

NEWSLETTER

Put year-end tax planning on your schedule



At the end of 2010, most of the provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 will “sunset” or expire. Only those provisions extended or made permanent by later tax legislation will remain effective in 2011. That fact makes year-end tax planning crucial for 2010. At the point of major tax change, there are always opportunities and pitfalls that should be analyzed if you want to keep your taxes as low as possible. With all the tax changes that have already occurred and the many more sure to come this year and next, you must review your tax situation now.

An important part of our service to you is helping to identify actions you can take before year-end to minimize your income tax bill. If you'd like to discuss tax-cutting options that fit your particular situation, please contact us soon for a year-end tax planning review.



Everyone needs a cash reserve

Many of us are living close to our financial limit these days. We pay our bills on time, but there's not a lot left over. That could be a dangerous situation. If things go wrong, your financial situation can change very quickly from adequate to critical. Without a cash reserve, you could find yourself in serious trouble.

It's important to have a cash reserve of at least three months' living expenses. Invest your reserve in a safe, liquid account. Consider investments such as a bank CD, a money market fund, or a very short-term bond fund. Make sure you have easy access to the funds without losing too much interest. And once you've built your fund, avoid temptations to raid it for non-essentials.

Tax filing reminders

- * September 15 - Third quarter installment of 2010 individual estimated income tax is due.
- * September 15 - Filing deadline for 2009 tax returns for calendar-year corporations that received an automatic extension of the March 15 filing deadline.
- * September 15 - Filing deadline for 2009 partnership tax returns that received an extension of the April 15 filing deadline.
- * October 1 - Generally, the deadline for businesses to adopt a SIMPLE retirement plan for 2010.
- * October 15 - Deadline for filing 2009 individual tax returns on extension.



New rules could let you convert to a Roth IRA

For the first time ever, high-income taxpayers are eligible to convert a traditional IRA to a Roth IRA. Prior to 2010, you could not convert to a Roth in a year in which your modified adjusted gross income exceeded \$100,000. But this limit was removed by a 2006 tax law change that took effect January 1, 2010. So the question of the year is, should you do a conversion?

First, you must understand the critical differences between the two IRAs. With a traditional IRA, contributions may be partially or wholly tax-deductible, but distributions are generally taxable at ordinary income rates. In contrast, contributions to a Roth IRA are never tax-deductible, but qualified distributions from a Roth in existence at least five years are completely exempt from tax. Qualified distributions are those made after age 59½, due to death or disability, or used for first-time homebuyer expenses (lifetime limit of \$10,000). Also, unlike a traditional IRA, mandatory distributions after age 70½ aren't required for a Roth.

Thus, by converting to a Roth, you pay an up-front tax on the current value of IRA assets in exchange for future tax-free withdrawals. For a conversion occurring in 2010, you can choose to split the taxable income evenly over the following two years, 2011 and 2012.

In analyzing whether you should convert or not, consider the following points:

- * If you have to pay all or part of the conversion tax with funds in your traditional IRA, the benefit of the conversion is diluted. The account can grow even larger if you have other resources to pay the required tax.
- * Both current and future income tax rates can affect your decision. For instance, if you're now in a high tax bracket but expect to be in a much lower bracket in retirement, you may be less inclined to convert from a traditional IRA. Conversely, the prospect of rising tax rates generally favor a Roth conversion. Also consider state income tax implications.
- * Spreading out the tax liability for a 2010 conversion over the next two years may not be the right choice in your situation.
- * Converting to a Roth could trigger alternative minimum tax (AMT) liability.
- * Be aware that you don't have to convert the entire balance in an IRA or all your IRAs. Partial conversions are permitted. Finally, you have the ability to "recharacterize" a Roth back into a traditional IRA if it suits your needs.

Call us if you would like to discuss the suitability of a Roth conversion in your personal situation.

Gambling winnings and losses can affect your tax bill

From time to time, some of you are lucky enough to win a shilling or two at your local casino, the track, or your state lottery. How will that gambling income impact your taxes?

All gambling winnings are taxable. This is true for cash winnings and for the fair market value of any non-cash prizes you might win (e.g., a car, vacation, etc.). Depending on your other income and the amount of your winnings, your federal tax on such winnings can go as high as 35%. You don't receive any capital gains rate break for gambling winnings, nor is there any income averaging to help lower your tax bill.

However, you are entitled to a tax deduction for gambling losses. These are taken as an itemized deduction and your losses can't exceed your winnings. In other words, if you report no gambling income, you can't report gambling losses. When you gamble and lose, you must keep documentary evidence of your losses (canceled checks, credit card charges, losing tickets, ATM receipts, etc.). Many casinos keep track of your wins and losses for electronic games if you belong to their player clubs.

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Are all your business eggs in one basket?

Many small business owners share one problem, especially in their early days. It's being over-reliant on a single customer or supplier for much of their business. If you're in that position, your business is operating with higher risk. Just as with investments, you don't want all your eggs in one basket. Your goal should be a well-diversified portfolio of customers and suppliers.

That's in an ideal world. In the real world you may have to live with the situation, at least short-term. But there are steps you can take to understand your risk and, over time, to change it.

* Measure the problem. Work with your managers and accountant to quantify how your sales break out by customer. You only need to do this for the top five or ten customers to see whether you have an over-reliance problem. If you're a manufacturer or retailer, take a similar look at your principal suppliers. Quantify how dependent you are on the top few.

