

# Tax Talk

*A quarterly publication of Bridges & Dunn-Rankin, LLP*

**Inside this issue:**

<b>The 2010 Tax Relief Act</b>	<b>1</b>
<b>Member in the Spotlight – Laura Niklasson</b>	<b>2</b>
<b>Potential Changes to Georgia Tax System</b>	<b>2</b>
<b>Georgia Tax Credit for Angel Investors</b>	<b>2</b>
<b>Sales Taxation of Software Based Transactions</b>	<b>3</b>
<b>Client in the Spotlight – QuantiSense, Inc.</b>	<b>3</b>
<b>Dealing with Residences which have Declined in Value</b>	<b>3</b>
<b>C-corp with Net Operating Loss Carryforwards? Watch out for IRC §382</b>	<b>4</b>

Dear Clients and Friends,

The traditional “busy season” is well under way at Bridges & Dunn-Rankin, as we focus on getting financial statements and tax returns completed, along with keeping busy with our ongoing consulting and transactional work and representation of clients in matters with the taxing authorities. We always love to see April 15 fall on a Saturday or Sunday (that extends the due date by a day or two), and this year with the 15<sup>th</sup> falling on a Friday which is Emancipation Day (a D.C. holiday) the deadline is extended to April 18; so don’t panic if your returns (or extensions) are not filed this year until the 18<sup>th</sup>.

More of you will be filing your returns electronically this year. Prior to this year, e-filing was required for partnerships with more than 100 partners or businesses which file more than 250 Federal tax forms (including W-2s and 1099s), but optional for everyone else. This year, substantially all returns for individuals, estates or trusts which are prepared by CPA firms will have to be filed electronically (unless strict opt-out procedures are followed).

Shortly after our last newsletter went out, favorable Federal tax legislation was enacted extending the “Bush tax cuts”. In this issue we will review that legislation as well as potential changes to the Georgia tax system, a new Georgia tax credit for angel investors, sales taxation of software-based transactions, dealing with residences which have declined in value, a potential limitation on corporate loss carryforwards, and, as always, highlight a member of our firm and one of our clients.



Kent Bridges,  
Managing Partner

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

*Kent Bridges*

**The 2010 Tax Relief Act**

In December 2010, shortly after our last newsletter went out, the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010* (the “2010 Tax Relief Act”) was enacted. We summarized the highlights in an e-mail at that time, but, due to the significance of this legislation, we will review it again here.

*Ordinary income tax rates* – Absent this legislation, the highest individual rate was scheduled to rise to 39.6% effective January 1, 2011. With this legislation, it remains at 35%. The current rates for the lower income brackets are retained as well (i.e. 10%, 15%, 25%, 28%, and 33%, rather than increasing to 15%, 28%, 31% and 36%).

*Qualified dividend income* – Effective January 1, 2011, the highest rate on “qualified dividends” (which includes most dividend income other than interest income equivalents like money market mutual fund dividends) was scheduled to go to 39.6%. This legislation retains the current 15% rate.

*Long-term capital gains* – Currently, long-term capital gains enjoy a historically low Federal rate of 15%. Effective January 1, 2011 the rate was scheduled to rise to 20%. This legislation retains the 15% maximum rate.

*Estate tax* – For persons dying in 2009, there was a \$3.5 million exemption from the estate tax and a maximum rate of 45%. For those dying in 2010, there was no estate tax. Effective January 1, 2011, the exemption was scheduled to revert to only \$1,000,000 and the top rate to revert to 55%. Instead, the exemption will be \$5,000,000 and the top rate will be 35%.

*Extenders* – A number of favorable tax provisions expired at the end of 2009. Amongst them were the higher alternative minimum tax exemptions, research tax credit, deduction of sales tax in lieu of state income tax, charitable distributions from IRAs, and above-the-line deductions for college tuition and educator expenses. These favorable provisions have been extended retroactively.

