Burke, Montague & Associates L.L.C.

Certified Public Accountants, Advisors & Auditors

Members - Partners: Charles R. Burke, CPA Jodi K. Gill, CPA Raymond J. Raymond, CPA Kathleen C. Wilson, CPA

Professionals: Randall Hill, CPA Sheila Hessler, BS Robert Owens, CPA Richard Schiltz, CPA

Consultant: Robert J. Montague, CPA

253 West Broadway, Bradley, Illinois 60915 Phone 815.933.5641 Fax 815.939.0016
33 North Main, Manteno, Illinois 60950 Phone 815.468.8802 Fax 815.468.8805

Toll Free 800.272.8753 • www.mybmacpa.com

Client Information Bulletin

March 2010

How to Choose Your Business Successor

Practical ideas for picking the next leader

Say you have spent most of your adult life building a small start-up business into a thriving company. At long last, you may be preparing to step away from the business or at least scale back your heavy workload. After all, you deserve it.

But whom will you pick to run the company when you are not around on a full-time basis? Finding someone to "fill your shoes" may not be an easy task. You will probably want someone to carry out your legacy.

Usually, this will be another family member, but it might also be a longtime employee who knows the business inside-and-out. In either event, you should try to ensure that your choice will not throw the business into a tailspin or irreparably damage any family relationships.

Here are several suggestions you might follow when choosing the next leader of your company:

♦ Make your future intentions clear to the rest of the family. Don't suddenly spring it on them that you have decided to walk away. Give them some time to get used to the idea.

♦ Do not make any hasty decisions. Draw up a list of the attributes each individual brings to the table. Also, consider each candidate's negatives. Try to avoid preconceived notions and focus on actual performance.

♦ Schedule a family retreat over a long weekend to discuss the need for a successor. Give other family members a chance to express their opinions about who should be leading the company. To avoid the usual distractions, try to hold the retreat in a remote location, or at least far away from the main office. Include all family members, including in-laws, in the invitation.

♦ If a clear successor does not emerge right away, or if multiple family members are interested in taking the helm, develop a job description to cut down the emotional aspect of the decision. State what the job requires in terms of talent, expertise and personality.

♦ If no family members are up to the task or if they do not want the responsibility, consider a nonfamily leader. Typically, a business will already employ a manager who understands your values and can be groomed to lead the company. If not, you might use an executive search firm to identify candidates.

♦ Seek advice from an outside board of directors, if you have one, or from professionals or consultants familiar with your business and succession planning.

Keep in mind that choosing the next leader is only part of a succession plan. For instance, you should have a "buy–sell agreement" drafted

Inside

that establishes the value of the business. This is vital not only when you retire but if you decide to sell your business interest or if you should suddenly die or become disabled.

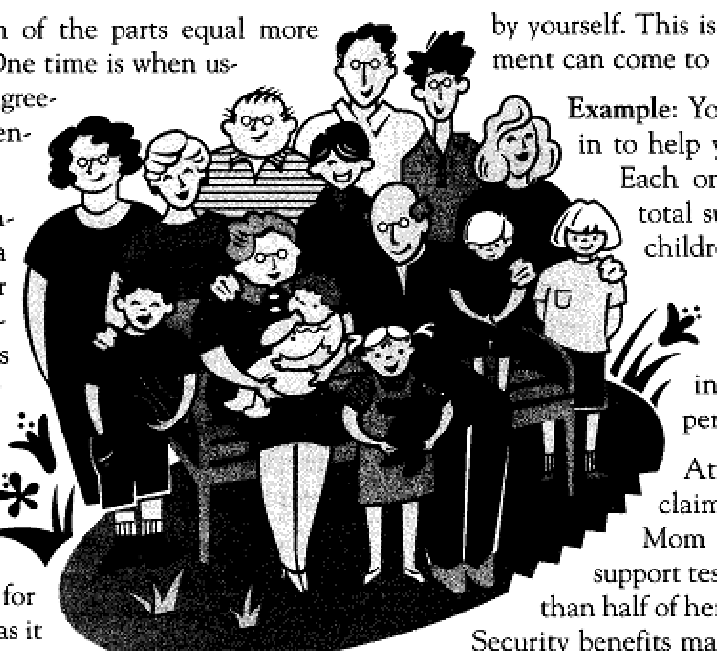
Similarly, a power of attorney can give your successor some flexibility in the event of an unexpected incapacitation. Also, secure adequate life insurance for yourself and other key executives. The proceeds from a life insurance policy could be used to pay estate taxes and to meet other potential liquidity needs.

Finally, coordinate aspects of your business succession plan with your estate plan. Your professional advisers can help you address the key issues and investigate ways to minimize your family's tax burden.

