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Client Information Bulletin

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One Management Style Does Not Fit All

Three different styles of running a business

There are many critical factors that will determine whether a small business is successful or not, but one of the most important is the leadership exhibited by its owner. In this competitive environment, business fortunes can rise or fall quickly, in direct correlation to the owner's management techniques. Naturally, you need to have good people working for you, but it all starts at the top.

If you possess superior management skills, your employees will function better and therefore accomplish more. Conversely, no matter how efficient you are in completing your own tasks, the business will suffer if you don't provide leadership for others.

What sort of management style are you using? There are three basic types: aristocratic, paternalistic and democratic. As the names suggest, the individual style reflects the manner in which you treat your workers.

1. **Aristocratic style**: An aristocratic manager rules with an iron fist. Usually, he or she cannot be swayed by other employees from following a predetermined course. The owner might not actually say, "it's my way or the highway," but actions speak louder than words.

It should be noted that the aristocratic management style has some benefits—for instance, it can result in quick decision-making and a steadfast pursuit of excellence—but the detriments are obvious. Most important, employees generally will not want to work under these conditions, and their performance will often reflect their disenchantment. Accordingly, the aristocratic style is not as common as it once was.

2. **Paternalistic style**: With this type of approach, the manager expresses greater concern about the welfare of workers. In fact, the business owner may act more like a "father" or a "mother" than the person in charge. Frequently, the owner will go so far as to put the interests of the employees ahead of the success or failure of the company.

Although some employees enjoy working for paternalistic managers, others may find it condescending or uninspiring. Again, this management style is more indicative of days gone by and is largely disappearing in the current business climate.

3. **Democratic style**: In contrast, the democratic style of management appears to be gaining in popularity. A democratic manager empowers employees to make more decisions on their own. Employees can grow on the job, but they are also likely to make mistakes. The manager's intention is that they learn from these mistakes and make the necessary adjustments.

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The democratic style requires managers to show more faith in employees. It can be beneficial in the future, but could create short-term problems. Employees may be slow to make decisions on their own. Even worse, a significant mistake by an empowered employee could be devastating to the company.

Clearly, there is no "right" or "wrong" method. You should find the management style that best suits your personality and your business needs. It may be sensible to combine elements of all three styles, or at least two of the styles, into a singular approach. In any event, remember that employees are looking for you to show the way.

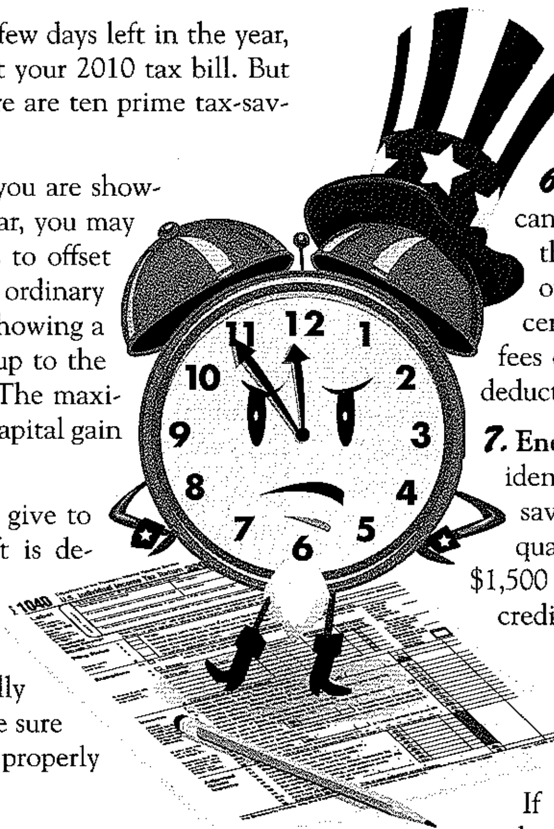
The Clock Is Ticking: Ten Last-minute Tax Moves

Quick ways to reduce your 2010 tax liability

Although there are precious few days left in the year, it is still not too late to cut your 2010 tax bill. But you may have to move fast. Here are ten prime tax-saving ideas to consider.

1. Capital gains and losses: If you are showing a net capital gain for the year, you may realize losses from security sales to offset the gain, plus up to $3,000 of ordinary income. Conversely, if you are showing a net loss, any gains are tax-free up to the amount of the loss. **Reminder:** The maximum tax rate on net long-term capital gain in 2010 is 15%.

