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Client Information Bulletin

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Five Ways to Manage Money in Tough Times *How to weather current conditions*

The economic downturn is certainly taking its toll. Even successful entrepreneurs and well-paid professionals have been forced to tighten their belts. Here are a few practical suggestions to avoid further financial difficulties:

1. Cut down on debt. It is easy to fall into the trap of using plastic to pay for discretionary expenses. But this can quickly mushroom into a financial catastrophe if you don't rein in your spending habits. Do your best to keep credit card purchases within reason while you chip away at the debt. You may want to consolidate debts into a single monthly charge if you can obtain a relatively low rate. **Note:** Personal interest expenses are generally not tax-deductible.

2. Put yourself on a strict budget. This means figuring out how much you spend on a monthly basis and how you can reduce your cash outlays. Perhaps you might decide to forgo a few nights out at expensive restaurants or pass up that extra latte every morning. Obviously, this requires great discipline on your part, but you will notice positive results over time. To help pinpoint saving opportunities, try tracking your budget on a spreadsheet so you can see exactly what you are taking in and what you are spending.

3. Protect yourself against inflation. Even though inflation has not been much of a factor of late, some economic commentators believe that it could return. They point to the \$750 billion stimulus package, a proposed federal budget of \$4 trillion (up from \$3 trillion in the previous year) and billions more in other rescue packages. In addition, short-term interest rates are near record lows. These factors could be the kindling that eventually sparks a rapid hike in inflation. For protection, you should refine your investment portfolio to include inflation hedges.

4. Develop a sound stock-market strategy. Many investors have been sitting on the sidelines since the stock market tumbled in 2008. But that is not necessarily the best thing to do. Consider building a diversified portfolio that takes into account both the inherent risks of the market and the potential rewards for smart investments. Of course, your time horizon is a critical factor in these decisions. If you are near retirement or have already retired, you should generally adopt a conservative stance, while younger individuals may be more aggressive. Consult with a professional adviser for an overall viewpoint.

5. Keep more of what you have. Learn your lessons from recent eco-

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conomic developments. You cannot rely on bull markets and escalating home prices to provide security for the future. Be aware that the value of assets typically rises and falls over time. Build yourself an emergency cushion to see yourself through tough times. Financial experts usually advise individuals to maintain cash reserves that

could last for six months in the event of a job loss. If that is beyond your means, do what you can.

Rely on your professional advisers for guidance in this area. They may provide other recommendations pertaining to your personal situation.

Are You Starting a Business Late in Life?

Steps for embarking on this new path

For most people, retirement means a life of relaxation, travel or pursuit of hobbies. But for others, it is a chance to realize a lifelong dream: to start up their own business. The business might be an extension of a hobby or a new enterprise based on your field of expertise.

However, if you have harbored a desire to be an entrepreneur, don't go into the new business undertaking with your eyes closed. The rewards may be many, but so are the obstacles. Keeping that in mind, here are several suggestions for starting out:

◆ **Consider all the ramifications of starting a business.** Common scenario: Panic overtakes you the first few weeks you are away from the job. It may take a while to settle into a comfortable routine. Explore any business possibilities carefully; do not leap at the first opportunity that comes along.

◆ **Make smart retirement plan decisions.** This is a complex process that requires professional assistance. For instance, you may want to use part of the distribution from a company retirement plan as "seed money" for your new business. As the business grows, you might set up a retirement plan for yourself and any other employees.

◆ **Delegate payroll responsibilities.** Many late-starting entrepreneurs do not want to be bothered with the hassle—not to mention the potential liabilities—of handling a payroll, withholding taxes and filing tax forms. If you do not have expertise in this area, consider the use of a reputable professional or payroll service.

◆ **Weigh the impact on Social Security benefits.**

A retiree under age 66 (the current full retirement age) may earn up to \$14,160 in 2009 without losing any Social Security benefits. However, if you exceed this limit, you must forfeit \$1 of benefit for every \$2 received. The earnings limit is \$37,680 for those who turn 66 this year. In that case, you lose \$1 of benefit for every \$3 earned. In some cases, it may pay for you to delay the start of a new business until you reach full retirement age.

