



SKILLED • RELIABLE • TRUSTED

# HOLTZ RUBENSTEIN

## adviser



SEPTEMBER, 2001

### Roth IRA Conversions Can Be Undone

If you converted a traditional IRA to a Roth IRA during the year 2000, you have until **October 15, 2001** to change your mind and undo the conversion.

With the ups and downs of the stock market over the past two years, you may find yourself in a position where the income you recognized in 2000 (based on the value of the account at the date of conversion of your traditional IRA to a Roth IRA) is significantly greater than the value of your Roth IRA account today.

Traditional IRA accounts converted to a Roth IRA during 2000 are subject to tax

based on the value of the assets at the time of conversion. For example, if you converted a traditional IRA to a Roth IRA when your account was worth \$50,000 and the value has since dropped to \$35,000, recharacterization should be considered, since you will pay tax on \$50,000, including the \$15,000 decline in value of the account.

Additionally, you also may wish to recharacterize your Roth IRA if you determine that your adjusted gross income in 2000 exceeds \$100,000, thus making you ineligible for a Roth IRA conversion.

In order to perform the recharacterization, you must instruct the trustee of the IRA (your banker, broker, or mutual fund trustee) to roll the money back to a traditional IRA.

If you've already filed your tax return, you must file an amended return to report the recharacterization by the October 15 deadline. Report the recharacterization on the amended return and write "Filed Pursuant to Section 301.9100-2" on the return.

It is also important to note that you must wait at least 30 days after the recharacterization before it can be converted back into a Roth IRA for 2001.

Given that considerable tax savings could be available through recharacterization, before the October 15 deadline review any Roth IRA accounts converted in 2000.

### Work-Related Education

The tax consequences of educational programs related to work are confusing to many people. However, knowing how the rules function can ensure that you get the proper deductions.

### Notable and Quotable

In increasing numbers, when businesses start up, their entity of choice is to become a limited liability company (LLC). How will tax law changes affect LLC planning? What LLC legal rules and concepts do lawyers and accountants need to know?

Senior Tax Partner **Alan E. Weiner** recently participated in a panel discussion that taught attorneys and accountants drafting tips and techniques, terms and provisions that should and shouldn't be included in New York agreements, and other considerations they should have.

Alan is also an attorney who has written the booklet, *"All About Limited Liability Companies and Limited Liability Partnerships."* He is a frequent lecturer on LLC issues and has written for *The Journal of Taxation, Practical Accountant*, and other national and local publications.

We are pleased to welcome some new people to the firm:

**Lisa DiMichele** is an account executive with the firm's employee benefits division, Holtz Rubenstein Benefits Consulting.

*(continued on page 4)*

Many employers provide educational assistance and have human resource personnel that administer the program and answer questions. But if your employer can't provide information or you are self-employed, the answer to whether you can deduct work-related educational expenses might not be so easy to find.

Below is a summary of the IRS's rules for deducting such expenses.

*(continued on page 2)*

## This Month

- ⇒ Roth IRA Conversions Can Be Undone
- ⇒ Work-Related Education
- ⇒ Capital Gains Election and Your 2001 Tax Return
- ⇒ CyberNotes – IRS.gov
- ⇒ *The Adviser Corner: A Primer on Family Limited Partnerships*
- ⇒ Tax Amnesty Programs
- ⇒ Estate Tax Changes
- ⇒ DFK Website of the Month

### HOLTZ RUBENSTEIN & CO., LLP

Certified Public Accountants • Business Advisers

Long Island: 125 Baylis Road, Melville, NY 11747

631/752-7400 • Fax: 631/752-1742

New York City: 1120 Avenue of the Americas

New York, NY 10036 • 212/398-7600

Visit our website: [www.hrcpa.com](http://www.hrcpa.com)

## Capital Gains Election and Your 2001 Tax Return

The following article appeared in the Holtz Rubenstein Adviser in February, 2001. In addition, we have included similar information with all of our clients' income tax returns or extension requests due by March 15, 2001 (flow-through entities) and April 15, 2001 (individuals).

We again encourage you to review the comments regarding this election (especially if you are a fiscal year flow-through entity whose year ended, or will end, in 2001) and determine, or consult with your assigned Holtz Rubenstein tax adviser or partner as soon as possible, whether this election is appropriate for you.

If your flow-through entity (defined below) already has filed its tax return for a fiscal year ended in 2001, you may be eligible to file an amended tax return, within a short window of time, if you opt to make the election (described below).

