GS Blog Round-Up

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4 Steps to Stopping and Restarting a Construction Project

Gumbiner Savett Inc. has been working with the construction industry since we opened our doors in 1950. I have seen many ups and downs in the industry throughout the years and in these uncertain economic times, many construction projects have been put on hold — sometimes indefinitely and other times for a relatively short duration. If you find yourself in such a predicament, here are four steps to stopping and restarting a project effectively:

1. Demobilize in an organized manner. When a job shuts down, you may rush your people, materials and equipment off site, leaving any existing project elements exposed to the weather. This could lead to safety concerns and increased work time when the job restarts. Instead, create a formal demobilization plan that outlines withdrawal procedures, names those responsible for the removal of assets and materials, and mandates the inspection of existing job elements. Also look into negotiating with the project owner to allow you to perform compensated work to stabilize the job site.

2. Secure the project. The weather isn't the only thing that could damage a dormant job site. Thieves and vandals could seize the opportunity to take or destroy elements that are in place, again creating safety pitfalls and additional work should the project restart. Minimal or no security measures could also allow children (or others) to wander on-site and into harm's way. Your first defense against intruders is proper fencing. Be sure the job site is completely closed off with stable fencing, secure gates and plenty of warning signs. (On a related note, you may want to remove signage reflecting your company's logo to prevent bad PR.) In addition, consider fire protection measures if remaining elements could be set alight.

3. Check your insurance. One of the biggest challenges of a stopped job doesn't happen on-site but back at the office. That is, you'll need to ensure that your insurance is both in effect and effective. If you're participating in an owner-controlled insurance program, check with the owner about whether it intends to continue coverage. You may need to contact your own broker to negotiate some gap coverage. And if you sponsor your own contractor-controlled insurance program, determine what kind of coverage to provide going forward and how to handle subcontractors involved in the job.

4. Reassess safety, deadlines upon restart. When the project eventually restarts, follow your formal withdrawal plan in reverse. Inspect the stability of existing project elements and reintroduce materials, equipment and workers onto the site gradually, safely and strategically. Additionally, reconsider your deadlines. The owner may want to accelerate the job schedule to make up for lost time. But rushing your work could lead to defects and breakdowns that cost you time and money. If the time frame looks unfeasible — or too expensive — negotiate the additional costs with the owner.

By Michael Reiff, CPA

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Understand Bad Debt Losses to Avoid IRS Scrutiny

There is a level of skepticism at the IRS when individual taxpayers claim deductions for bad debts. To claim a bad debt loss that will survive IRS scrutiny, you must be prepared to prove that the loss was actually from a bad loan transaction instead of some other ill-fated financial move.

There must be a valid and legally enforceable obligation to pay you a fixed or determinable sum of money. This means having a formal written agreement.

Assuming you can establish that you made a legitimate loan that has now gone bad, the next question is whether you have a business bad debt loss or a non-business bad debt loss. This is an important distinction.

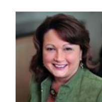
Business Bad Debt Losses

Losses from bad debts that arise in the course of the taxpayer's business are treated as ordinary losses. In general, ordinary losses are fully deductible without any limitations (for an exception, see the "Warning" below). In addition, deductions can be claimed for business debts that go partially bad under *Internal Revenue Code Section 166(b).*

Note:
If a taxpayer makes a loan to his or her employer to help protect their job, this would be classified as a business bad debt if the employer defaults. The IRS says this write-off should be treated as an unreimbursed employee business expense. That means the write-off is subject to the 2 percent-of-AGI threshold (when combined with certain other miscellaneous itemized deductions such as investment expenses and tax preparation fees). In addition, miscellaneous itemized deductions are completely disallowed under the AMT rules. Unfortunately, the courts have supported the IRS position.

Non-Business Bad Debts Losses

Losses from bad debts that do *not* arise in the course of an individual taxpayer's business are treated as short-term capital losses. As such, they are subject to the capital loss deduction limitations. Specifically, you can deduct a maximum of $3,000 net capital loss each year ($1,500 for married filing separate status), after your capital losses are netted with capital gain income. The balance of the loss would be carried over to future years. So if you have a big non-business bad debt loss and capital gains that amount to little or nothing, it can take many years to fully deduct the bad debt loss. In addition, losses cannot be claimed for partially worthless non-business bad debts.