2. Charitable donations: If you give to charity via credit card, the gift is deductible in 2010 as long as it is posted by the credit card company before the end of the year. It does not matter if you actually pay off the charge in 2011. Make sure that all charitable donations are properly substantiated.



3. State and local taxes: If you prepay next year's state and local taxes, you can increase your current deduction. However, do not prepay if you expect to owe the alternative minimum tax (AMT) this year, because these taxes are not deductible for AMT purposes.

4. Dependency exemptions: If your child is younger than 19, or a full-time student younger than 24, you can generally claim a $3,650 dependency exemption for the child if you provide more than half of his or her support. You might give some end-of-year support—perhaps a generous holiday gift—to push you over the threshold.

5. Medical expenses: Medical expenses are deductible to the extent your annual total exceeds 7.5% of your adjusted gross income (AGI). If you have cleared this threshold in 2010, you can schedule routine medical or dental examinations for December. Otherwise, you might postpone these visits.

6. Miscellaneous expenses: Similarly, you can deduct miscellaneous expenses only to the extent the annual total exceeds 2% of your AGI. Therefore, you might pay certain expenses—like safe deposit box fees or tax advisory fees—to maximize your deduction for 2010.

7. Energy credits: The tax law provides a residential energy credit for certain energy-saving installations made in 2010. If you qualify, you can claim a 30% credit up to $1,500 this year (reduced by the amount of the credit claimed in 2009).

8. 401(k) contributions: There is still time to boost your retirement nest egg by allocating part of your last paycheck to your 401(k) account. If you have cleared the Social Security wage base of $106,800 for 2010, you can use the payroll tax savings without reducing your take-home pay.

9. Hybrid vehicles: If you are in the market for a hybrid vehicle, make your purchase before 2011. You may be entitled to a special tax credit. **Caveat:** Credits are phased out for several popular models.

10. Mutual funds: Generally, it is beneficial to sell mutual fund shares before the fund declares dividends (the ex-dividend date) to avoid tax. Similarly, you may acquire shares after the ex-dividend date has passed.

Depending on changes in the tax law, you might bypass some of these ideas. Of course, everyone's situation is different. Obtain professional assistance in this area before you take any action.

Highlights of the New Small-business Law

Tax breaks intended to stimulate the economy

The new Small Business Jobs and Credit Act—signed by the president on September 27, 2010—provides several tax breaks designed to stimulate the economy. Here's a summary of the key provisions in the new law of interest to employers:

♦ **Section 179 deductions:** Under Section 179 of the tax code, your business may currently deduct (i.e., "expense") the cost of qualified assets placed in service during the year. The maximum deduction is phased out for purchases above an annual threshold.

Previously, the maximum deduction for 2010 was $250,000, with an $800,000 phaseout threshold. The new law increases the maximum deduction for 2010 and 2011 to $500,000, with a $2 million phaseout threshold. The new law also allows a maximum Section 179 deduction of $250,000 for qualified real estate for 2010 and 2011.

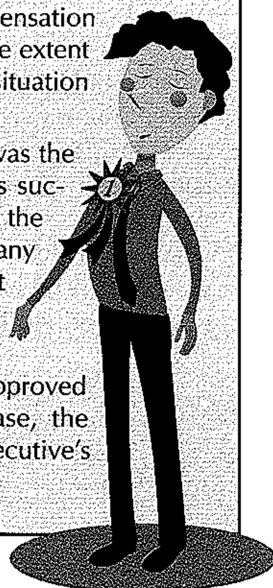
♦ **Bonus depreciation:** The "bonus depreciation" deduction for qualified business assets expired after 2009. The new law retroactively extends the deduction for assets placed in service in 2010 (through 2011 for certain assets). If you qualify, you can deduct an amount equal to 50% of the cost (after any Section 179 deduction).

Reasonable Comp for a Dynamo

A corporation can deduct the compensation it pays to employees, but only to the extent it is "reasonable" in amount. Each situation is decided on its own merits.

New case: A firm's sole executive was the driving force behind the company's success. He controlled all facets of the business operation. When the company had a record sales year in 2002, it rewarded the executive with a $1.9 million bonus.

Based on the facts, the Tax Court approved the deduction. **Reason:** In this case, the bonus was warranted by the executive's dynamic performance.



♦ **Capital gains exclusion:** Prior to the new law, you could exclude 75% of the gain from qualified small-business stock (QSBS) acquired between February 17, 2009, and January 1, 2011, for stock held more than five years. The new law increases the exclusion to 100% for acquisitions made from September 28, 2010, through December 31, 2010. It also removes the exclusion for QSBS as a tax preference item for alternative minimum tax (AMT) purposes. It is expected that these provisions will generate a slew of new business ventures by entrepreneurs.

