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GOOD NEWS IS NOT NEWS

Many of us have considered, if not concluded, that too much of our local newspaper and TV reporting is negative or "bad news." A study by the Media Research Center concluded that only about 15 percent of the three major network broadcast news items were optimistic. Two items of good news about our local economy have escaped notice by the local media.

First, *Forbes* magazine named Shreveport as one of the ten best medium-sized cities in the nation for locating work. Three of the top ten cities were in Louisiana with the others being Baton Rouge and Lafayette.

Second, Louisiana was listed No. 1 among the 50 states for economic momentum. The ranking is by the *State Policy Reports*, a Washington, D.C. newsletter affiliated with the National Governor's Association and the National Conference of State Legislatures in its "index of state economic momentum." The index reflects growth in personal income, employment, and population.

Obviously, Louisiana and the Ark-La-Tex have problems, and many areas are in need of improvement. Nonetheless, we are blessed with a good economy.

BORROWING FROM RETIREMENT PLANS – A BAD IDEA

The accompanying *Tax and Business Alert* discusses on page 3 some ideas about a 401(k) plan participant's borrowing money from the plan. The article considers some of the general rules concerning the limits on plan loans, the prohibition on deducting the interest payments, and the income tax consequences of failure to repay plan loans. These factors alone cause us to conclude that such borrowing is almost always a very bad idea. In the words of the TV pitchman, "but wait – there's more." The article also omits some of the other more significant problems that might arise when a key employee or business owner borrows from the retirement plan. In two recent cases, the Internal Revenue Service revoked the plan's tax-deferred status after the owner borrowed from the plan.

Exclusive Benefit Rule

The assets of qualified plans must be used for the exclusive benefit of the participants and their beneficiaries. To ensure that a plan investment meets this exclusive benefit rule, the investment must satisfy a four-part test.

1. The cost of the investment must not exceed its fair market value at the time of purchase.
2. The investment must provide a rate of return comparable to prevailing market rates.
3. The plan must maintain enough liquidity to permit distributions.
4. The plan must provide the safeguards and diversity that a "prudent person" would require.

(Continued on reverse)

A prudent person would require that the investment be part of a reasonably designed portfolio intended to further the plan objectives and would look at (1) how the investment affects the diversification of the portfolio, (2) how the liquidity of the investment compares to the anticipated cash flow requirements of the plan, and (3) how the rate of return and safety of the investment measures up against the objectives of the plan.

In both of the adverse cases, the exclusive benefit rule and the prudent person rule were violated. The loans to the owners were not prudent investments because (1) there was no collateral to serve as security for the loans, (2) the loans that were in writing did not have a stated term or repayment schedule, and (3) there was no objective consideration about whether the owner/trustees were able to repay the loans. As a result, both plans were disqualified, and the loan amounts, which were almost all of the plans' assets, were considered fully taxable withdrawals and subject to penalties.

Prohibited Transaction

In addition to having violated the exclusive benefit rule, each owner was found to have

engaged in a prohibited transaction. Both owners attempted to repay the loans with real property. The transfer of property to the plan was a prohibited sale or exchange between a plan and a disqualified person (company owners, officers, and plan trustees). Even though the property transfers were intended to repay the loans, they were still considered prohibited transactions.

Lesson for Business Owners

When dealing with qualified retirement plans, business owners should not treat the plan's assets as if they were their own or part of the business. Owners who use a plan's assets for personal or business reasons will lose the tax benefits of the plan and incur substantial penalties. Business owners who are plan participants and want to borrow from a company's plan should seek professional advice. Even where participant loans are allowed under the law, the cost of a loan to a key employee is increased because the interest on participant loans to key employees is never deductible in computing taxable income. Accordingly, most plans will save administrative expenses and complexity, and most plan participants and sponsors, we believe, will be best served by plan provisions that prohibit participant loans.

CHANGES AHEAD TAXES AND UNCERTAINTY

With October, the season for the final 2009 tax planning decisions is at hand. We still do not, however, know the new administration's plan for estate and income taxes.

As you might recall, the individual death tax exclusion amount increased to \$3.5 million (\$7 million for a couple) on January 1, 2009. Under present law, the tax disappears altogether on January 1, 2010 and reappears higher on January 1, 2011. Most tax commentators continue to believe that the President will propose that the estate tax be continued at its current exemption level and top rate of 45 percent.

There is more uncertainty concerning the future of the top two federal tax brackets. As a candidate, the new President proposed:

- Raising the top two federal personal rate brackets to 39.6 and 36 percent from the 2008 level of 35 and 33 percent
- Raising the federal capital gains rate and the top federal dividend tax rate from 15 percent to 20 percent, and
- Raising payroll taxes on high producers by eliminating the \$106,800 maximum amount subject to payroll taxes for taxpayers with incomes above \$250,000

Some commentators anticipate that the President will allow the income tax cuts of the prior administration to expire December 31, 2009. If so, most top bracket taxpayers' burden will increase by over 10 percent for 2010 as compared to 2009. For year-end income tax planning, most of us can prudently assume that brackets will be significantly higher in 2010 and plan accordingly.