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Client Information Bulletin

December 2008

Business Owners: Do You Have a Plan for 2009?

Five ways the business may benefit

Before you know it, another year will be here. If you are like many small-business owners, you have had to take your lumps in 2008. Revenues have been down and outstanding debts have been up. What can you do to improve your situation next year in this uncertain economy?

Start with a plan. Specifically, we are referring to a comprehensive business plan. The plan may serve as a blueprint for the coming year. Here are five good reasons for putting such a plan in place.

1. **The plan charts a path.** It can help tell you where you are, where you are going and how to get there. Of course, the plan does not have to be permanent (nor should it be). For instance, certain new developments may require some slight deviations from your original plan.

However, your business decisions probably will be more solid if they are made within the context of the original plan. If something is way off base, it should raise suspicions.

2. **The plan enables you to be proactive.** Instead of addressing problems as they arise, a business plan is a proactive step. Committing yourself in a document requires a great deal of discipline, but going through the process is worth it.

For example, a hastily conceived plan of action will not look as appealing when you see it in writing. One might even argue that the experience of assembling the plan is more worthwhile than having the plan itself.

3. **The plan can improve communication.** First, it forces you to crystallize your vision of the company. Second, it encourages feedback from key players who become involved with the planning. This kind of dialogue may be particularly vital in small firms. **Reason:** Employees have a chance for give and take with the top business managers.

4. **The plan gives you credibility.** It can be especially impressive to creditors and the lending officers of the banks that you deal with. And it may satisfy a psychological need for you and your company to be taken seriously.

5. **The plan can help you raise capital for the company.** For instance, by focusing on accounts receivables in your business plan, you may be able to free up additional funds. Also, it is likely that a lender will require you to present a business plan plus cash projections to obtain a loan.

How do you put together a business plan? In general, most plans include the following: a statement of objectives, strengths and weaknesses;

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position in the marketplace; future direction; critical issues; and so forth. It certainly cannot hurt to obtain input from your professional advisers with regards to the specifics.

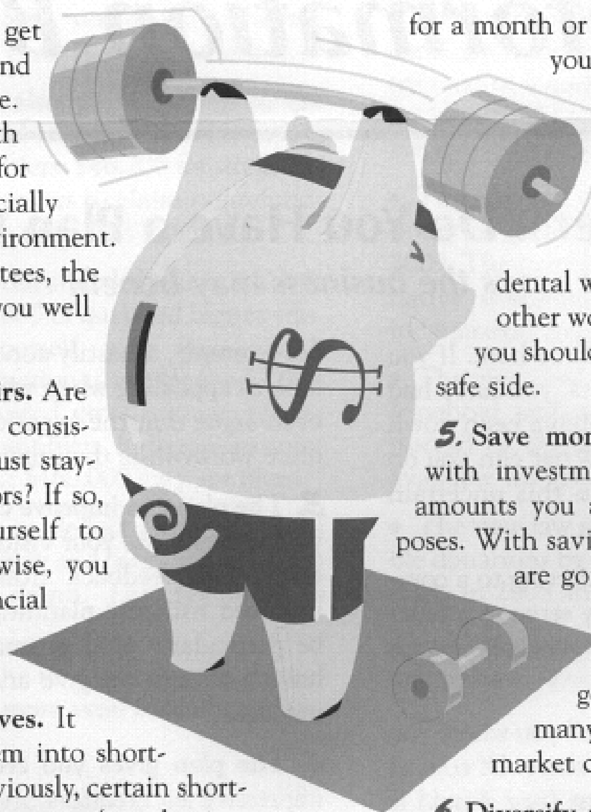
However, be aware that there is no "magic formula" for creating a successful business plan. It's your plan, so you can shape it into a format that seems best suited for your situation.

Final point: *In the usual situation, you will want to make changes in the plan's format from year to year. The important thing is to touch all the bases that are essential to your particular industry.*

Seven Ways to Improve Your Finances

Keys to maintaining financial fitness

It takes a lot of hard work to get into top physical shape … and even more work to stay there. Usually, the effort is well worth it. The same thing is true for staying "financially fit," especially in the current economic environment. Although there are no guarantees, the following regimen can serve you well throughout the coming year.



1. Take control of your affairs. Are you the type of person who consistently overextends yourself, just staying ahead of the bill collectors? If so, you need to motivate yourself to change your lifestyle. Otherwise, you could find yourself in a financial hole you simply cannot dig yourself out of.

2. Write down your objectives. It may be helpful to divide them into short-term and long-term goals. Obviously, certain short-term goals will often take top priority (e.g., buying a new car if your old clunker is breaking down). But don't ignore such long-term objectives as saving for your child's college education or a comfortable retirement.

3. Track income and expenses. If you have more money going out than coming in, you have a problem. Try to keep a detailed record of all your income and expenses for a month or two. This financial exercise may show you where you can cut back (e.g., lavish vacations or entertainment expenses) without doing too much damage.

