The Oregonian

A buyout with a blessing and a tax bite

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Stalwarts of Portland-based Willamette Industries may be sorry to see their venerable Oregon company disappear down Weyerhaeuser's hatch, but at least the Federal Way, Wash., timber company is paying a good price for the meal.

The $55.50-a-share buyout price -- a 60 percent premium for Willamette shares -- is a two-edged sword for stockholders: It bears the blessing of a windfall and the curse of a potentially big tax bill for those who hold shares outside a sheltered retirement plan.

The cash buyout also offers investors and retirement savers a golden opportunity to think hard about where they'll reinvest the money to the best advantage and how diversified those investments will be.

Enron employees who loaded up on their company stock and then couldn't sell it can only dream about such a second chance.

In this column, we talk about the need to diversify your holdings and how to mitigate the tax burden if you have capital gains.

Diversify your plan

Willamette and Weyerhaeuser say the details still are being worked out, but employees who own Willamette stock in their 401(k) have some choices to make.

They'll receive cash for their stock within the 401(k). Employees who tender their shares by this week's deadline will get the cash sooner, but even those who wait to tender will see their shares converted to cash, probably in mid-March.

The price of $55.50 will be the same, so considering the time value of money, it makes sense to tender the shares and get the dough sooner rather than later. Instructions on how to tender appear in an accompanying story.

Once their shares are converted to cash, Willamette employees probably will have a chance to invest in the other options in Willamette's 401(k). Down the road, the Willamette 401(k) could be transferred into Weyerhaeuser's, but neither company was willing to speculate about that late last week.

"This is a case where, if you owned a lot of Willamette stock in your plan, you really made out," says Suzanne Rague, a Portland investment adviser. "It's the flip side of Enron.

"It's an opportunity to diversify," she adds, "to say to yourself, 'Wow, I lucked out. Now I should take a look at my account -- am I diversified enough? Should I sell something?' "

Diversification means owning different asset classes -- stocks, bonds, cash -- in different industries and locales. If one or two hit the skids, your whole retirement doesn't crash.

Another reason to cut your concentration of company stock in a 401(k) -- or, in the case of retired employees, a rollover IRA -- is that you'll have to pay ordinary income tax rates on your gains when you start withdrawing money from your account.

When you sell stock outside a retirement plan, you generally will pay 20 percent capital gains on shares you've held longer than a year. If you sell them inside a plan and then pull out the money, you could pay up to 38.6 percent federal income tax, depending upon your bracket.

To take advantage of the difference in tax rates, financial planners often suggest that you put income-generating investments such as bonds, preferred stocks or CDs inside your tax-deferred plans and keep common stocks and stock mutual funds outside.

Warning to share donors

Investors who own Willamette shares outside of retirement plans and IRAs will have immediate tax consequences this year.

For profits on shares owned for a year or less, the tax is assessed at ordinary income tax rates. The profits on shares owned longer are taxed at lower capital gains rates: 10 percent for those in the lowest bracket and 20 percent for others.

Shareholders who donated shares before the Willamette deal was a sure buyout will get benefits to reduce the tax on the rest of their gains. They won't have to report any gain for tax purposes on the shares they donated, and they'll get a tax deduction equal to the shares' market value.

Several gifts, for example, of from $50,000 to $500,000 in Willamette stock recently have been given to the Oregon Community Foundation, reports James Draznin, charitable gift planner at the foundation.

But if you haven't done it already, it's too late if you're seeking tax benefits. Yes, the tender offer is still open and the deal hasn't officially closed. But shareholders who want to exclude the gain on shares donated now, after Willamette's board of directors has approved the buyout, will be on thin ice with the Internal Revenue Service.

The tax court has held, and the 9th Circuit U.S. Court of Appeals has affirmed, that donors can't exclude their capital gains on stock even if it is given before a deal's official close. It's enough that the deal be "practically certain."

In the 1999 case, Ferguson v. Commissioner of IRS, two Idaho couples wanted to exclude gains on stock they had donated to charities before the deal closed but after the buyout was certain.

But the 9th Circuit nixed the notion, saying, "Any tax lawyer worth his fees would not have recommended that a donor make a gift of appreciated stock this close to an ongoing tender offer and a pending merger."

The court said finding the fine line between tax avoidance and tax evasion is "dangerous business" -- and added that "we will not go out of our way to make this dangerous business any easier for taxpayers who knowingly assume its risks."

Ouch.

De non desperandum

If you missed that boat, do not despair. You've still got 11 months to catch another strategy, says Adam P. Cohen, a West Hartford, Conn., certified public accountant and consultant to nonprofits. He's been following the Willamette deal and suggests several other steps if you're staring at a fat tax liability:

Donate other stock in which you have little invested and a big gain. Then get a deduction, subject to a limit of 30 percent of your adjusted gross income.

Cohen notes the case of an investor who normally has an income of $50,000. Now, she also has a $50,000 gain on her 1,000 Willamette shares.

After deductions, her taxable income jumps from the usual $30,000 to $80,000. She ends up paying $21,000 in state and federal tax, $14,500 more than her usual bill.

But if she donated $30,000 worth of another stock to charity, she'd boost her deductions and reduce her taxes to $11,400 -- nearly $10,000 less than if she hadn't made the donation.

Take some losses. Capital losses may be offset against capital gains, so review your holdings with an eye toward selling some losers to offset your gains.

Use year-end planning techniques now. Try to bunch every deduction you can into 2002 and try to shift all the income you can into 2003.

Get tax advice. How you treat a big lump sum can affect the tax on your Social Security, tip you into the alternative minimum tax quagmire or open up more gifting possibilities that yield income and tax benefits. If you need a CPA, call the Oregon Society of CPAs at 503-641-7200, ext. 11, or visit its Web site (www.orcpa.org).

Bite the tax bullet. "Taking the cash and paying the tax on the gain is not a bad outcome," Cohen says.

If you've owned the stock for ages, you don't have much in it, aside from the sentiment. Even a 29 percent federal and state bite leaves you with a nice souvenir of a great old Oregon company. Enjoy your good fortune.

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