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Tax Court News

In a 2012 decision, the Tax Court concluded that an individual taxpayer was only entitled to a non-business bad debt deduction for worthless loans made to two software development companies.

Harry Robert Haury was a software engineer who managed and held substantial stock ownership interests in the two companies, which were attempting to obtain contracts to develop national alert warning software for the Department of Homeland Security. Haury withdrew $434,933 from his IRA and gave the money to the two companies in exchange for interest-bearing promissory notes. The hoped-for government contracts never materialized, and the companies were unable to fully repay the loans, although one company did repay $40,000.

"Non-business bad debt losses are treated as short-term capital losses that can potentially take many years to fully deduct"

After the taxpayer failed to file a federal income tax return for 2007, the IRS stepped in, and Haury eventually filed a tardy Form 1040 for that year. On the return, he claimed a $413,156 business bad debt deduction. The IRS denied the deduction, and the unhappy taxpayer took his case to the Tax Court where he represented himself.

Unfortunately, the Tax Court opined that the IRS had acted properly in denying the business bad debt deduction. The court felt the taxpayer's dominant motivation for making the ill-fated loans was not to protect his business of being an employee but to protect his stock investments in the companies. The court gave little weight to the fact that Haury actually received meaningful amounts of salary from one of the companies.

The taxpayer's "investment in, and management of, the companies do not amount to a trade or business," the court stated.

Lessons Learned:

The taxpayer was only allowed to claim a non-business bad debt loss. As we explained earlier, non-business bad debt losses are treated as short-term capital losses that can potentially take many years to fully deduct. In this particular case, the taxpayer would need to collect some very hefty post-2007 capital gains to be able to deduct his whopping big non-business bad debt loss anytime soon.

To add insult to injury, the 51-year-old taxpayer also owed the 10 percent early withdrawal penalty on the taxable portion of the money withdrawn from his IRA that was in turn loaned to the two companies. IRA withdrawals before age 59 1/2 are hit with the 10 percent penalty unless an exception applies, and no exception was available in this case. The penalty amounted to more than $30,000. (*Harry Haury, TC Memo 2012-215)*

Seek professional tax advice anytime you're about to engage in a significant financial transaction. With advance planning, you may get better tax results. Even if better results are not in the cards, you'll at least know what you're getting into tax-wise before you make the deal.

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Smart Business Practices for Start-up Entertainment Companies

You have a start-up entertainment company, and like most entrepreneurs, you want it to be successful. Although you can't predict how successful your movie or media venture will be, set your company up using established business practices to help get off on the right foot.

The Strategic Plan

A map of near- and long-term goals and how to reach them lies at the core of most companies. If you do not have a strategic plan or have been lax about updating your existing plan, creating or updating your plan should be a top priority.

The scope of your plan will be specific to your goals, and to some degree the changes your experience as you grow. But basic principles used by most businesses apply to entertainment companies as well. Pay particular attention to each strategic goal's return on investment.

For instance, consider the resources required to a marketing campaign using social media. You'll need to consider the employee hours involved relative to your allocated budget. Working through the financial implications of ideas can help your entertainment company avoid the kind of initiatives that sound good in theory but are unlikely to provide returns — financial, social or otherwise.

Using SMART Principals

Many companies use "**SMART**" principles when setting their strategic goals. Such principles help leaders focus on priorities and create achievable objectives.

Specific: To be SMART, a goal must first be *specific*. Goals should be as clear and detailed as possible. Include names, dates, locations, processes and requirements for completion.

Measurable: Goals also should be *measurable*. Clearly identify the outcome you're seeking. For example, if you need corporate sponsor, your goal might be "Find at least three sponsors before the end of the calendar year." Simply wanting "some sponsorship" isn't measurable — or motivating.