4. Plan ahead for contingencies. You have to make allowances for unexpected expenses such as emergency dental work, a fender bender or a leaky roof. In other words, if you are currently breaking even, you should still reduce your expenses to be on the safe side.

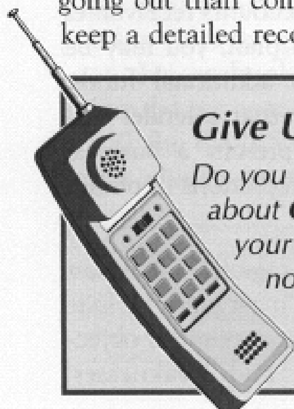
5. Save money to invest. Don't confuse savings with investments. In effect, your savings are the amounts you are setting aside for investment purposes. With savings, you usually know how much you are going to receive in return without risking your principal.

On the other hand, investments generally carry an element of risk. In many cases, your return may fluctuate due to market conditions, economic factors, etc.

6. Diversify your portfolio. It's highly unlikely that you will be able to realize your long-term goals by concentrating on one single type of investment. In fact, there is a greater chance you will get burned. By spreading your investments among several different categories, you may be able to minimize your overall risk.

7. Monitor your investments. Just because an investment plan seems to be working in the short term does not mean it will work forever. You need to make sure that your investments continue to perform up to your expectations. If they don't, it may call for a change in strategy. Finally, you should reassess your goals and needs periodically.

These are just a few basic ideas for improving your overall financial picture. Use them to build a strong financial foundation for the future.



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*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.*

Dividing Up Your Interest Expenses

How to determine tax return deductions

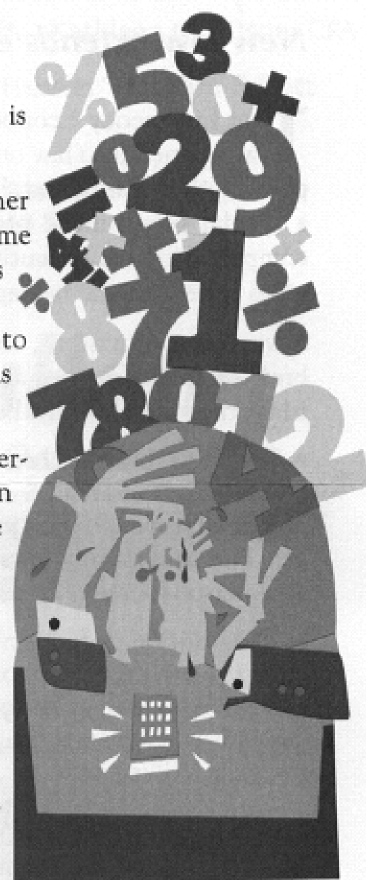
How do you distinguish interest expenses on your tax return? There are four main "baskets" of interest expenses for this purpose (although there are technically other categories of "interest" in the tax law). Here are the key points you should know about.

1 Personal interest: If an interest expense does not fall into one of the other three baskets, it is generally treated as personal interest. Simply put, personal interest is nondeductible. However, there is a key exception for interest paid on student loans. In brief, you can claim a limited deduction for interest paid for qualified higher education expenses—such as tuition, room and board, books and fees—if the loan is in your name. The maximum deduction of $2,500 is phased out for high-income taxpayers.

2 Mortgage interest: As a general rule, you can deduct "qualified residence interest" paid during the year. To qualify, you must be legally obligated to pay the mortgage, and the mortgage must be secured by a qualified home (i.e., your principal residence and one other home). The deduction limit depends on whether the debt is an acquisition debt or a home equity debt.

- **Acquisition debt**: This is a debt incurred to buy, build or improve a qualified home. The interest paid on up to $1 million of acquisition debt is fully deductible.
- **Home equity debt**: Any other qualified debt, such as a home equity loan or line of credit, is treated as a home equity debt. The interest paid on up to $100,000 of home equity debt is fully deductible.

Unlike most other types of interest expenses, the interest on home equity debt may be deducted no matter how the loan proceeds are used. Home equity debt cannot exceed the fair-market value of the home on the last day of the year reduced by the outstanding acquisition debt.

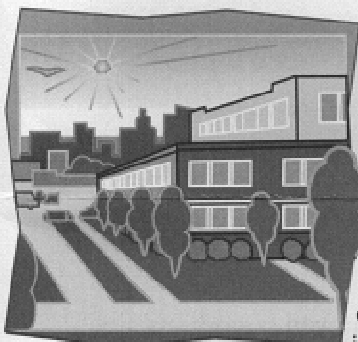


3 Investment interest: If you borrow funds to buy property held for investment purposes (e.g., securities or real estate), the interest paid on the loan is treated as investment interest. The amount of investment interest you can deduct is generally limited to the amount of your "net investment income" for the year. Any excess is carried over to the next year.