*Payroll tax reduction*- For 2011, the employee’s portion (but not the employer’s portion) of the social security tax is reduced by 2 percentage points (from 6.2% to 4.2%). This applies for self-employed persons as well, and represents a potential tax savings of up to \$2,136.

*Bonus first-year depreciation* – For most new depreciable assets (other than buildings) placed in service after September 8, 2010 and before January 1, 2012, 100% of the cost can be expensed



Laura E. Niklasson

### Member in the Spotlight – Laura Niklasson

Ms. Niklasson serves as Office Manager and Paraprofessional for Bridges & Dunn-Rankin, LLP, as well as providing services to clients, including payroll assistance, preparation of quarterly and annual payroll tax returns, accounting software assistance, and general bookkeeping assistance.

Laura holds a Bachelor of Arts in International Relations from Agnes Scott College. She has over twenty years of experience in office administration and support. Prior to joining Bridges & Dunn-Rankin,

she assisted a start-up technology firm in the set-up and implementation of administrative and marketing procedures.

Professional affiliations include the American Institute of Professional Bookkeepers. Laura, husband Rob, and their three children live in Temple, and are members of First United Methodist Church of Douglasville.

Bridges & Dunn-Rankin is proud to have Laura Niklasson as a member of our firm.

### The 2010 Tax Relief Act – continued

*(Continued from page 1)*

immediately. For qualifying assets placed in service during 2012, 50% of the cost can be expensed immediately, with the balance recovered under the regular depreciation rules. This special first-year deduction applies both for regular tax and alternative

minimum tax. For autos and light trucks, for which first-year depreciation would otherwise be limited under the so-called “luxury automobile rules”, bonus depreciation of \$8,000 may be taken (bringing the total deduction to approximately \$11,000).

### Potential Changes to Georgia Tax System

In 2010, the Georgia General Assembly created the Special Council on Tax Reform and Fairness for Georgians and directed the Council to do a thorough study of Georgia’s overall tax system and recommend potentially broad reforms. The Council’s guiding principles were that the state tax system should be growth enhancing, efficient, stable, clear, fair and equitable, properly developed, and provide an avenue for dispute resolution.

In January 2011, the Council released its recommendations. From a very high level, the Council’s recommendations were basically to:

- Reduce the personal and corporate income tax rate from the current 6% to 4%
- Eliminate most differences between Federal and Georgia adjusted gross income

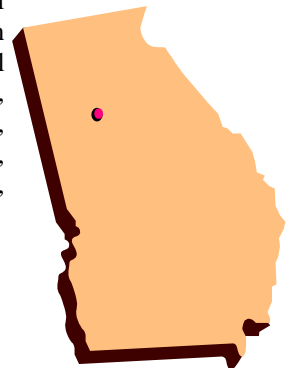
- Repeal the scheduled increases to the retirement income exclusion
- Eliminate personal itemized deductions, standard deduction and exemptions
- Sunset most corporate and personal tax credits (while grandfathering in those earned prior to the sunset date)
- Eliminate most exemptions to the sales tax
- Increase the number of services subject to the sales tax
- Establish a state tax court to hear tax disputes

The recommendations are currently being debated by the Georgia General Assembly. As anticipated, there has been strong opposition to many of the proposals, so stay tuned to see what comes out of the Legislature.

### Georgia Tax Credit for Angel Investors

Recently-enacted Georgia legislation (which applies to investments in early stage companies made in 2011 to 2013) provides a Georgia tax credit of up to 35% of the amount invested in an early stage company (with utilization of the credit limited to \$50,000 per year). The credit is claimed in the year following the year the investment is made. It is available to accredited individuals and special purpose flow-through entities which are investment vehicles. A maximum of \$10,000,000 per year of credit is available for the entire state. Qualified companies have to be less than three years old, employ fewer than 20 people, have less than \$500,000 in revenue in any prior year, be headquartered in Georgia, have raised less than \$1,000,000 in equity and debt

financing (other than commercial loans), and cannot be engaged in retail, real estate, professional services, membership based activities, gambling, natural resource extraction, investment activities, insurance, entertainment, amusement, recreation, etc.



