

# client focus

## 2009 Tax Updates: The Good, the Bad, and the Actionable

The past year has been a mixed bag for taxpayers in terms of new tax legislation. In addition to the usual tax-code wrangling that takes place on Capitol Hill every year, Congress and the Obama administration responded to the market downturn by passing several laws aimed at easing the burden of the recession.

This article looks at some of the most important legislative changes and describes steps investors can take during the last few weeks of 2009 to minimize their tax bill come April 15, 2010.

### The Good

- **Roth IRA conversions available to everyone starting in 2010:** Starting on January 1, 2010, everyone, regardless of income, will be allowed to convert funds already invested in a traditional IRA to a Roth IRA. See the article "Does a Roth IRA Conversion Make Sense for You?" on page 6 for more details about this conversion opportunity.
- **Tax-free withdrawals from annuities for long-term-care expenses:** Starting January 1, 2010, withdrawals from nonqualified deferred annuities with long-term-care insurance riders will be tax-free if used to pay for qualified long-term-care expenses.
- **Private-purpose municipal bonds no longer subject to AMT:** Housing and airport bonds are often classified as private-purpose bonds, which means the interest income on these bonds could be subject to the alternative minimum tax (AMT). The fiscal stimulus package passed in 2009 included a provision that exempted any bonds issued in 2009 or 2010 from AMT treatment for the life of the bond.
- **Exemption and deduction "phaseouts" scheduled to disappear...for now:** The income-based reduction, or "phaseout," of most itemized deductions and personal exemptions is scheduled to be eliminated in 2010. But the Obama administration has proposed reinstating these phaseouts in subsequent years.
- **Potential extension of IRA charitable rollovers:** A bill to permanently extend IRA charitable rollovers, which permit IRA owners age 70 1/2 and older to donate up to \$100,000 directly from an IRA to a charity, has been introduced in both houses of Congress. A one- or two-year extension seems more likely, however, given current budgetary concerns.

### The Bad

- **Brace for the AMT, again:** If Congress does not act before the end of 2009, AMT exemption amounts for individuals are scheduled to drop drastically in 2010. In addition, most nonrefundable personal credits will not be available to offset the AMT.
- **Inflation adjustments for 2010 de minimus:** Because of low inflation over the past 12 months, many of the inflation-based components of the tax

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fourth quarter 2009

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# Does a Roth IRA Conversion Make Sense for You?

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investor plans to contribute to charity, it may be more beneficial to keep a traditional IRA because of the potential tax deductibility of charitable gifts. On the other hand, an investor who does not plan to tap the IRA during retirement, thanks to the availability of other income sources, would likely benefit from a conversion. The lack of required minimum distributions and the availability for tax-free distributions make Roth IRAs a powerful estate-planning tool.

Fortunately, Roth conversions are not an all-or-nothing proposition. As a result, you could do a Roth conversion on the portion of your IRA that you intend to pass to your heirs and leave the portion earmarked for charitable contributions in the traditional IRA. It should be noted, however, that the conversion cost is calculated on a weighted average of all traditional IRA

contributions; you can't simply convert the portion that would incur the lowest conversion cost.

It is also possible to undo a Roth conversion if account value decreases after the conversion, potentially mitigating the market-timing risks. Contact your William Blair & Company financial advisor to discuss whether a Roth IRA conversion makes sense for you and your specific circumstances and time frame.

*This information has been prepared solely for informational purposes and is not intended to provide or should not be relied upon for accounting, legal, or tax or investment advice. Please consult with your tax and/or legal advisor with regard to your individual circumstances.*

## Third Quarter 2009 - William Blair & Company Initiated Research Coverage on the Following:

Ticker Symbols	Company	Sector	Industry
AAPL	Apple Inc.	Technology	Digital Media
ARG	Airgas, Inc.	Business Services	Industrial Distribution
ARST	ArcSight, Inc.	Technology	Security Technology
ATHR	Atheros Communications, Inc.	Technology	Communication Semiconductors
AXP	American Express Company	Financial	Specialty Finance
BEAT	CardioNet, Inc.	Healthcare	Healthcare Services
BIIB	Biogen Idec Inc.	Healthcare	Biotechnology
BRCD	Brocade Communications Systems, Inc.	Technology	Data Networking and Storage
CAVM	Cavium Networks, Inc.	Technology	Communication Semiconductors
CERN	Cerner Corporation	Healthcare	Healthcare Information Technology
CFN	CareFusion Corporation	Healthcare	Medical Devices
CHKP	Check Point Software Technologies Ltd.	Technology	Security Technology
DFS	Discover Financial Services	Financial	Specialty Financial
EM	Emdeon Inc.	Healthcare	Healthcare Information Technology
EVR	Evercore Partners Inc.	Financial	Financial Services
EXLS	ExlService Holdings, Inc.	Business Services	Business Process Outsourcing
FUQI	Fuqi International, Inc.	Consumer	Hardlines
G	Genpact Limited	Technology	Business Software & Services
GHL	Greenhill & Co., Inc.	Financial	Financial Services
HEAT	SmartHeat Inc.	Business Services	Industrial Technology
IDIX	Idenix Pharmaceuticals, Inc.	Healthcare	Biotechnology
LNN	Lindsay Corporation	Business Services	Filtration and Water Management
MAN	Manpower Inc.	Business Services	Staffing
MFE	McAfee, Inc.	Technology	Security Technology
MYGN	Myriad Genetics, Inc.	Healthcare	Diagnostic Services
NETL	NetLogic Microsystems, Inc.	Technology	Communication Semiconductors
NZ	Netezza Corporation	Technology	Business Software & Services
PEGA	Pegasystems Inc.	Technology	Business Software & Services
QDEL	Quidel Corporation	Healthcare	Diagnostic Products
SLAB	Silicon Laboratories Inc.	Technology	Communication Semiconductors
SYKE	Sykes Enterprises, Incorporated	Business Services	Business Process Outsourcing
TTEC	TeleTech Holdings Inc.	Business Services	Business Process Outsourcing
TYL	Tyler Technologies, Inc.	Technology	Specialty Technology
VRTX	Vertex Pharmaceuticals Incorporated	Healthcare	Biotechnology
VRUS	Pharmasset, Inc.	Healthcare	Biotechnology
WNS	WNS (Holdings) Limited	Business Services	Business Process Outsourcing

