed its concern in an article titled “When ‘Too Good to Be True’ Very Well May Be: Funding Business Startups with Plan Assets” (the “ROBS Memo”). In a teleconference on August 27, 2010, IRS officials said that ROBS transactions were among several potential abusive tax-avoidance transactions that are among the IRS’s top priorities in examinations. The Department of Labor has likewise expressed (unofficially) concern about ROBS transactions.

In a typical ROBS transaction, the process works as follows: first, the promoter assists the owner of an IRA

or other retirement account (the would-be business owner) in incorporating a C-corporation. The corporation typically has no assets or employees, and may not have a contribution to capital. Next, the corporation adopts a (purportedly) qualified defined contribution plan (usually a pre-approved prototype 401(k) profit sharing plan provided by the ROBS transaction promoter). This pre-approved plan provides that plan participants may invest their entire account in employer stock (*i.e.*, stock of the newly-created corporation). The owner of the IRA becomes the sole employee of the corporation and, with the help of the promoter, rolls over the proceeds from his IRA into this newly created plan. The individual then directs that his retirement account invest in employer stock. Accordingly,

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Taking Real Estate Out of a Corporation

Corporations should not own real estate. Let me say that again. Corporations should not own real estate. EVER! Much like the mob, it’s easy to get in, but hard to get out. This newsletter does offer enough space to detail all the reasons to avoid this situation. Nevertheless, I shall highlight the key reasons for both S-corps and C-corps.

Before we get started, know that there are two ways to transfer property (not just real estate) out of any kind of entity: sell it or distrib-

ute it to the owners.

S-corporations

Let’s start with S-corps. The primary concern with real estate in an S-corporation is terminating the S election. If the S-election terminates or the tax landscape changes and client does not desire S corporation status anymore, it is very difficult to sell the real estate or even give it away because of the taxes owed on the property. Or, what if it is time to sell the business and

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Rollovers As Business Start Ups (Cont'd from page 1)

the plan acquires the stock of the newly-established corporation using the rolled-over IRA assets. The rolled-over assets, having been moved through the newly-established plan to the corporation, permits the individual, acting through the corporation, to now use the funds to pursue his business venture.

A ROBS transfer allows a participant to move assets from one tax-exempt vehicle (the IRA or 401(k) plan) to another tax-exempt vehicle (the newly-created plan), and then invest those funds in company stock.

The ROBS Memo identifies a few of the tax issues with ROBS transactions:

Potential Prohibited Transactions

Two potential prohibited transactions with respect to ROBS arrangements are: (1) valuation of stock, and (2) promoter fees.

Valuation of Stock

A prohibited transaction occurs in a sale, exchange or lease of any property between a plan and a disqualified person. IRC §4975(c)(1)(A). A disqualified person includes the employer, or a 50% or more owner. An exchange of stock between the plan and its employer sponsor is a prohibited transaction. An exception exists for acquisitions or sales of qualifying employer securities; however, such acquisition or sale of employer securities must be for "adequate consideration."

The company involved in a typical ROBS transaction is a newly-established corporation; therefore valuing the company is difficult at best. Thus, the company stock may not actually be worth the value of the tax-deferred assets exchanged for the stock. If the employer securities are not exchanged to the

plan for adequate consideration, the participant just triggered a prohibited transaction.

Promoter Fees

A prohibited transaction also occurs if a fiduciary deals with the assets of the plan in his own interest or his own account. A fiduciary is defined as any person who exercises any discretionary authority or control, renders investment advice for a fee or other compensation, or has discretionary authority or responsibility in the administration of the plan. If the promoter qualifies as a fiduciary by providing "investment advice" to the plan, such payment could constitute a prohibited transaction.

Numerous other risks apply with ROBS; the long and short of them being, don't do it. As the IRS suggests, if it looks to good to be true, it probably is.

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Why Should I Create An Entity

People often ask, "why do I even need an entity? Can I not just own the property/run the business myself?"

Our answer? You absolutely can, but why would you? An entity provides, at minimum, asset protection for those assets owned by the entity; and, the correct type of entity provides protection for those assets outside the entity, i.e. bank accounts, investments,

other high dollar personal assets. or form. Such entities are also entitled to deductions and credits business assets substantially limits to which individuals are not. liability.

In addition, for those of your business owner clients, entities have more flexibility from a taxation perspective. With the "new" (since 1996) check-the-

box regulations, entities can literally high value assets, but why choose to be taxed in any way, shape shouldn't they?



Thus, the question becomes, not why should your client create an entity to protect his or her business and other

Taking Real Estate Out of a C-Corp... (Cont'd from Page 1)

Client desires to keep the real estate as rental property? Now client cannot sell the stock, at least not easily. What if client expands the real estate or the S activity income falls off and client falls into the passive activity rules, which disqualifies the S corporation if more than 25% of receipts are rent? Too many factors and too many risks exist for an S-corporation to own real estate.

