



More Changes for The Federal Estate Tax

Under the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," enacted at the end of 2010, the federal estate tax, which disappeared for 2010, springs back to life in 2011 and is imposed at the top rate of 35% of the estate's value after the first \$5 million.

Background

The modern estate tax dates back to 1916, when it was imposed at a rate of 10% on the portion of estates above \$50,000. Over the following years, the rates and exemption amounts have varied, reaching a high of 77% from 1941 to 1976 with a \$60,000 exemption amount.

In 2001, congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the first of the two large legislative packages that contain most of what are now commonly referred to as the Bush tax

cuts. EGTRRA gradually lowered the maximum estate tax rate and substantially raised the applicable exclusion amount over the years 2002 through 2009. The maximum tax rate fell from 60% under prior law in 2001 (a 55% marginal rate on taxable estate values over \$3 million plus a 5% surtax from \$10 million to \$17 million) to 45% in 2007 through 2009. EGTRRA repealed the estate tax completely for decedents dying in 2010. That led to several well-publicized instances in which famous people died in 2010 leaving multibillion-dollar estates that will pass to their heirs without paying so much as a penny in federal estate tax. However, all of those provisions were scheduled to expire on December 31, 2010, meaning that if Congress had not acted, starting January 1, 2011, the estate tax would have sprung back at a level that no one seemed to want. Where the exclusion was \$3.5 million in 2009—a level at which it affected

relatively few households—it would have been \$1 million in 2011. The tax rate would also have risen, from a top rate of 45% in 2009, to a top rate of 55% in 2011.

New Law

The new law brings back the estate tax for 2011 and 2012. During 2011 and 2012, the top rate will be 35%. For 2011, the exemption amount will be \$5 million per individual (indexed for inflation after 2011). At those levels, the vast majority of estates (all but an estimated 3,500 in 2011) will not be subject to any federal estate tax, and the tax will raise about \$11.4 billion for the government. By way of comparison, the 55% tax with a \$1 million exemption would have resulted in about 43,000 taxable estates in 2011, and raised about \$34 billion. Tax historians would also note that except for the temporary repeal of the estate tax in 2010, the estate tax rate has not been less than 45% since 1931.

The new law also gives heirs of decedents dying in 2010 a choice of which estate tax rules to apply—2010's or 2011's. That's important because although there is no estate tax in 2010, some inherited assets are subject to higher capital gains tax under the 2010 rules, a situation that actually raises the tax burden for some heirs. Inherited assets under the 2010 rules have a tax basis equal to the price when they were purchased (referred to as "carryover basis") rather than their value at death. That could lead to a significant tax burden for heirs who sell assets such as stocks that had been held for many years and have greatly appreciated in value. Under the 2011 rules, by contrast, heirs will be allowed to inherit assets with a "stepped-up basis." While most heirs would choose the 2011 regime (\$5 million exemption from both estate and generation-skipping tax and an unlimited step-up in the basis of assets to their current market value),

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Bormel, Grice & Huyett Business Scholarship Awarded

This year's recipient of the Bormel, Grice & Huyett Scholarship is Matt Zielinski, a senior from Reservoir High School. Barry Fields presented the scholarship award at the Senior Award Ceremony on May 27. The Scholarship is sponsored by the **Baltimore Washington Corridor Chamber Foundation** in conjunction with **Bormel, Grice & Huyett, P.A.**, and is presented annually to area high school seniors for scholastic achievement and interest in pursuing a business curriculum in college. ■

Barry Fields and Matt Zielinski

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the heirs of wealthy decedents could find it more advantageous to elect the original 2010 law (limited step-up in the basis of assets and not estate tax).