As of September 30, William Blair & Company had initiated coverage of 66 companies this year and had 414 companies under coverage.

William Blair & Company makes a market in these securities.

# 2009 Tax Updates: The Good, the Bad, and the Actionable

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code will not undergo cost-of-living adjustments for 2010; these include the standard deduction for most taxpayers, personal exemption amounts, and IRA contribution limits. Other parts of the tax code will undergo minimal increases for 2010, including some tax-bracket thresholds and deductible contribution limits to health savings accounts.

• **Wealth surtax being considered in Congress:** Part of the healthcare reform proposals being debated in Congress include the creation of a new surtax of up to 5.4% on wealthy individuals and business. The new tax would raise an estimated \$544 billion over 10 years and could push the top marginal tax rate as high as 45%, up from 35%. The wealth surtax would begin at income levels as low as \$280,000 for single taxpayers and affect all types of income.

## The Actionable

• **Take advantage of tax breaks scheduled to expire:**

There are a host of tax breaks available in 2009 that will not be available next year unless Congress acts to extend them. This list includes:

- Option to deduct state and local sales and use taxes instead of state income taxes
- Standard or itemized deduction for state sales and excise tax on the purchase of motor vehicles
- Above-the-line deduction for qualified higher-education expenses
- \$8,000 first-time homebuyer credit and \$6,500 credit for existing homeowners who have lived in their current home for at least five years; both credits apply to binding purchase contracts signed before May 1, 2010 and closed before July 1, 2010.
- Special deduction for state and local sales and excise taxes on the purchase of a new vehicle before January 1, 2010; this applies to

joint filers with modified adjusted gross income below \$260,000

• **Understand your required-minimum-distribution options in 2009:** Required minimum distributions (RMDs) from IRAs and employer-sponsored retirement plans, such as 401(k)s, are waived for 2009 only. Ordinarily, upon reaching age 70 1/2, you must begin taking RMDs from IRAs and, if you are retired, from employer-sponsored plans. Congress voted to waive RMDs for 2009 so investors would not be forced to take distributions on the heels of a drastic market downturn.

• **Perennial year-end tax-planning techniques:** In addition to the recommendations above, which are specific to 2009 tax-law changes, the following techniques can be effective year-end tax-planning strategies in any year:

- Postpone recognition of ordinary income until next year and accelerate deductions into the current year
- Contribute to IRAs, 401(k)s, or other tax-advantaged retirement accounts
- Make charitable donations
- Take advantage of the annual gift-tax exclusion amount, which is \$13,000 for individuals and \$26,000 for married couples
- Use up flexible-spending account balances; any amounts left in the account as of May 15, 2010, will be forfeited
- Look for opportunities to offset capital gains, and in some cases ordinary income, with capital losses; consult your tax advisor for details of the netting process for capital gains and losses

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## Have You Scheduled Your Annual Fiscal?

Just like annual physical examinations with your physician, an annual review of your portfolio's status with your financial advisor is a healthy practice. In addition to discussing any changes to long-term financial goals or reviewing asset allocations, an annual meeting with your advisor is an excellent opportunity to review charitable strategies, discuss estate plans, retirement, family legacy, and other important issues.

