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Accelerate gain in Anticipation of Higher Tax Rates?

Gain. For those who anticipate tax increases after 2008 and have valuable capital assets to sell for tax gains, in some cases it might make sense to accelerate gain or income into 2008.

For a taxpayer with an income-producing asset:

If the taxpayer expects an effective **30**% LTCG rate (up from 25%) in 2009 and later, it does NOT make sense to accelerate gain into 2008.

If the taxpayer expects an effective **38**% LTCG rate in 2009 and later, it DOES make sense to accelerate gain into 2008 if it would otherwise be recognized in 2009, but NOT if it would be recognized after 2009.

If the taxpayer expects an effective **50**% LTCG rate in 2009 and later, it DOES make sense to accelerate gain into 2008 if it would otherwise be recognized in 2009, 2010 or 2011 but NOT if it would be recognized after 2011.

I assumed the sale of a business owned by an S corp, generating $10M of gain, with no appreciation in value after 2008, but with operating income of $2M in each year after 2008 (all of which is distributed to the shareholders and taxed at an effective **50**% -- up from 40% -- tax rate for ordinary income). I assume all of the gain is LTCG and there is no built-in gain. (The $10M value is 5 times EBITDA, assuming no depreciation or amortization. This is a weak multiple for the very consistent earnings in the example, but might be reasonable -- or even optimistic -- in these tough times.) This should be a fair example of an income-producing asset. I used 4% (which has been the prime rate since 10-29-08) to calculate the time value of money. Of course, the results would change for different assumptions.

Deductions. Generally, it does not make sense to take extraordinary measures to accelerate deductions if the deductions will shelter income that would be taxed at higher rates next year. However, if a taxpayer expects the **itemized deduction cut-back** to be expanded, it might make sense to move itemized deductions into 2008 or to defer AGI (on which the cut-back is based) to 2009. Taking deductions ASAP and deferring income is normal tax planning, so this is not particular to 2008. It will rarely make sense to defer deductions, except for taxpayers in **unusually low tax brackets** for 2008.

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11-5-08

Analysis.

Sale in 2008

EBITDA/Gain	$10.0M
LCTG Tax rate	**25%**
Tax	$2.5M
After tax 2008	**$7.5M**

Sale in 2009 @30%

	2009 Values	2008 (Present) Values @ 4%	
EBITDA/Gain	$10.0M		
LCTG Tax rate	**30%**		
Tax	$3.0M		
After tax 2009	**$7.0M**	**$6.73M**	
Operating income	**$2.0M**		
Ord. inc. tax rate	**50%**		
After tax	$1.0M	**$0.96M**	
Total		**$7.69M**	**Exceeds 2008 after-tax, so wait**

Sale in 2009 @ 38%

	2009 Values	2008 (Present) Values @ 4%	
EBITDA/Gain	$10.0M		
LCTG Tax rate	**38%**		
Tax	$3.8M		
After tax 2009	**$6.2M**	**$6.2M**	
Operating income	$2.0M		
Ord. inc. tax rate	50%		
After tax	$1.0M	$0.96M	
Total		**$7.16M**	**Less than 2008 after-tax, so sell now**

Sale in 2010 @38%

	Future Values	2008 (Present) Values @ 4%	
EBITDA/Gain	$10.0M		
LCTG Tax rate	**38%**		
Tax	$3.8M		
After tax 2010	$6.2M	**$5.73M**	
Operating income	$2.0M		
Ord. inc. tax rate	50%		
After tax 2009	$1.0M	$0.96M	
After tax 2010	$1.0M	**$0.92M**	
Total		**$7.61M**	**Exceeds 2008 after-tax, so wait**

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Sale in 2009 @ 50%

	2009 Values	2008 (Present) Values @ 4%
EBITDA/Gain	$10.0M	
LCTG Tax rate	**50%**	
Tax	$5.0M	
After tax 2009	**$5.0M**	**$4.82M**
Operating income	$2.0M	
Ord. inc. tax rate	50%	
After tax	$1.0M	$0.96M
Total		**$5.77M** **Less than 2008 after-tax, so sell now**

Sale in 2010 @50%

	Future Values	2008 (Present) Values @ 4%
EBITDA/Gain	$10.0M	
LCTG Tax rate	**50%**	
Tax	$5.0M	
After tax 2010	$5.0M	**$4.62M**
Operating income	$2.0M	
Ord. inc. tax rate	50%	
After tax 2009	$1.0M	$0.96M
After tax 2010	$1.0M	**$0.92M**
Total		**$6.5M** **Less than 2008 after-tax, so sell now**

Sale in 2011 @50%

	Future Values	2008 (Present) Values @ 4%
EBITDA/Gain	$10.0M	
LCTG Tax rate	**50%**	
Tax	$5.0M	
After tax 2011	$5.0M	**$4.44M**
Operating income	$2.0M	
Ord. inc. tax rate	50%	
After tax 2009	$1.0M	$0.96M
After tax 2010	$1.0M	$0.92M
After tax 2011	$1.0M	**$0.89M**
Total		**$7.21M** **Less than 2008 after-tax, so sell now**

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Sale in 2012 @50%

	Future Values	2008 (Present) Values @ 4%	
EBITDA/Gain	$10.0M		
LCTG Tax rate	**50%**		
Tax	$5.0M		
After tax 2012	$5.0M	**$4.27M**	
Operating income	$2.0M		
Ord. inc. tax rate	50%		
After tax 2009	$1.0M	**$**0.96M	
After tax 2010	$1.0M	$0.92M	
After tax 2011	$1.0M	$0.89M	
After tax 2012	$1.0M	**$0.85M**	
Total		**$7.89M**	**Exceeds 2008 after-tax, so wait**

Your comments and questions are invited.

For those who are surprised that the coffee at McDonalds is hot: This analysis has projections of future tax rates, which I cannot predict with any certainty.

[End.]

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