Joining Together to Support a Relative

Use a special agreement for tax benefits

When does the sum of the parts equal more than the whole? One time is when using a "multiple support agreement" to salvage a dependency exemption.



Starting point: As a general rule, you may claim a dependency exemption for someone only if you provide more than half of his or her total support for the year and the dependent's gross income subject to tax is less than the personal exemption amount. The personal exemption amount for 2010 is $3,650 (the same as it is on 2009 returns).

There are, however, several exceptions to these basic rules. For instance, if you pass the half-support test, you can generally claim a dependency exemption for a child who is younger than 19 years (or a full-time student younger than 24 years), regardless of how much annual income he or she earns.

You may even be entitled to a dependency exemption for an elderly relative without meeting the half-support test by yourself. This is where a multiple support agreement can come to the rescue.

Example: You and your two siblings all chip in to help your aging mother pay her bills. Each one of you provides 25% of her total support for the year. So the three children collectively provide 75% of mom's support. She uses her Social Security benefits for the bulk of her support. Her annual investment earnings are below the personal exemption amount.

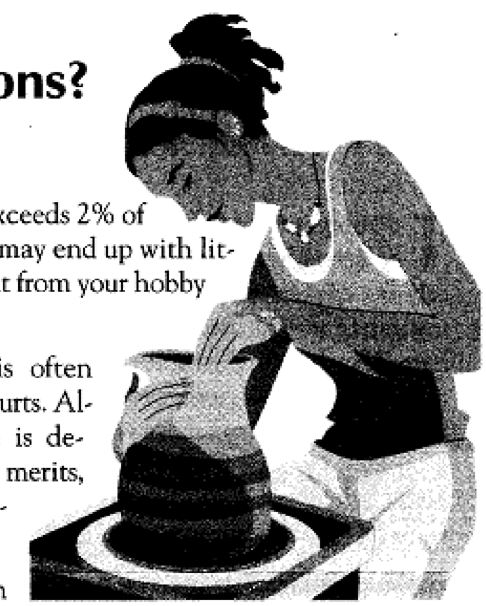
At first glance, none of you can claim a dependency exemption for Mom because no one meets the half-support test. But together you provide more than half of her support. **Note**: Although Social Security benefits may be subject to income tax, they do not count as gross income for purposes of the dependency exemption.

As long as certain other requirements are met, the three children can sign a multiple support agreement, taking effect for the current tax year. A professional tax adviser can help you fill out the necessary paperwork. Under the agreement, one of you is able to claim a dependency exemption for Mom on your tax return. To be fair, you can trade off the exemption from year to year (assuming you still qualify). The person claiming the exemption must provide more than 10% of the relative's support.

Caution: *Be aware that there may be other complications with a multiple support agreement. For instance, some of the tax benefit of personal exemptions is phased out for certain high-income taxpayers on their 2009 returns (e.g., beginning at an AGI of $250,200 for joint filers). Remember this point when you choose the person who is entitled to claim the exemption in any given year.*

Do You Qualify for Hobby Loss Deductions?

Analyze tax factors for sideline activities



For many individuals, a personal passion can turn into a money-making endeavor. It makes a big tax difference if the activity is treated as a business or a hobby.

Here's why: When you operate a business, you can claim a tax loss to the extent your annual expenses exceed your income. In fact, it is not unusual to run losses the first few years of operation. You can use a loss from a sideline business to offset other highly taxed income on your personal tax return, such as wages from your full-time job or investment earnings.

On the other hand, if the activity is one in which you are not engaged in for profit (i.e., it's a hobby), your expenses are deductible only up to the amount of the income received from the activity. In other words, you cannot claim a tax loss. For this purpose, deductions must be claimed against your hobby income in the following order: (1) expenses that would otherwise be deductible (e.g., taxes, interest or casualty losses), (2) operating expenses other than depreciation and (3) depreciation and other basis adjustment items.

Furthermore, if an activity is classified as a hobby, the expenses must be deducted as miscellaneous expenses. Miscellaneous expenses are deductible only to the extent the annual total exceeds 2% of your AGI. So you may end up with little or no tax benefit from your hobby expenses.

The distinction is often contested in the courts. Although each case is decided on its own merits, the following factors are critical:

- The manner in which the taxpayer carries out the activity.
- The expertise of the taxpayer, or his or her advisers.
- The time and effort expended by the taxpayer in carrying out the activity.
- Expectations that assets used in the activity may appreciate in value.
- The success of the taxpayer in carrying out other similar or dissimilar activities.
- The taxpayer's history of income or losses with respect to the activity.
- The amount of occasional profits, if any, that are earned.
- The financial status of the taxpayer.
- Any elements of personal pleasure or recreation.