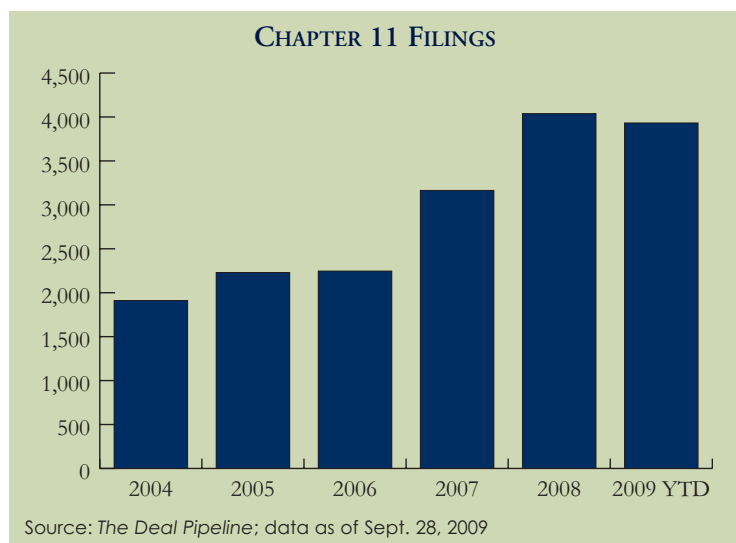
Please contact your William Blair & Company financial advisor to obtain more information or to request one of our brochures: Financial Health Checklist, A Differentiated Approach to Private Wealth Management, Financial Independence: Planning for a Successful Retirement, Education Financing Options and Analysis, Concentrated Stock Positions: Managing Risk and Reward, and Asset Allocation and Portfolio Management.

# Strategic Alternatives for Distressed Companies

The credit crisis and recession have created challenging conditions for public and private companies across many industry sectors. As a result, the past two years have been two of the busiest of Geoffrey Richards's career.

As the head of William Blair & Company's Special Situations and Restructuring Group, Richards advises companies confronting difficult market conditions, liquidity crises, and other issues adversely affecting cash flows and profitability. Richards, who in June was named Restructuring Financial Advisor of the Year by Global M&A Network, has advised on more than 30 deals since November 2007.

Chapter 11 bankruptcy filings averaged 2,129 a year between 2004 and 2006. That figure skyrocketed to 4,039 in 2008, and 2009 is well on pace to surpass that mark. Although economic activity stabilized in the second and third quarters of 2009, Richards said leading indicators such as high unemployment, depressed home values, and reduced consumer spending point to continued high levels of bankruptcy activity for the next several quarters.



Against this backdrop, Richards discussed Chapter 11 and the other strategic alternatives available to companies facing liquidity crises during a September 29 Financial Talk Series webinar.

"Both on an out-of-court and an in-court basis, there are a number of different alternatives companies should be exploring in this cycle as a way to preserve going-concern value," Richards said.

One example of an out-of-court sale process that has generated an increasing amount of interest recently is the Article 9 sale. Relative to Chapter 11 bankruptcies, an Article 9 sale is both cheaper and faster, with some transactions closing in under 30 days. Because they can be private transactions, Article 9 transactions also can minimize the impact on customers, suppliers, and employees. "It enables a sale to be conducted in a way that does not create an impression in the marketplace that the company

might be experiencing some degree of financial distress," Richards said.

Article 9 sales, however, are not appropriate for every situation, particularly larger and more complex cases, Richards said. One primary limitation of Article 9 sales is that they cannot involve the sale of real estate. Other limitations include the inability to extinguish liens senior to the secured creditor exercising its Article 9 rights, the threat of the selling company getting caught up in a bankruptcy proceeding, and potential risk of challenges to the validity of the transaction.

The most prominent type of Chapter 11 transaction for distressed companies is a Section 363 sale, Richards said. The timeline for these proceedings has been compressed in the current environment because of liquidity concerns, lender impatience, and a reduced amount of DIP financing. The primary benefits of a Section 363 sale include assurance to the buyer that assets are purchased free and clear of liens, claims, and encumbrances and the value creation that comes from a public sale process. "The 363 process really taps into the entire universe of potential buyers, unlike most out-of-court sale processes," Richards said.

He then described the pros and cons of the two primary types of 363 sale—naked auctions and auctions with stalking horse bids. Richards said the market for identifying bidders has become more diverse in today's environment. In addition to increasing interest by foreign bidders, existing sponsors and lenders are taking more aggressive roles in becoming owners of the business, according to Richards.

Debt restructuring offers additional strategic alternatives for distressed companies. Richards said purchasers of existing debt can include third parties, opportunistic lenders such as hedge funds, and industry competitors. He said the terms of the underlying credit agreement dictate who can purchase the debt. Other potential purchasers include existing equity owners or junior debt holders who are looking to move themselves up in the capital structure as a way to protect their junior position.

An extend-and-amend transaction is one more debt restructuring option to be considered, Richards said. In this type of transaction, lenders extend the maturity date in exchange for better loan terms, such as a higher interest rate or different covenants. "This strategy ends up buying the borrower time to try to deleverage the balance sheet by improving earnings, cutting costs, or doing other things that give the company some breathing room by kicking out the maturity date and repayment schedule," he said.

Richards also noted that debt-for-equity swaps have become increasingly common in the current environment as certain lenders are more aggressive in their attempts to preserve value.

*William Blair & Company clients can view the entire webinar by logging into Investor Annex at [www.williamblair.com](http://www.williamblair.com).*