◆ **Protect your business assets.** For instance, you might make provisions to continue the business if you should die or become disabled. One way to do this is to set up a buy-sell agreement with a junior partner that is funded with life insurance. The insurance proceeds can be used to buy the business from your heirs.

◆ **Trust your business to a trust.** Consider using a trust to preserve the privacy and continuity of the business. The trust may be funded with corporate or other business assets. In addition, a trust may be used as a vehicle for saving federal estate taxes. See a professional tax adviser for more details.

◆ **Plan ahead.** The best time to get started is actually before you retire from your regular job. For example, it may be beneficial to set up an office in your home while you are still employed on a full-time or part-time basis. Spend some time each week in the office planning the enterprise, organizing files, collecting lists of contacts and so on. For tax purposes, be sure to keep track of any expenditures related to the business.

In summary: There still may be time to realize your dream of owning your own business if you are at or nearing retirement. But proceed with caution.



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.



New Law Generates Energy Tax Breaks

Rundown of key tax benefits for energy savings

The new economic stimulus law enacted earlier this year—the American Recovery and Reinvestment Act of 2009—provides tax incentives for saving energy both at home and at work. Here is a brief overview of the key tax rules in this area.

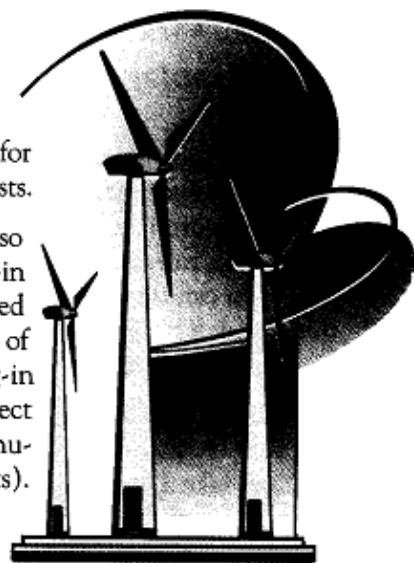
Tax breaks for homeowners: The new law triples the residential energy credit from 10% to 30% for qualified expenses after 2008 and before 2011. The list of qualified expenses includes:

- ◆ insulation materials;
- ◆ exterior windows (including skylights);
- ◆ exterior doors;
- ◆ central air conditioners;
- ◆ natural gas, propane and oil water heaters, or furnaces;
- ◆ hot water boilers;
- ◆ electric heat pump water heaters;
- ◆ certain roofs and stoves; and
- ◆ advanced main air-circulating fans.

In addition, the lifetime \$500 dollar cap has been eliminated. Instead, the new law imposes a limit of \$1,500 for 2009 and 2010 combined. The dollar caps for solar hot water property, geothermal heat pumps and wind energy property installed by homeowners are also removed. How-

ever, a \$500 cap remains for qualified fuel cell property costs.

Note that the new law also enhances the credit for plug-in electrical vehicles purchased after 2009. The base amount of the credit for qualified plug-in vehicles will be \$2,500 (subject to a phaseout once a manufacturer sells 200,000 units). **Note:** Plug-in vehicles are not in the commercial marketplace yet.



Tax breaks for business owners: If you own a business building, you may be able to claim a tax deduction equal to \$1.80 per square foot for energy systems placed in service after 2005 and before 2014. Alternatively, a partial deduction of up to \$.60 per square foot may be available.

To qualify for this deduction, the following four conditions must be met:

1. The property must be installed as part of the interior lighting systems; the heating, cooling, ventilation or hot air systems; or the building envelope.
2. The property must otherwise be depreciable or amortizable.
3. The property must be installed on or in a building in the United States that meets Standard 90.1-2001 of the American Society of Heating, Refrigerating and Air Conditioning Engineers (ASHRAE).
4. The property must be certified as a part of an overall plan designed to reduce the total annual energy and power costs by 50% or more in comparison to a reference building meeting the minimum requirements of ASHRAE Standard 90.1-2001.

The new law also enhances the energy tax benefits for certain business owners. Among other changes, it increases the credit for commercial refueling stations for alternative fuel vehicles from 30% to 50%. It also raises the cap on the credit to \$50,000 for property placed in service in 2009 and 2010. The previous limit was only \$30,000. Finally, the new law extends the credit for electricity produced from renewable sources through 2013 (2012 for wind facilities).