C-Corporations

C-corporations are even worse. Double taxation becomes the issue. If corporation sells real estate and recognizes any kind of gain, the corporation shall pay tax and the shareholders shall pay tax upon distribution. If corporation decides to simply distribute the real estate to shareholders, it is a deemed sale. IRC §311(b)(1). Thus, corporation still must recognize any gain and shareholder must report any income re-

ceived from the dividend distribution. While the latter scenario may result in less tax, it is still far too much tax compared to a non-corporation owning real estate.

So, let's beat that dead horse one more time: do not put real estate in a corporation!

IF you have client with real estate in a corporation, do whatever you can to remove it.



The New Tax Bill

Three months have passed since Congress passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act") or as we know, the new tax bill. If you were unable to attend one of the four seminars we presented on the topic, the following is brief summary of the most important points in the bill.

Business Taxes.

(1) For 2011 only, self-employment tax reduced from 12.4% to 10.4% on net business income. This means employees go home with more money and employers remit less to the IRS. Thus, 2011 is a great year to fund (or start) a company retirement plan. Take that extra money and save it!

(2) For 2011 only, the Act extends the §179 deduction increase to \$500,000.00 and allows for 100% bonus depreciation. So, if client does not want to start a retirement plan, invest in some capital assets and write them off in 2011.

Estate Tax.

We thought 2010 had no estate tax, then we discover it was merely optional.

(1) The Act reunifies and increases the 2010, 2011, and 2012 estate tax exemption to \$5.0M and reduces the overall tax rate to 35%. Importantly, this change is retroactive to January 1, 2010. "How can they do that?? That's not fair!" Well, for those dying

in 2010, the Act provides an option whereby the Executor may elect to have the old 2010 law apply, i.e. no estate tax. However, keep in mind that the old 2010 law provides for a very limited step-up in basis. The new law reinstates the full step up in basis on inherited assets.

(2) The Act allows the portability of a spouse's unused estate tax exemption amount. What does that mean? Well, in the past, if Husband died without a properly drafted Will, which directed his estate tax exemption into a Bypass Trust, such exemption was lost forever and resulted in a large estate tax liability upon Wife's death. The Act allows Wife's executor to use Wife's exemption AND any of Husband's unused portion from his previous death. Thus, no more Bypass Trust required, right? Here is the catch: Wife must file a Form 706 estate tax return on husband's death electing to use such unused portion of his exemption amount. "Oh, that's fine, another form to file, no problem." Wrong, big problem. Average cost to file a Form 706 is \$10,000.00. Average cost to draft AND probate an estate tax planned will in Texas is \$5,000.00 (\$2,500 to draft and \$2,500 to probate). An IRS

attorney reviews every single Form 706 and the documentation provided must be painfully accurate, i.e. to the penny. More importantly, Husband's assets do not receive the protection from creditors and future spouses that the Bypass Trust provides. Nor are there descendants' trusts to protect the assets for Husband and Wife's children. Portability looks good on paper and, for those who DO NOT do the proper planning, it is better than nothing, but do not be fooled, estate tax planned wills and proper planning in general is still the way to go.

Income Taxes.

(1) The Act extends the 10%, 25%, 28%, 33%, and 35% individual income tax brackets;

(2) Capital gains rates for individuals remain the same;

(3) The Act extends the current qualified dividends rates for all taxpayers.

And finally, the best part, all of the above is good for two years so we'll revisit come Presidential election time. As for planning, nothing changes. Life insurance trusts still work and clients should implement them; we still recommend tax planned wills; and company formations and business planning continues.

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Who Works at Stone and Associates, L.L.P.?

Tom Stone started Stone and Associates, L.L.P. ten years ago with the goal of providing quality, reasonably priced legal services for The Woodlands and surrounding communities. Having lived in The Woodlands over 25 years, Tom's client list and reputation grew quickly and what started with just him and one legal assistant has grown into a law firm with four attorneys and four staff ready and willing to assist clients in any business, estate, and tax transaction with which he, she, or it requires assistance.

ATTORNEYS

Tom Stone is the founding member and handles some of the administrative

side of the law firm.

Jay Knighton became the managing partner three years ago and has grown the firm since assuming the role of managing partner. He handles all business transaction and estate planning matters.

Brent Stanfield has been with the firm nearly four years and handles all business litigation.

Nick Dupre joined the firm in October of 2008 and concentrates on probate, estate and gift tax planning, business planning and taxation, asset protection, estate administration, elder law, and charitable organizations

STAFF

Penni Clos is our office manager and keeps the rest of the staff and attorneys in line, organized, and focused on the ultimate goal of client satisfaction.

Meagan Katzer is the estate and business planning legal assistant and has worked with the firm for three years.

Lorna Welborn is the newest member of the firm and assists in all litigation and probate matters.

Vanessa Carballo assists with document preparation and other administrative duties that allows the firm to run more efficiently and cost-effectively.

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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, business transactions, 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 seek 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 articles dealing with tax, estate planning, business transaction, and general business 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



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