As a result of new legislation, it may be possible for you to reduce your future long-term capital gains tax rate to 18%. The legislation is complex considering that the long-term capital gains rate is currently 20% and the potential savings are only 2%.

The basic requirements are:

- a. As a general rule, you must have purchased the asset on or after

January 1, 2001 and hold it for at least five years and one day, meaning that the earliest you can take advantage of the lower rate will be in 2006.

- b. For almost any asset that you purchased prior to January 1, 2001 you may make a special election with the 2001 tax return that you will file in 2002, to report the built-in appreciation as income on your 2001 tax return. Built-in losses at January 1, 2001 will not result in a deductible loss. The sole purpose of making the election is to become eligible for the 18% capital gains rate in, and after, 2006, for assets purchased prior to 2001.
- c. A separate decision may be made for each asset owned by you.
- d. In addition to individuals, flow-through entities (S corporations, partnerships, limited liability companies, trusts and estates) also are eligible to make the election. Since some flow-through entities file tax returns on a fiscal year (i.e., a 12-month period with a month ending other than December 31<sup>st</sup>) basis, those entities will need to make the "election decision" sooner. Their tax returns for the year ending in 2001

will be due not later than the 15<sup>th</sup> day of the 10th month (9<sup>th</sup> month in the case of S corporations) after the close of the fiscal 2001 tax year.

- e. Since the basis of each asset is a critical factor in making the election decision, it is *imperative* that you gather the necessary records *now* and be in touch with us during 2001 if you have an interest in determining the current and future tax consequences of the election.
- f. Except for publicly traded securities, property appraisals as of January 1, 2001 may be required.
- g. The effort and cost needed to determine whether the election is worthwhile may be greater than the potential tax savings.



(continued from page 1)

### Work Related Education

#### Qualifying vs. nonqualifying education

You can deduct the costs of education as "work-related" if the education meets at least one of the following two tests.

1. The education is required by your employer or the law to keep your present salary, status, or job. The required education must serve a bona fide business purpose of your employer.
2. The education maintains or improves skills needed in your present work. Furthermore, you can deduct the expenses for qualifying education even if the education could lead to a degree. If your education qualifies, then the following expenses can be deducted:
  - Tuition, books, supplies, lab fees, and similar items.
  - Certain transportation and travel costs.
  - Other educational expenses, such as costs of research and typing when writing a paper as part of an educational program.

Nonqualifying education is defined as education that is:

1. Needed to meet the minimum educational requirements of your present trade or business, or
2. Part of a program of study that can qualify you for a new trade or business. This is true even if you don't plan to enter that trade or business.

### Cyber Notes – [www.irs.gov](http://www.irs.gov)

"Finally, something from the IRS that won't leave you with a stomach ache. Your hunger for the truth ends here, because keeping you up to date on where your dough is being spent is as easy as pie!"

Who says that our government doesn't have a sense of humor – sometimes. The opening words come directly from the IRS website [www.irs.gov/tax\\_edu/tax\\_rcpt/index.html](http://www.irs.gov/tax_edu/tax_rcpt/index.html). Are you interested in finding out how your Federal taxes are spent? This site can tell you. Simply enter what you paid last year in Federal income tax and see where your money went. Here's a sampling for a married couple filing a joint tax return:

Married Couple Taxable Income	2000 Federal Tax	Tax Bracket	National Defense	Social Security	Interest Expense
\$ 100,000	\$ 22,300	28.0%	\$ 3,568	\$ 5,129	\$ 2,676
150,000	37,621	31.0%	6,019	8,653	4,515
200,000	55,049	36.0%	8,808	12,661	6,606
250,000	73,049	36.0%	11,688	16,801	8,766
500,000	170,668	39.6%	27,307	39,254	20,480
1,000,000	368,668	39.6%	58,987	84,794	44,240

### A Primer on Family Limited Partnerships

By John R. McAteer, CPA/ABV

Family limited partnerships are entities that are frequently used to consolidate, administer and manage multiple types of family assets such as securities, real estate and stock of closely held corporations. The primary advantages to using family limited partnerships are as follows:

1. Family limited partnerships are a convenient vehicle to protect family assets against creditors.
2. The centralization of management enables the entity to control multiple family assets and take advantage of economies of scale, thereby reducing overhead expenses.
3. Senior members of a family can gift interests in a family limited partnership while still maintaining control of the family's assets.
4. The underlying partnership agreement can utilize right of first refusal to retain ownership of family assets by family members.
5. The gifting or value of an ownership interest in a limited partnership may be made at a lower value than the interest's pro rata share of net asset values.