For gifts made after December 31, 2010, the gift tax will be reunified with the estate, which means that the

\$5 million estate tax exemption will also be available for gifts. The law in effect prior to 2010 provided a \$3.5 million lifetime exemption for estates, but only \$1 million for gifts. The gift tax rate, starting in 2011, will be 35%. The exemption from the generation-skipping tax (GST)—the additional tax

on gifts and bequests to grandchildren when their parents are still alive—will also rise to \$5 million from the \$1 million it would have been without the new law. The GST tax rate for transfers made in 2011 and 2012 will be 35%. From a planning standpoint, a nice feature of the new law is that it makes

it easier to transfer the \$5 million exemption to a surviving spouse, so married couples can shield \$10 million of their assets from taxes. ■

Depreciation Rules Expire December 31, 2011

The 2010 Tax Relief Act was passed with an effective date of September 8, 2010. Under the Act, bonus depreciation changed from 50% to 100% through 2011. For qualifying assets placed in service after September 8, 2010 and any time during 2011, 100% of the cost can be written off immediately. Property that qualifies for 100% bonus depreciation consists of NEW property that 1) has a depreciable recovery period under 20 years; 2) the property is computer software; or 3) qualified leasehold improvements. The key is that the property must be new. For most assets used in a trade or business—the full cost of new computers, new machinery and

equipment, new office furniture, or new land improvements, to name a few—can be written off immediately.

Qualified leasehold improvement property is an improvement to an interior portion of nonresidential real property by a lessor or lessee. In order to qualify, the improvement must be placed in service in a building that is at least three years old, and the lessor and lessee may not be related. Also, expenditures for the following are NOT allowed: enlargement of the building, any escalator or elevator, any structural component that benefits a common area, or the internal structural framework of the building.

§179 is allowed for both new and used fixed assets. As a result of the enhanced 100% bonus depreciation described above, accelerated depreciation under §179 is not as favorable for new property. For 2010 and 2011, §179 is limited to a maximum expense of \$500,000 and phases out when assets placed in service exceed \$2 million. For years beginning in 2012, the §179 limits decrease to \$125,000 expense and phases out when assets placed in service exceed \$500,000. In addition, §179 is limited to income from a trade or business, thus property used in rental real estate or held for investment does not qualify.

Most states have “decoupled” from these enhanced depreciation rules. Thus depreciation for federal income tax and state income tax will need to be computed separately. For example, Maryland, Virginia, and the District of Columbia have no provision for bonus depreciation and limit §179 expense to \$25,000. ■

Limited Liability Companies (LLCs)

LLCs seem to be the most common new small businesses. Forming a business as an LLC has liability limitation advantages of a corporation and the tax advantages of a proprietorship or partnership. Only in rare circumstances would a new business be started as a sole proprietorship, partnership or S corporation. The LLC serves most new and growing businesses well.

Advantages of an LLC

Limited Liability. Limited liability is similar to a corporation as far as liability limitations advantages, but is not a perfect protection as many clients want to believe.

Pass-Through Entity. LLCs are generally pass-through entities for tax purposes.

Permanency. An LLC has the permanency of a corporation's perpetual existence if the party so elects. This means that it does not terminate on the death or disability of the member (contrasting to the sole proprietorship which would terminate on the death or disability of the proprietor).

Transferability. The LLC, as an entity, can admit new members and modify the membership and investment structure. This is an exceptionally useful feature for closely held businesses when transferring the business between family members of different generations.

Employment Taxes. The LLC is liable for employment taxes, both the trust fund portion and the employer portion. If the LLC terminates with the business owing employment taxes, the members would only be responsible for the trust fund portion and not the employer's portion (although penalties are high).

No basis issues over lending with LLC. If a bank lends to an S corporation and an owner guarantees the loan, the stockholder gets no basis for the purpose of deducting losses or receiving tax free distributions. To receive these basis benefits in an S corporation, the stockholders would have to loan directly to the corporation. This is not an issue in an LLC.

Flexibility. Being an LLC offers some flexibility such as no Board of Directors and ease of formation.

Distributions. With an LLC, you can take member distributions that are not based upon ownership, whereas in an S or a C corporation, they have to be.

Different Types of LLCs

Multiple-member LLCs are treated as partnerships and must file a US Partnership Tax Return Form 1065.

Single-member LLCs can be treated as a sole proprietorship and taxed on the member's 1040 Schedule C. (It should be noted that a LLC can elect to have tax treatment as a corporation if it so chooses, but this is advantageous only in rare circumstances.) ■

The Tax Man Cometh—Are You Prepared?