## Sales Taxation of Software-Based Transactions

Most states impose a sales tax on the sale of most items of tangible personal property, while typically exempting from the tax the sale of services and intangible property. So what is a sale of software? The sale of tangible personal property? The sale of an intangible? The sale of a service? Or some combination of the foregoing? Given that sales tax rates are typically 4% to 8% of the gross sales price, it is very important that software companies correctly answer these questions. Otherwise, the exposure for failure to properly collect and remit sales tax can be substantial. And for purchasers of software, these questions are also important, as the purchaser may have an obligation to pay “use tax” if the seller does not collect the sales tax. Also, the purchaser will want to ensure that it is not improperly charged sales tax which should not apply.

*Does the state in which the purchaser is resident have a sales tax?* Sales and use tax is a tax on the end user of the product. When the seller collects and remits the tax it is referred to as “sales tax”. When the end user instead remits the tax it is called “use tax”. Because it is a tax on the end user, you generally have to look to the location of the buyer to determine which state’s rules apply (except, for example, where dealing with a retail sale at a physical store location, in which case the rules for the location of the store will generally apply). 45 states plus the District of Columbia have a sales tax, so in most cases the answer to this question will be yes.

### Client in the Spotlight – QuantiSense, Inc.

In 2001, recognizing the need for a retail-specific data warehousing and business intelligence solution that was low risk, cost effective, and could be quickly implemented, entrepreneurs Jeff Buck and Juan Esteban formed QuantiSense, Inc.

Today, under the leadership of Buck and President Andy Winans, the company is the leading provider of analytics, business intelligence, and data warehousing solutions exclusively for retailers. With over 1,300 retail analytics and metrics, dashboard reporting for each role within the organization, and action-oriented business intelligence tools, QuantiSense’s software helps retailers transform their day-to-day decision making.

QuantiSense Playbooks are a set of “plays” for each retail job role that guide users to take action and make better decisions in

### Dealing with Residences which have Declined in Value

Unfortunately, many of our clients have residences which are worth less than what they paid for them, and in some cases worth less than the mortgage on them. This is especially true of beach homes and condos. Here are some general rules and considerations.

*Loss on sale of home* – Gain on the sale of a personal residence (unless it meets the exclusion for gain on sale of principal residence) is taxable, while loss on the sale of a personal residence is nondeductible. If the residence qualifies as a rental property, however, as opposed to a personal residence, the loss is tax deductible.

*Short sale and potential COD income* – Selling a home can be

*Does the seller have sufficient contact or “nexus” with the state for it to require collection of its sales tax?* - Even if the item you are selling is subject to sales tax, you must have some degree of physical contact with a state before it has the right to require you as seller to collect and remit the tax. Otherwise, it is the responsibility of the purchaser to remit the tax as use tax.

*Is the buyer exempt from sales tax?* - If the buyer is a governmental agency or a nonprofit organization, then it may be exempt from sales tax. Further, if the buyer is a reseller of your product, then you will not have to collect sales tax if provided a proper reseller’s exemption certificate.

*Is your product subject to sales tax in the state in which the sale is made?* - In general, most states treat the sale of canned or off-the-shelf software as taxable, while treating the sale of custom software as nontaxable. Maintenance, support, training and installation are generally not taxable, so long as the charge for such services is separately stated from the license fee.

*Does the means of delivery affect taxation?* - In some states, an otherwise taxable sale of software is not taxable if delivered electronically rather than via a tangible medium.

response to specific, recurring situations. The Playbooks help turn the methodology of a retailer’s most successful professionals and departments into standardized processes that are consistent across the organization, using the most sophisticated yet easy-to-use business intelligence tools, dashboard reporting, and retail analytics.