It is this last point, the use of multiple discounts utilized in the transfer of family limited partnership interests, that has been the bane of the Internal Revenue Service ("IRS") in combating what seemingly may be the driving force behind the creation of many family limited partnerships. Thus, the IRS often contests discounts for minority interests and lack of marketability.

It does not matter that if a principal purpose for utilizing a partnership structure is to reduce aggregate tax liability, as long as there exists a business, investment, or financial reason for using that form of organization.

Generally the transfer of a limited partnership interest in a family limited partnership requires the consent of the managing partner or a majority of the partners. The gift of a limited partnership interest will generally require the preparation of a Form 709, United States

Gift Tax Return, on or before April 15<sup>th</sup> of the year following the date of the gift.

Perhaps the single most important item with respect to any type of family limited partnership planning is obtaining a good and reasonable appraisal of the gift. The appraisal is required as part of the filings of a true, correct and complete Form 709. Generally the appraisal will include a lack of control and a lack of marketability discount on a limited partnership interest.

Family limited partnerships are valued utilizing similar methods that are used in valuing real estate – that is, the income method, the asset (or cost) method, and the market method.

Using the income and market methods result in an interest that is both marketable and noncontrolling. A family limited partnership interest, however, is not marketable. In order to convert this value to a marketable equivalent value the appraiser must apply a discount for the lack of marketability. These discounts may be calculated from a number of sources and must be done in a fashion that makes an adequate comparison between the family limited partnership being valued and the underlying source of the discount data.

The courts have developed substantial case law relative to marketability discounts to reflect the fact that there is no ready market for stock in a closely held corporation.

In addition to the lack of marketability discount, the courts have recognized that shares of stock of a corporation which represent a minority interest are usually worth less than a proportionate share of the value of the underlying assets of the corporation. The minority discount is recognized because the holder of minority interest lacks control over corporate policy, cannot direct the payment of dividends, and cannot compel the liquidation of corporate assets.

While the application of valuation discounts allow for significant opportunities to shift additional value and potential for appreciation out of the transferor's estate, it is possible that the IRS will challenge an appraiser's determination of the value of the gifts. If the transferors have an appraisal contemporaneous with the transfer, it is more difficult for the IRS to argue different values upon its subsequent audit of a gift

### Tax Amnesty Programs

Several states have instituted tax amnesty programs, which give taxpayers the chance to voluntarily pay any delinquent taxes owed, with any penalties and interest (depending on the state) waived.

#### Louisiana


The program lasts from September 1, 2001 through October 30, 2001 with all interest and penalties being waived. Amnesty will be granted for any taxable period prior to July 1, 2001. Taxpayers under audit or under pending civil or criminal investigation are not eligible to participate.

#### Ohio

The program lasts from October 15, 2001 through January 15, 2002 with penalties and one-half of the interest being waived. The taxes must have been due and payable on May 1, 2001. Taxes that have been billed or assessed, or for which an audit is being conducted, do not qualify for the amnesty program.


#### Maryland

The program lasts from September 1, 2001 through October 31, 2001. Maryland will not waive any interest or previously assessed fraud penalties but will waive any civil or certain criminal penalties. Amnesty will be granted for returns that were due on or before December 31, 2000.

If you would like more information, please contact Tax Manager Sid Leibowitz at 631-752-7400 x-265. 

tax return. While an appraisal does not eliminate the risk of IRS review, it enhances the taxpayer's ability to defend against any potential attempts by the IRS to adjust the value of the gift for gift tax purposes.

In New York State, family limited partnerships are required by law to advertise their formation. The cost of advertising, outside of New York City, is nominal, but the existence and name of the LP is made public.

For more information on whether you should consider family limited partnerships, contact Partner John McAteer at 631-752-7400 x-380, or [JMcAteer@hr CPA.com](mailto:JMcAteer@hr CPA.com). 

## Estate Tax Changes

Under the heading “strange, but true,” barring further legislation between January 1, 2002 and 2011, there is a pattern of increasing estate tax relief until 2010, when the estate tax is repealed for one year (2010). In 2011, all the relief is rescinded and the estate tax goes back to where it is now, unless future legislation makes the repeal permanent. Therefore, Congress will be forced to revisit this issue again under, perhaps, a different political environment.