♦ **S corporation BIG tax:** If a C corporation converts to S corporation status, it may have to pay the built-in gains (BIG) tax on gains realized in its first ten years of operation. The ten-year period was shortened to seven years for gains realized in 2008 and 2009. Now, the new law reduces the recognition period still further to five years for gains realized in tax years beginning in 2011.

♦ **Business credits:** Normally, general business credits—such as the research and Work Opportunity Tax Credit (WOTC)—cannot be used to offset the AMT. Under the new law, a qualified small business is allowed an offset for 2010. The new law also authorizes businesses to carry back these credits for up to five years.

♦ **Health insurance deduction:** For 2010 only, the new law permits self-employed individuals to reduce self-employment income by the amount of their deductible self-employed health insurance.

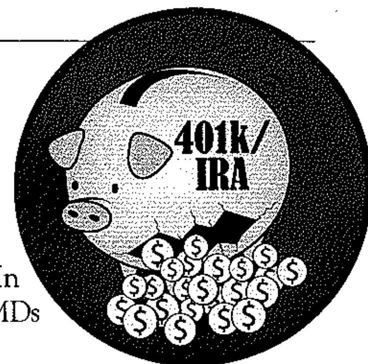
♦ **Start-up expenses:** The new law increases the maximum $5,000 deduction for qualified start-up expenditures to $10,000 for 2010 only. It also increases the phaseout threshold from $50,000 to $60,000.

But not all the tax news is favorable. Taxpayers who receive rental income from real estate and incur expenses of $600 or more must now file information returns with the IRS and their vendors.

Finally, the new law creates a special fund of $30 billion to help increase small-business lending by banks. Contact your professional advisers for more details.

Resume RMDs from Retirement Plans

End of temporary reprieve for retirees



Unlike the past year, retirees may have to take required minimum distributions (RMDs) from their 401(k) and traditional IRAs before the end of the year. The one-year reprieve from this obligation is over. Now it's back to business as normal for retirement-savers.

Background: Distributions from qualified retirement plans and IRAs are taxed at ordinary income rates reaching as high as 35% in 2010. In addition, you must pay a 10% penalty tax on distributions prior to age 59½, unless a special exception applies. (On the other hand, RMDs are not required for Roth IRAs.)

Usually, you must begin taking RMDs no later than April 1 of the year following the year you turned age 70½. For instance, if you turned age 70½ this year, the first distribution must occur by April 1, 2011.

However, there is an exception to these rules if you are still working on a full-time basis and you are not a 5%-or-more owner of the employer. In this case, you can postpone RMDs until your retirement.

To soften the impact of the economic downturn, a 2008 law temporarily suspended the RMD rule for IRAs and defined contribution plans—such as 401(k) and 403(b) plans—for the 2009 tax year. Now that the one-year waiver has expired, you must resume taking RMDs for 2010. **Note**: The one-year waiver did not apply to participants in defined benefit plans such as pension plans.

How much do you have to withdraw? The amount of the annual RMD is based on IRS life expectancy tables for the participant and the value of the account on the last day of the previous year. In other words, your RMD for the 2010 tax year depends on your balance as of December 31, 2009—even though you are taking it almost one year later.

If you fail to comply with the rules, the IRS may impose a harsh penalty equal to 50% of the amount that should have been withdrawn (or the difference between the required amount and a lesser amount actually withdrawn). The penalty is added to the regular income tax due for the RMD.

In summary: Do not leave things to chance. Consult a professional adviser regarding the rules for distributions from qualified retirement plans and IRAs.

Give Us A Call!

*Do you have any questions or comments about **Client Information Bulletin** or your individual situation? Please do not hesitate to contact our office. We would be glad to serve you in any way we can.*

Facts and Figures

Timely points of particular interest

➡**Grandfather Plans**—A health insurance plan that qualifies for "grandfather" status does not have to comply with all the expansive health care reforms in the new Patient Protection and Affordable Care Act (PPACA) signed on March 23, 2010. But employers may lose this favorable status if they switch insurance carriers or increase out-of-pocket costs of employees. Consult your business advisers.

➡**Estate-tax Discount**—The estate-tax value of a closely held business may be discounted by a potential built-in gains tax. **New case**: The owner of a closely held company, which owned real estate, died in 2005. The estate deducted the full amount of capital gains tax that would be due if the real estate was sold because the deal would likely include a discount. **Result**: The Tax Court basically followed the estate's approach.

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