QuantiSense is *Retailing with Insight*, and Bridges & Dunn-Rankin is proud to be associated with QuantiSense, Inc.



very difficult when the amount owed on it exceeds the potential selling price, since the lender must be paid in full at closing. Sometimes lenders will agree to a “short sale”, whereby the home is sold for less than the mortgage, with the lender not being paid in full at closing. In most cases, however, unless the lender specifically agrees otherwise, you continue to be personally liable for any shortfall. If the lender does agree to forgive some or all of the shortfall, then you have cancellation of indebtedness (COD) income, which is generally taxable. If the property is a rental property and you are selling at a loss or if you have “suspended passive losses” from prior years, then you may be able to offset such against the COD income.

*(Continued on page 4)*

## Dealing with Residences which have Declined in Value – continued

(Continued from page 3)

*Suspended passive losses* – If you have incurred tax losses in past years from the rental of the home, then you may have suspended passive losses which will be freed up and become deductible when the home is sold.

*Converting from personal use to rental* – In order to avoid the

limitation on deductibility of loss from the sale of a personal residence, you may benefit from first converting the property to a rental property for a period of time. However, the conversion to rental status must be bona fide, and you should be aware of a special rule which may require your tax basis in the property to be adjusted down to fair market value at the date of the conversion.

## C-corp with Net Operating Loss Carryforwards? Watch out for IRC §382

Early stage companies often incur tax losses in their first few years of existence. And even mature companies can have loss years; particularly companies in cyclical industries, or almost any company in a bad economy. Fortunately, the tax law generally provides that operating losses can be carried back 2 years or forward 20 years.

In order to prevent “trafficking” in net operating losses (NOLs), tax rules place potentially severe limitations on the use of a company’s tax losses and tax credits following a change in ownership. These rules can be a trap for the unwary.

IRC sections 382 and 383 provide that, where the ownership of a company changes by more than 50 percentage points in any 3-year period, the ability of the company to deduct its tax carryforwards in any future year is limited to the value of the company on the date the 50-percentage point threshold is crossed multiplied by a fluctuating rate that is currently around 4.5%. In other words, if the value of the company is \$1 million at the time of the ownership change, then its ability to use its loss carryforwards is limited to \$45,000 per year, no matter how

large its carryforward may be.

In situations where all of the stock of a company is sold, it is pretty clear that these rules apply, unless the value of the company is more than 25 times the amount of its loss carryforwards. However, where these rules can sneak up and bite you is when you are raising equity capital; particularly, in situations where you have multiple rounds of venture capital, for example. The 50-percentage point test is based on value of shares, not number of shares, so even if the founders continue to hold greater than 50% of the common stock, the limitation can be triggered by the issuance of preferred stock (which typically has greater value due to its liquidation preferences).

An entrepreneur trying to build a company certainly doesn’t want to let the tax tail wag the dog, and we generally wouldn’t recommend foregoing needed equity capital to avoid these rules. However, with knowledge of the rules and careful planning you can generally avoid unnecessarily triggering these limitations and wasting a potentially valuable asset.

## Bridges & Dunn-Rankin, LLP

CERTIFIED PUBLIC ACCOUNTANTS

200 Galleria Parkway  
Suite 1950  
Atlanta, GA 30339

Phone: 770-563-8888  
Fax: 770-563-8885

[www.bridgesdunnrankin.com](http://www.bridgesdunnrankin.com)



### Claiming Georgia Tax Credits against Withholding Tax

As discussed in a previous issue of our newsletter, companies can now elect to claim Georgia jobs tax credits and research tax credits against their Georgia withholding tax. This can be advantageous for companies which have no income tax to offset the credits against.

### Member News

Congratulations to firm member Michael Sudduth on his upcoming marriage to Kristen Howser.

Bridges & Dunn-Rankin, LLP is an Atlanta-based full-service accounting firm serving clients in the technology, real estate, services, manufacturing, distribution, construction and healthcare industries, as well as high net worth families.

*The information provided in this newsletter is presented for educational and informational purposes only, and is not intended to constitute legal, tax or accounting advice. The articles provide only a very general summary of complex rules. For advice on how these rules may apply to your specific situation, contact a professional tax advisor.*