The following is a table of increased exemption (the amount that can pass to another person, estate tax free) and decreased rates ending in repeal in 2010 and reinstatement in 2011:

Calendar Year	Estate Tax Exemption	Highest Estate and Gift Tax Rates
2002	\$ 1 million	50%
2003	\$ 1 million	49%
2004	\$1.5 million	48%
2005	\$1.5 million	47%
2006	\$ 2 million	46%
2007	\$ 2 million	45%
2008	\$ 2 million	45%
2009	\$3.5 million	45%
2010	N/A (taxes repealed)	Top individual rate under the bill (gift tax only)
2011	\$ 1 million	55%

The repeal of the estate tax comes with a price – under the old law, inherited assets had a basis equal to fair market value at the time of death. Under the new law there is a modified carryover basis rule. This means that gain in the sale of inherited assets will be measured as the difference between the decedent’s cost and the selling price except for assets which receive a stepped-up basis under the modified carryover basis rules.

Taxpayers need to keep good records on the basis of property. The burden of proof will be on the taxpayer to support the

original cost of an asset. The Internal Revenue Service may challenge the reported basis and without proof of the original cost the taxpayer will pay a higher tax. It should be noted that carryover basis rules were tried in the 1970s and were repealed retroactively because it was unworkable.

The two exceptions to the carryover basis rules are:

- \$1.3 million of stepped-up basis will be allowed regardless of who inherits the property
- \$3 million of stepped-up basis will be allowed for assets passing to a spouse who is a U.S. citizen.

Note that the gift tax has *not* been repealed. The logic for not repealing the

gift tax was that, without a gift tax, assets could be transferred to family members in lower income tax brackets prior to sale to reduce the income tax. Although there would seem to be no logic to taxing a transfer between family members in the same income tax bracket, the new law would impose a gift tax in that situation.

The exclusion for gift tax purposes will be increased to \$1,000,000 in 2002. Unlike the exemption for estate tax, which gradually increases to \$3,500,000 in 2009, the gift tax exemption will remain at \$1,000,000. Gifts will be taxed at the

highest individual tax rate, which is scheduled to drop to 35% in 2006.

Planning with a law that begs to be rewritten is going to be very difficult. Taxpayers should keep the following thoughts in mind when considering any immediate planning:

- *We would advise against undoing any planning that has been done in the past at this time* under the assumption that the estate tax is repealed. The scheduled repeal does not take place until 2010 and may never take place. There has been some sort of estate tax since 1916.
- All estate plans should be reviewed, since many wills fund trusts based on formulas tied to the exemption amount. As the exemption increases, the trust could absorb the whole estate, leaving nothing to a spouse or other beneficiary.
- Under the old law, it was sometimes advisable to pay a gift tax currently to remove assets from your estate.

For further information on the new estate planning complexities, contact one of our tax partners, Alan E. Weiner, Arnie Haskell, or Tim Mulcahy.

(continued from page 1)

### Notable & Quotable

After graduating from C.W. Post with a B.S. degree in accounting, **Jennifer Ladasky** joins the firm’s tax department, on the entry level.

**Jenifer Maziotti** graduated from Adelphi University with a B.B.A. degree and is with the firm’s health care division as a Reimbursement Analyst.

**Melissa Oliviero** is a senior auditor in the firm’s not-for-profit division, with 2 years prior experience. She has a B.S. degree in accounting from SUNY Oneonta.

**Christopher Scirica** joins the firm’s not-for-profit division as a senior auditor, with 3 years prior experience. He earned his B.S. degree in Business Administration from Villanova University, and a Masters in accounting from C.W. Post.

### DFK Website of the Month

DFK International is the worldwide association of independent accounting and business advisory firms in which Holtz Rubenstein is actively involved. Through our affiliation we are able to provide enhanced services to you, and to other clients throughout the United States and the world.

This month we spotlight DFK Switzerland. Please visit them at [www.dfk.ch](http://www.dfk.ch).



*This publication is designed to present matters of general interest relating to accounting, taxation and business management. It is not intended to constitute accounting or tax advice. Articles were written by the staff of Holtz Rubenstein & Co., LLP and the American Institute of Certified Public Accountants. Please consult your HR & Co. adviser before taking any specific actions.*

©2001 Holtz Rubenstein & Co., LLP