Attainable: Additionally, your goals should be *attainable*. Set goals that are within your control. Although it would be great if you could grow 50%   this year over last, is it really within the realm of possibility?

Realistic: And they must be *realistic*. While there's nothing wrong with dreaming big, it pays to be realis-

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tic. Focus on initiatives that you're both willing and able to pursue and that you believe you can accomplish. But be careful not to lowball your goals and shortchange opportunities.

Timely: Last but not least, goals need to be *timely*. Building in a time factor is essential to staying on track. Time frames can vary by goal and can be tricky in entertainment but necessary.

"...goals need to be timely. Building in a time factor is essential to staying on track."

Coordinate Your Plan with Your Budget

You probably already developed an annual budget, but how closely does it follow your strategic plan? Established companies use budgets to support strategic priorities, putting greater resources behind higher priority projects.

Businesses also routinely carry debt on their balance sheets in the belief that it takes money to make money. This is tough concept for start-ups and needs to be monitored, but it's possible to operate so lean that you shortchange your efforts. Although bare-bones budgets are unavoidable with young companies, consider putting some muscle behind your more promising initiatives as your finances improve.

Applying for a loan could provide you with the funds to grow. Building up your reserves also will help provide the additional cash flows essential to pursuing strategic opportunities in the future.

Allocating for Professional Advice

Successful companies usually budget for experienced professional advice. Although start-up companies typically see these costs as something they can't afford, it typically will save you money in the long run. A lawyer, bookkeeper and accountant will help keep your business on the right track.

Paying for professional advisors is particularly critical when you're embarking in major fundraising. Banks and investors want to know that the money they provide will be allocated and tracked properly. They will also want to "look under the hood" so solid financials and legal documents are critical.

Embrace Flexibility

For creatives, moving forward or being flexible is usually something you can embrace. These traits are critical in business as well. Just remember to apply best practices, both new and traditional, on the growth path of your start-up entertainment company.

Smart Business Practices for Start-up Entertainment Companies

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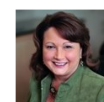
Blunders Made when Starting a New Business

According to the **Small Business Administration**, one-third of small businesses fail during the first two years. Over half fail in the first five years. If you are starting a small business, it is important to take an honest look at yourself, your business idea, and the marketplace. Be aware of the common mistakes typically made by new businesses so you can avoid becoming a statistic.

1. **Improper Business Planning:** To build a business, you need a foundation, clear goals, and an implementation strategy. Where do you want to be a year from now? Or three years from now? Developing a sound business plan involves doing solid research. It means understanding the marketplace, knowing what sets your product apart, and getting a grip on the costs to implement your plan. An idea is not a business plan. You need to flesh out the idea and get down to specifics.
2. **Poor Cash Needs Assessment:** Before you enter the marketplace, it is a good idea to accumulate a cash reserve that is several times your estimated need. Small businesses often face down times, when sales slow and revenues drop. This is especially true for new businesses. Unforeseen expenses for insurance, staff, buildings, advertising, taxes (the list goes on and on) can cripple your business and shut it down before it even gets going. Extra cash can make the difference between a survivor and a statistic. A reserve fund provides an extra cushion to keep the business operating while you work toward the next sales goal.
3. **Rigidity:** Be willing to adapt your business plan to changing conditions. More than a few businesses have started with a great business model, and then failed to modify that model when market conditions evolved. If your customers or or competitors change (and they will over time), you may need to change with them.

If you are considering starting a small business, your accounting advisor can steer you in the right direction and help you make the choices that are right for you and your new business.