We've been hearing that it's coming, and it's now here. Unfortunately for those selected, the IRS has stepped up its audit and enforcement efforts well beyond what we have seen in the past decade.

High-income individuals and self-employed businesses appear to be among those most likely to be examined by the taxing authorities. Taxpayers with incomes of more than \$200,000 are three times more likely to be audited than the Average Joe, and those with income of more than \$1 million are six times more likely to be audited. The government needs additional revenue, and it's easier to get it from those who have money.

More than 1.5 million tax returns were audited in 2010, with approximately three-quarters being correspondence audits and one-quarter being face-to-face. There were almost twice as many audits last year as compared to 10 years ago.

A few of the common areas subject to IRS scrutiny include business use of vehicles, meals, and entertainment; travel, professional and consulting fees; employment of family members; and charitable contributions.

The key to successfully substantiating your deductions is to maintain proper and contemporaneous documentation. Auto logs supporting

business use of your vehicle are the preferred record of car and truck use. Restaurant receipts should include the "who," "what," "when," "where," and "why" of the business meals. Acknowledgement receipts or letters from qualified charitable organizations will best support your charitable contributions.

Another area of close IRS scrutiny is the home office deduction. Taxpayers can claim this deduction only if the "regular" and "exclusive" business use tests are met. Rules governing this deduction have changed over the years, causing many uninformed taxpayers to be caught not complying to current regulations in this area.

Perhaps the most important action to increase your chance of navigating an IRS examination successfully is to hire a qualified certified public accountant (CPA) to represent you during the audit. Although some people try to handle their own audits, they generally fare poorly because they are nervous, raise issues that the IRS was not challenging, provide more information than necessary, and lack the experience to take an assertive position with the auditor.

If audited, hopefully yours will be among the 5% of tax audits that result in additional refunds from the IRS. ■

Congress Repeals Expanded 1099 Information Reporting Requirements

On April 5, the Senate approved H.R. 4, the "Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011" by a vote of 87–12. The measure, which retroactively repeals expanded Form 1099 information reporting rules added by recent legislation, was passed by the House on March 3 by a vote of 314–112. Thus, H.R. 4 (the Act) was cleared for the President's signature on April 14, 2011.

Here are the highlights of the tax changes in the Act.

For payments made after December 31, 2011, the Act repeals the provisions in Sec. 9006 that impose a reporting requirement for payments to corporations and payments for goods or other property. And for payments made after December 31, 2010, the Act also repeals application of the information reporting requirements to recipients of rental income from real estate who are not otherwise considered to be engaged in the trade or business of renting property. ■

Standard Mileage Rates Increased for Rest of 2011



To reflect the recent increase in gas prices, the IRS raised the standard mileage rates for the last six months of the year. The rate will increase to 55.5 cents per mile for business miles driven from 7/1/11 through 12/31/11, a 4.5-cent-per-mile increase from the rate in effect for the first six months of 2011. The rate for computing deductible medical or moving expenses will also increase by 4.5 cents per mile to 23.5 cents per mile, up from 19 cents per mile for the first six months of 2011. The rate for providing services for a charity is set by statute and remains at 14 cents per mile. ■

Tax Due Date Calendar



AUGUST 1

Second quarter 2011 payroll tax returns due.

Due date for 2010 Annual Return/Report of Employee Benefit Plan (Form 5500).

SEPTEMBER 15

Payment of third installment of 2011 estimated tax by individuals, trusts, and estates.

Payment of third installment of 2011 estimated tax by calendar-year corporations.

Last day for filing 2010 Form 1065 for partnerships that obtained an automatic five-month filing extension.

Last day for filing 2010 Form 1041 for trusts that obtained an automatic five-month filing extension.

Last day for filing 2010 income tax return by calendar-year corporations that obtained an automatic six-month filing extension.

OCTOBER 17

Last day for filing 2010 individual income tax returns for those who obtained an automatic six-month filing extension.

Last day for filing 2010 Annual Return/Report of Employee Benefit Plan (Form 5500) for those who obtained a two-and-one-half-month filing extension.

OCTOBER 31

Third quarter 2011 payroll tax returns due.

DECEMBER 15

Payment of last installment of 2011 estimated tax by calendar-year corporations.