Net investment income includes gross income from property held for investment such as interest, annuities and royalties. It does not include capital gains and qualified dividends eligible for tax-favored treatment. The maximum tax rate for long-term capital gain and qualified dividends is only 15% as opposed to ordinary income taxed as high as 35%. However, you can elect to include long-term capital gain and qualified dividends as net investment income if you are willing to forfeit the preferential tax rate.

4 Business interest: The interest incurred in a trade or business, or in the production of rental or royalty income is fully deductible. That's pretty straightforward. Unlike the deductions for mortgage interest and investment interest, there are no limits on deductible amounts.

Of course, this is only a brief summary of the main rules. Obtain professional advice for your situation.



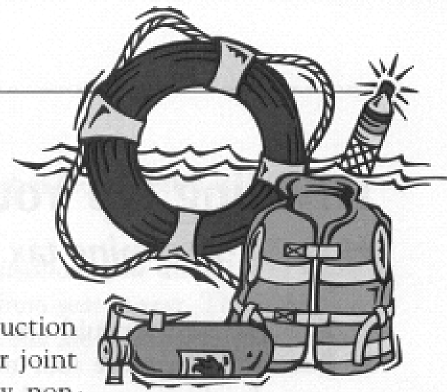
Medical Deductions at Assisted Living Facilities

Is a family member entering an assisted living facility (ALF)? Part of the cost may be deductible as a medical expense.

To qualify for medical deductions, costs must be required for rehabilitation services, maintenance or personal care services for a chronically ill individual. Also, a licensed health care practitioner must establish a plan of care.

Generally, a "chronically ill individual" is someone who is unable to perform at least two of the six activities of daily living (ADLs) without substantial assistance from another person. The ADLs are eating, toiletry, transference, bathing, dressing and continence.

The deductible ALF costs must be properly allocated to health care. **Reminder**: Medical expenses may be deducted only to the extent the annual total exceeds 7.5% of adjusted gross income.



Key Tax Breaks in the Rescue Plan

New law extends expired tax provisions

The Emergency Economic Stabilization Act of 2008 was signed into law on October 3, 2008. This "rescue plan" authorizes the purchase of financial assets through a special government program. It also curbs excessive compensation for executives of financial firms and provides relief to some beleaguered homeowners.

Several tax provisions, including extensions of key tax breaks that had expired after 2007, were added to the legislation at the eleventh hour. Here is a brief rundown.

♦ The new law patches the alternative minimum tax (AMT) again. For 2008, the AMT exemption amount is increased to $69,950 for joint filers; $46,200 for single filers. The patch also allows taxpayers to claim nonrefundable personal credits to reduce their AMT liability.

♦ The "tuition deduction" is reinstated through 2009. It allows you to deduct up to $4,000 of qualified higher education expenses paid for yourself, your spouse or a dependent. However, the deduction is reduced to $2,000 for single filers with an adjusted gross income (AGI) above $65,000; $130,000 for joint filers. It disappears completely if AGI exceeds $80,000; $160,000 for joint filers.

♦ An individual can choose to deduct state and local sales tax in lieu of deducting state and local income taxes on his or her personal tax return. This tax break is extended through 2009.

♦ The new law also extends the new property tax deduction for nonitemizers for one more year. Initially authorized only for 2008, a deduction of up to $500 ($1,000 for joint filers) may be claimed by nonitemizers in addition to the standard deduction.

♦ An educator may deduct up to $250 of unreimbursed classroom expenses. This deduction is extended through 2009.

♦ Under the new law, taxpayers aged 70½ or older may continue to take tax-free IRA withdrawals that are contributed to a qualified charitable organization. The maximum annual contribution remains at $100,000. This tax break is now available through 2009.

♦ The research credit is extended, with certain modifications, for qualified amounts paid or incurred in 2008 and 2009. The modifications include an increase in the alternative simplified credit and repeal of the alternative incremental credit.

♦ The new law enables taxpayers to write off certain leasehold and restaurant improvements over 15 years instead of the usual 39-year period. This tax break is available though 2009.

♦ The new law revives enhanced deductions for charitable donations by businesses of food, books and computers made in 2008 and 2009.

This is just an overview of the key tax provisions. More details are available upon request.

Facts and Figures

Timely points of particular interest

➡**Tax Wrapper on Gifts**—If your company gives small holiday gifts to employees, they may be exempt from tax as de minimis fringe benefits. Reason: It's impractical to value the gifts. But there is no official dollar limit on this tax break. Example: In a new private ruling, a firm did not impose any tax on gifts it valued at less than $50. But the IRS said the firm could not use a plan with this arbitrary limit to determine tax-free fringe benefits.

➡**Expanding Workforce**—How can you smooth out the transition when you acquire a new company? Before the ink has even dried, establish an integration plan addressing everything from titles and business cards to strategic development. Make the newcomers feel welcome and part of the group. Finally, remember consolidation takes time.

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