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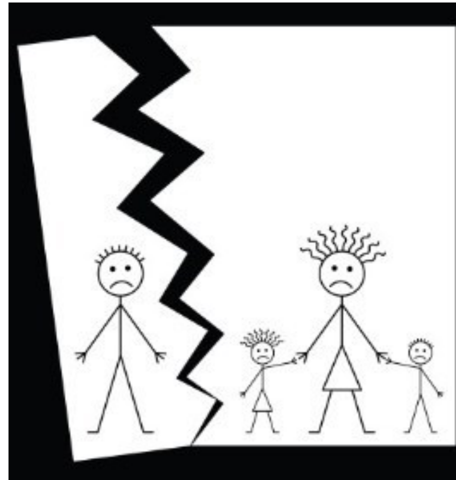
7 Key Deductible Alimony Requirements



When couples separate or divorce, one is often required to make payments to the other. If these payments meet the tax-law definition of alimony, the one making the payments can deduct them, and the recipient must include them as taxable income. Payments intended as alimony are often substantial, so it is important to identify and record these payments correctly.

Whether payments qualify as deductible alimony is determined by tax law and stringent regulations — not by what a divorce decree might say or what divorcing couples might intend. The one exception is when individuals stipulate in divorce papers that the payer will not deduct (and the recipient won't include in gross income) amounts that normally would qualify as deductible alimony.

By GS Editor

For a payment to be deductible, alimony must meet the following requirements:

Requirement #1.

It must be made according to a written divorce or separate maintenance decree, or a separation instrument. Here are some definitions:

- Under a separate maintenance decree, a couple is legally separated but the marriage is not legally dissolved. For federal tax purposes, this is equivalent to being divorced.
- Separation instruments settle certain marital rights before obtaining a divorce decree or a separate maintenance decree.
- Other written court orders and decrees such as temporary support orders can qualify as divorce or separation instruments. For example, payments made under temporary support orders can be deducted if all the other requirements are met.
- It must be made to or on behalf of a spouse or ex-spouse. Payments to third-parties such as attorneys and mortgage lenders also qualify when they are part of a divorce or separation agreement or requested in writing by the spouse or ex-spouse.

Requirement #2.

It must be paid in cash or cash equivalents.

Requirement #3.

Divorce or separation instruments cannot state, or effectively stipulate, that a payment is not alimony

because it isn't deductible or cannot be included in the recipient's gross income.

Requirement #4.

The two parties cannot live together or file a joint return after a divorce or legal separation.

Requirement #5.

Fixed or deemed child support does not qualify. The rules regarding what constitutes child support for this purpose are complicated. Consult with your tax adviser if your proposed divorce agreement includes payments that you want to be child support.

Requirement #6.

The payer's tax return must disclose the recipient's Social Security number.

Requirement #7.

If the recipient dies, the obligation ends, unless the payment is for delinquent amounts. If the divorce papers are unclear on this, state law takes over. If state law requires the payments to continue, they do not qualify as deductible alimony.

Divorce papers should always explicitly state whether a lump-sum or recurring payment obligation will continue after a recipient dies. Failing to meet the requirement is probably the most common reason for lost alimony deductions.

Tax Court Examples

Three recent U.S. Tax Court cases illustrate issues that may arise when taxpayers seek to deduct alimony:

1. **Child Support Case.** An ex-husband was required to make monthly child support payments of $8,307 and monthly alimony payments of $8,205, for a total of $16,512. However, he paid only $9,688 each month to cover both and claimed the entire amount as alimony.

Under tax law, if a combined payment is less than the full amount required, the partial payment is treated first as nondeductible child support. Any excess is deductible alimony, assuming all requirements are met.

The court allowed only $1,381 a month ($9,688 minus $8,307) to be treated as deductible alimony (*Becker,* T.C. Summary Opinion 2015-2).

2. **Future Fees Case.** An ex-husband made payments to cover his ex-wife's attorney fees following the terms of the divorce decree. He was also required to pay certain "future fees" incurred by the ex-wife. The ex-husband attempted to deduct the payments as alimony.

However, tax law stipulates that future payments can be treated as deductible alimony only if the requirement to make them ends when the recipient dies. In this case, the divorce decree did not state whether the requirement ended on the death of the ex-wife, and state law was inconclusive on the question.

Therefore, payments of the fees did not qualify as deductible alimony (*Hampers*, T.C. Memo 2015-27).

3. Draft Divorce Agreement Case. A husband made payments to his wife following the terms of a draft of the couple's marriage dissolution agreement. The final divorce decree was issued later in the year and did not call for alimony payments in that year (they were to begin in a later year).