Client Profile:

Bormel, Grice & Huyett, P.A. is proud to feature our client, **ciena**.



Ciena is a provider of communications networking equipment, software and services that support the transport, switching, aggregation and management of voice, video and data communications. Ciena is one of the engines that makes communication happen by equipping network operators to support bandwidth-intensive applications. Whether it be a phone call, email, text message, video session or web-based meeting—Ciena's innovations are hard at work, helping connect people to the information they need, when they need it.

Incorporated in Delaware in November 1992, Ciena's founding mission was to radically change the economics of communications networks. Initially, the company advanced innovation by pioneering a technology that splits light across fiber optic lines, thereby enabling the transport of greater volumes of information such as voice, video and data. This breakthrough propelled Ciena to rapid success and led to Ciena's initial public offering in February 1997, during which the company achieved a market capitalization of \$3.4 billion—the largest first-day

market capitalization of any venture-funded startup company to that date. Since then, Ciena has continued to revolutionize the fields of optical transport, intelligent optical switching and software tools for automating large-scale communication networks.

Ciena has also made a number of key acquisitions that have helped drive its competitive advantage. Most recently, the company acquired the optical networking and Carrier Ethernet assets of Nortel's Metro Ethernet Networks (MEN) business. This acquisition significantly changed the communications equipment vendor landscape by creating the largest global supplier exclusively focused on the practical transition to converged optical Ethernet-based networking. As a result, Ciena now boasts the #1 market position in each key area of its business with significant technology development leads in each of these areas.

Today, Ciena has more than 4,000 professionals working across the Americas, Asia and Europe. The company now serves more than 1,000 customers in over 60 countries, including nearly three-quarters of the world's largest service providers as well as global enterprises, research and education institutions and other essential government agencies worldwide.

To learn more about Ciena, visit www.ciena.com. ■

BGH NEWS

BGH Small Business Services, LLC, our Small Business Services Division, is expanding! **Trish Slatin**, Director of SBS, announces the addition of two associates in 2011. Welcome to **Deidre Randol** and **Laura Quinn**. Contact Trish Slatin or your BGH representative to learn more about the Small Business Services that we offer.

Susan and Bruce Quigley's son, Jason, and **Tina and Manny Megofna's** son, Mario, recently returned home from military service overseas. Jason returned from Afghanistan and Mario from Iraq. Welcome home and thank you for your service!

Dawn Milam has joined our firm's administrative and technical support staff. Dawn and her husband, Dave, reside in Glen Burnie, MD.

Brian Jordan was recently presented an award in appreciation of 10 years of outstanding service from Bormel, Grice & Huyett, P.A.

Congratulations to **David and Sheila Young**, who were married on April 22, 2011. They currently reside in Baltimore, MD.

Sally and Rodger Johnson recently celebrated the marriage of their daughter, Emily Johnson, to Patrick Smith.

Emily graduated from Grove City College and works at the Bureau of the Census. Best wishes, Emily and Patrick!

Congratulations to **Tina and Manny Megofna** on the birth of their second grandson, Carson Kenneth. He was born on March 22, 2011 and joins his older brother, Declan.

Briana Phair, daughter of **Catherine Newman**, graduated from Northern High School and will be attending Towson University this fall, majoring in accounting.

If you haven't already done so, please visit our website at www.bormel-grice.com. Through our website, you can access information about our firm and its specialty groups, the latest issue of our newsletter, and links to other sites such as tax forms and publications, Maryland Comptroller of the Treasury, Maryland Association of Certified Public Accountants, American Institute of Certified Public Accountants, Baltimore Washington Corridor Chamber, State Department of Assessments and Taxation, Bloomberg Financial Services, and various client websites. Your comments and feedback are welcome and appreciated.

The BGH UPDATE is published for our clients, staff, and professional contacts. Copies will be provided to other business people upon written request. Any action based on information contained herein should be taken only after a detailed review of the specific situation.

The following members of our firm have contributed to this edition: **Larry Bormel, Marlene Collins, Brenda Cummings, Martina Megofna, Bette Anne Sanders, Edie Manney, Catherine Newman, Barry Fields, and Susan Quigley.**