No single factor on its own is conclusive. But if the factors are heavily weighted in one direction, it can make or break your case.

Key point: The tax law presumes that an activity is not a hobby if you have shown a profit in any three out of the last five consecutive years. This tax presumption is even more lenient for an activity involving the breeding, training, showing or racing of horses. In that case, the activity is presumed to be a business—not a hobby—if it shows a profit in only two of the last seven consecutive years.

Of course, the IRS can rebut the tax law presumption by offering proof that the activity is actually a hobby. Keep detailed records.

Bottom line: *Make sure you are standing on firm ground if you claim hobby loss deductions. A professional tax adviser can provide assistance.*

New Turns in Standard Mileage Rates

The IRS recently announced the standard mileage rates drivers may use in 2010 instead of keeping all the detailed records required for deductible travel. The rates either declined or stayed the same.

The rate for business travel drops from 55 cents per mile in 2009 to 50 cents per mile in 2010. Business-related tolls and parking fees may be added on.

The rate for medical and moving expenses drops from 24 cents per mile in 2009 to 16.5 cents per mile in 2010.

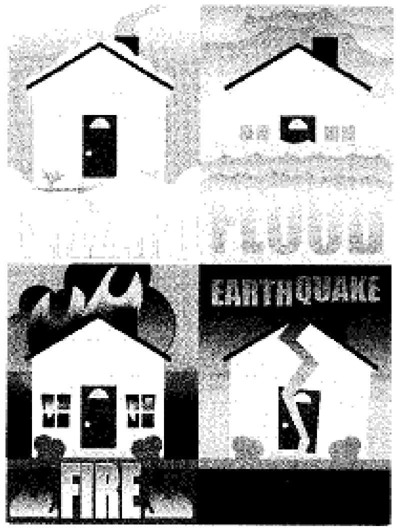
The rate for charitable travel remains at 14 cents per mile for 2010.

Note: The new mileage rate reductions may encourage you to keep more detailed records of your tax-deductible trips.

A Complete View of Homeowners Insurance

When you may need supplemental coverage

To protect yourself financially against catastrophes to your house, you may rely on coverage from your homeowners insurance policy. But don't think that a bare-bones policy is sufficient in every case. You may be surprised to learn that damage from certain events is not covered under your policy. Or, even if a particular event is not excluded, you still may have to pay for some losses on your own.



Basic premise: Typically, a homeowners insurance policy will cover losses resulting from fires, tornadoes and severe storms. But coverage may not extend to floods and earthquakes unless you add a rider to the standard policy. The cost of the rider generally depends on whether you reside in a high-risk area or not.

Similarly, if a water or sewer line backs up, the cost of the cleanup may not be covered by standard homeowners insurance. Again, you may be able to purchase a rider for a relatively modest cost.

What other events are generally not covered? The list can range from damage caused by termites or insects to mold damage in the basement or attic. Also, most policies will exclude damage caused by terrorism, war or nuclear attack. Furthermore, assuming the policy or rider provides benefits based on the property's replacement cost as opposed to its fair-market value, you may be responsible for at least part of the cost of rebuilding a house.

Practical advice: Don't panic. It is relatively easy to fill in the cracks in a homeowners insurance policy. First, find the relevant papers. They may be buried in a drawer or a dusty file cabinet. Assess your exposure to some common risks. Ensure that you have the necessary riders in place or secure them from your insurer.

Another possibility is to supplement your current coverage with an "umbrella" policy. As the name implies, an umbrella policy provides shelter on top of existing policies, like your homeowners and auto insurance policies. For instance, an umbrella policy may provide protection if an individual is injured on your property. As with other insurance policies, there is an expansive marketplace for umbrella policies.

***Caution**: Coverage under an umbrella policy is triggered only after application of other insurance policies and subtraction of a deductible. Consult a professional adviser concerning the best options for your particular situation.*

Facts and Figures

Timely points of particular interest

➡**No Apology**—In a prior case, the Tax Court ruled that a taxpayer could deduct the full amount of alimony claimed on his 2004 return. Just two years later, the IRS challenged the same taxpayer's alimony deduction. **Result**: This time around, the IRS quickly acquiesced, because the facts were similar to the previous deduction. However, the IRS would not issue the formal written apology requested by the taxpayer.

➡**Complaint Department**—How do you deal with criticism of your business? Everyone is different, but these five tips may help. (1) Don't take it personally. (2) Recognize it may be about something else. (3) Discuss it with others. (4) Analyze whether the criticism is justified. (5) When it is warranted, correct the situation. **Note**: At the very least, business owners should treat complaints with the attention they deserve.