This is just the tip of the iceberg. More details about energy tax breaks are available upon request.

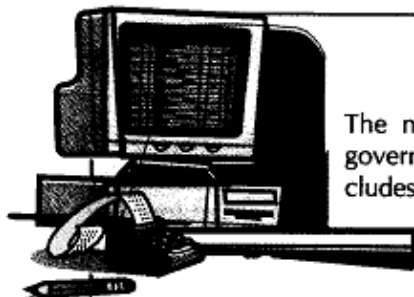
Audit Info in New Data Book

The new IRS Data Book for the government's 2008 fiscal year includes lots of tax return information.

For instance, the Data Book shows that almost 1.4 million individual tax returns

were audited out of 137.8 million returns filed in 2007, for an audit rate of 1.0%. While 22.3% of the audits were conducted by IRS personnel, 77.7% of the audits were correspondence audits.

The audit rate for individuals whose returns showed a total positive income (TPI) between \$200,000 and \$1 million rose to 2.6%. **One surprise:** The audit rate in fiscal year 2008 for those with a TPI above \$1 million declined from 9.3% to 5.6%. The IRS attributed this, in part, to activities related to sending out economic stimulus checks.



Why You Might "Fail" the Trust Rules

Tax advantages for intentionally defective grantor trusts

Things can get turned upside down in the tax world. For instance, depending on your situation, it may make sense to fail certain tax rules for grantor trusts on purpose. You can do this by creating an intentionally defective grantor trust (known as an IDGT, for short).

In fact, an IDGT may be especially effective this year because of current interest rate levels. Let's take a look at how this sophisticated estate-planning technique works.

Basic premise: In the normal situation, you might transfer assets like cash or securities to a trust paying out annual income to designated beneficiaries. By giving up all rights to the assets, you are not responsible for paying federal income tax on the earnings. This can be particularly beneficial if you are in the top 35% income tax bracket. The income tax is generally paid by the trust, with a graduated tax-rate structure beginning at a 15% rate.

However, be aware that the income tax brackets for trusts are highly compressed. In other words, the dollar amounts for each bracket are relatively small when compared with the tax brackets for individuals, so the higher tax rates are triggered quickly. In the end, the trust could pay more tax than you would have been assessed as an individual.

Facts and Figures

Timely points of particular interest

➔ **FSA Expenses**—As a general rule, you can deduct medical expenses relating to your care and well-being to the extent the annual expenses exceed 7.5% of your adjusted gross income. The same expenses generally may be reimbursed through a flexible spending arrangement (FSA). However, in a new ruling, the IRS said that an FSA could not reimburse the cost of a breast pump. **Reason:** While breast pumps are helpful, they do not treat or mitigate a medical condition.

This is where an IDGT can help you out. Assuming the trust document is properly structured, the trust will be treated as a "grantor trust" that allows you to retain certain rights or interests. This means that the income will be taxed to you as the grantor rather than to the trust—even though you are not receiving any of the annual income.

Besides the income tax savings, the current interest rate environment makes it conducive to establish an IDGT. **Reason:** The resulting gift-tax liability for the remainder is based on the assumed IRS interest rate at the time the trust is created. When interest rates are low, the gift-tax consequences are favorable to the grantor.

Note that an IDGT could lead to estate-tax complications. This is because your taxable estate generally includes assets you have transferred to trusts and individuals in which you have retained possession or enjoyment of the property being transferred. In effect, you must give up control over the assets to preserve the tax benefits of the trust. Thus, dire estate-tax consequences can be avoided with proper planning.

Obviously, this is not a do-it-yourself proposition. Consult an experienced adviser to determine if an IDGT is right for your situation.

➔ **Supply and Demand**—Don't be shortsighted in your treatment of small company suppliers and vendors. For example, using (or not using) a discount may cost you a little now, but save you lots later on. In the worst-case scenario, a key supplier might be driven out of business, forcing you to deal with a larger company with inflexible prices. That's not to say you should not negotiate a fair price with your current suppliers and vendors, but keep the big picture in view.