The draft agreement did not qualify as a written divorce or separation instrument, because the parties did not agree to the terms of the draft or sign it.

Consequently, the payments were voluntary and did not qualify as deductible alimony (*Milborn*, T.C. Memo 2015-13).

Identify Tax Issues Before the Divorce

There are several ways taxpayers can make mistakes under the rules for deductible alimony. In addition to alimony, divorces often involve other significant tax issues. One example entails which parent will be entitled to various child-related tax breaks after the divorce.

For each situation, the relevant tax issues should be identified and addressed before the divorce papers are signed. Otherwise, it may be too late to obtain the best tax results.

Contact your tax adviser at the beginning of the divorce process. Waiting too long could turn out to be an expensive tax mistake you might have to live with for many years.

7 Key Deductible Alimony Requirements

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3 Steps to Estate Planning

If you own assets, you have an estate. This means that nearly everybody has an estate, whether it is small or large and therefore should have a written plan. Without a plan in writing your state of residence will choose who receives your assets when you die. The state's choice may not be the result you intended. We see issues like this even in very large estates. How can you ensure your intentions will be realized? We outline three basic steps to get you started in planning:

1. **Create a will.** No matter the size of your estate, your plan should begin with a will. A will lets spell out who gets what. It allows you to distribute property to your chosen beneficiaries, designate guardians for your dependents, and make charitable contributions. You can also use your will to establish trusts, which are another important part of estate planning. Trusts can be used for asset management, distribution timing, and protecting the inheritance of heirs who cannot manage their own affairs. In addition, trusts can be useful to bypass the complexities of probate, the state court system governing distributions.
2. **Update beneficiary designations**. Another important planning move is to update your beneficiary designations. Some assets, such as life insurance proceeds and retirement accounts, bypass your will and go directly to the designated beneficiaries. When you open these types of accounts, you would have filled out a form indicating who gets the account when you die. It is worth reviewing these beneficiary designations from time to time to be sure your accounts accurately reflect your intended beneficiaries.
3. **Consider estate taxes.** Estate tax applies to the excess of your gross estate over the allowable exclusion and deductions. Your gross estate is the current value (not the cost) of everything you own. The allowable exclusion for 2016 is $5,450,000, and an estate can deduct the following:
    a) Assets left to a surviving spouse, without limitation.
    b) Property left to qualifying charities.
    c) Mortgages, debts, and administrative expenses and losses.

Because property in your estate is valued at current market value, your heirs will benefit from a "step-up" in basis. Here's an example. Say your home cost $120,000. If the value of the home is $520,000 at the date of death, then when the house passes to your heir, your heir's basis becomes $520,000. That means if your heir later sells the house for $600,000, the taxable gain is limited to $80,000 ($600,000 less the $520,000 value at date of death).

Your accountant can assist in starting your estate plan. They will work with your attorney as well as other members of your financial team to help you achieve the results you intend.

By GS Editor

Art, Antiques & Collectibles – Plan To Maximize Tax Benefits

Do you own art, antiques or collectibles? Whether you're a collector that is surrounded by great works, or you only have the antique furniture that your great-grandmother left you, it is important to understand the unique tax planning opportunities that are available for these assets.

Art, antiques and collectibles are mentioned in portions of the Internal Revenue Code, usually with more stringent rules surrounding them. For example, currently capital gains from the sale of art, antiques and collectibles are taxed at 28%, whereas the capital gains for most other assets are taxed at 20% or less depending on your income tax rate. Note that by donating the same piece of art instead of selling it, you would remove the 28% capital gains tax and you would receive an income tax deduction for the appraised value of the art.

In Estates

These types of assets are ideal to pass through an estate. Inherited assets enjoy a special "stepped up" basis. This means that the person who inherited the asset can reflect their basis to be the value at the date of death of the person they inherited the art from. The new basis is the value placed on the art by an appraiser hired by the estate.

Example: *You bought a piece of art 40 years ago for $500. That art is now worth $20,000. Your basis is the $500 you paid for it. If you sold the piece for the $20,000, you would have a taxable capital gain of $19,500 ($20,000 – $500).*

However, if you hold on to the piece, when it passes through your estate, the heir's basis is the value at the date of death. In this case, the piece was worth $20,000 at the date of death (the date they inherited). If they then sell the piece for $20,000, their taxable capital gain is zero.

The step up in basis works well for appreciated assets. But keep in mind that this works both ways, and there could also be a "step-down" in basis if the value of the art is less than the original purchase price or cost basis.

Donation

When donating art, antiques, or collectibles, your charitable deduction is the fair market value at the time of donation. In the example above, even though you had only paid $500 for a piece of art, if the item was donated, the charitable contribution deduction would have been the $20,000 appraised value.

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Note that the donation of art to a qualified public charity must meet the "Related Use Rule" or you may not be able to deduct the appraised value of the

Note that the donation of art to a qualified public charity must meet the "Related Use Rule" or you may not be able to deduct the appraised value of the donation. You may be limited to your cost basis in the art.

There are other ways to donate art, such as (1) a bargain sale where the donor receives some cash and a charitable deduction and (2) the partial or fractional interest in the art that is being donated. The rules for either type of donation, bargain sale or partial interest, require planning and having your advisors assist you in the transaction.

The form to use with the filing of your income tax return along with any required attachments to report the noncash donations over $500 is IRS **Form 8283, Noncash Charitable Contributions.** There must be an appraisal if the value of your donation is $5,000 or over. If the value is $20,000 or more, you must include a complete copy of the appraisal with your return, and also have all parties who were involved in the donation sign the appraiser and the charity Form 8283.

If you donate an item of art that has been appraised at $50,000 or more, you may request a Statement of Value for that item from the IRS prior to filing your income tax return to avoid any potential future audit regarding the donation. Currently the cost for a Statement of Value is a $2,500 payable to the IRS and is usually non-refundable.

The cost of an appraisal, delivery of the art, tax advice and any other related expenses cannot be deducted as a charitable contribution, but you may be able to claim the expenses as a miscellaneous itemized deduction on your tax return, subject to certain limitations.

If you are an artist that is donating art to a qualified organization, your charitable deduction is usually zero except in a very narrow circumstance.

NOTE: *The IRS has a special Art Advisory Council that will review art appraisals, above certain amounts, that have been used for gifting, donating, or estate purposes. So be sure your qualified appraiser is above reproach and follows all the rules.*

See **IRS Publication 526** for more information on charitable contributions, and **IRS Publication 561** for more information on determining the value of donated art.

Insurance

Keep in mind that you should have good appraisals on hand for fine art insurance purposes. If you do not have an idea of the current value of your pieces, then you probably don't have them properly insured. The appraisals should be reviewed from time to time as values of the fine art will fluctuate, going up and down.

I was working on an estate, and met with the family at the home of the deceased. In this home, I noticed a

beautiful collection of Native-American baskets and other collectibles. I knew there had to be value in these items, but there were no records and the items were not insured. After arranging an appraisal, the family was shocked to learn that the collection was worth over $500,000. They had no idea that such a large asset was sitting there uninsured.

Inheritance

I have a client who inherited a painting from his father, and the estate had it valued at $1. Fifteen years later, he started investigating this painting and found that the current appraised value was $300,000. He was in a position where if he sold it, not only would he be hit with a large tax bill, but he had to consider his siblings and the issues that could arise from selling this asset for such a significant sum. He consulted with me, and we took a different approach. I advised that he donate the painting. He liked the idea and it now hangs in the Metropolitan Museum of Art in New York City. He received no cash for the siblings to quibble over, and the client actually benefited from a $300,000 charitable contribution deduction.

When it comes to estates and money, you have to know what can be done to lessen the problems that will inevitably arise within family dynamics.

Art, antiques and collectibles can make up a large portion of a person's net worth. You will want to be sure you are getting experienced guidance to protect that investment. Ask your advisor if they have experience in this area, or ask for recommendations to somebody who does.

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