* Understand the risks. List the factors that could jeopardize your business with your chief customer or supplier. These will vary with your specific circumstances. They might include a natural disaster that interrupts your customer's business or that prevents you from shipping or receiving goods. It could be a change in the marketplace or a new technology that cuts demand for your product. It could be actions by your competitors. It might even be problems in your own operation, such as a drop in quality, delays in shipping, or poor inventory control. The list may be daunting, but until you understand the risks, you can't develop solutions.

* Look for ways to minimize your risks. Brainstorm with your managers on long-term steps to reduce each risk. It might be to enter new markets or to tweak your product design. Think through contingency plans to address possible disasters or find alternative suppliers. Discuss how you would respond to changes in the marketplace. Try to set measurable goals for change and clearly assign responsibility.

Working after retirement affects your benefits and taxes

People often work beyond the "normal" retirement age. Here's how extending your work life can affect your taxes and retirement benefits.

"Normal" retirement age is not a fixed number. For social security purposes, the "full" retirement age threshold ranges from 65 to 67, depending on your birth date. However, you can elect to start receiving lower payments as early as age 62, or you can maximize your benefits by forgoing them until you're 70. Once you reach age 70, there's no incentive to postpone your benefits further, since you'll already have reached your maximum.

* Earnings limit. If you're working, you probably should forgo the early
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Gambling *(continued from page 3)*

But gambling deductions might not be all that beneficial. You can't simply "net out" your winnings and losses. Instead you must report your entire winnings as income, and use your losses as itemized deductions. In many cases (especially for older taxpayers with little income other than social security benefits, and with very few itemized deductions), the losses might not be tax beneficial. If you take the standard deduction rather than itemizing deductions, you will receive no tax benefit whatsoever. However, the winnings could have a significant impact on your income and may cause you to pay additional taxes (such as making some of your social security benefits taxable when they otherwise wouldn't be).

Evaluate investment risk in your profile

If nothing else, the recent financial meltdown provided an important learning experience and reinforced time-tested concepts about risk in investing. None of these lessons will comfort investors. However, we can still evaluate investment risks, at least on a relative scale.

Conservative investors fear loss of principal above all. They flock to lower-risk vehicles, such as Treasury bonds, CDs, and money market funds, which are comparatively well known and easy to understand. They're willing to accept a lower ceiling on their potential earnings in exchange

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Working after retirement

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payment option. Benefits received before full retirement age will be reduced by \$1 for every \$2 earned over an annual limit (currently \$14,160). However, you will receive a compensating increase when you do reach full retirement age, and your payments will not be reduced thereafter no matter how much you earn.

* Taxable benefits. Whether or not you draw benefits, you'll continue to pay social security and Medicare taxes on any income you earn from wages or self-employment. Up to 85% of your benefits may become subject to income tax, depending on the amount of your other income.

* Medicare. Medicare eligibility begins the year you reach age 65. The program encompasses four types of coverage: hospital insurance, general medical insurance, Medicare Advantage, and prescription drug coverage.

Working beyond retirement age can require several complex decisions. Call us for help with planning the outcome that's best for you.

Give your business a competitive edge

It's a fact. When competition is based on price alone, smaller companies often find themselves squeezed by high-volume, low-priced competitors. How do you, as a small or mid-size business owner, survive in such an environment? You survive by differentiating yourself from the competition, creating a niche or identity that isn't based on cut-rate pricing. In other words, you offer something that your competitors don't offer, something that's different.

To truly differentiate your business, you need to identify your target customers and their needs. Let's say your firm sells stereo speakers. You might decide to focus on serious audiophiles only. Such customers will likely pay a premium for higher performance, technological innovation, or customization. Perhaps you've dined at expensive restaurants that offer an unusual menu, a remarkable atmosphere, or superior service. Such eating establishments are often packed at the dinner hour. Why? Because customers perceive value in the products and services that these businesses offer, a value they're willing to pay for.

The key is to identify the qualities that make your company different. How do you discover such qualities? One way is to study your competition. Clip their ads, examine their websites, buy their products and services. Determine what makes your product or service different and more valuable than that of your competitors.

Once you've identified the qualities that could set your company apart, it's time to prioritize them. Decide which would be easiest to develop, which would address your customers' most important buying criteria, and which would be hardest for your competitors to emulate.

Finally, seek to convey that value to your target customers. The goal is to "brand" your product, being clear about what you want to be in your customers' minds.

If you need help identifying the qualities that could set your business apart, give us a call.

Evaluate investment risk

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for a lower risk of losing principal. However, this reasoning ignores or underrates a different but no less serious risk: that inflation will outstrip the earning power of the investor's savings, causing the principal to lose value even when achieving its maximum rate of return. In the worst case, conservative investors can outlive their investments.

Aggressive investors have no problem with risky investments if the investments carry a high profit potential. The more rational risk-takers recognize a corresponding loss potential and accordingly risk no more principal than they can afford to lose. Their less rational fellows may continue to risk everything until little or nothing remains.

The wisest investors take a balanced approach. Since most have neither the time nor the resources to analyze individual investments in depth, they generally refer to advice and analysis provided by outside sources. They also diversify their holdings so that if one investment fails, their portfolios are not irreparably damaged.

The mix of assets in your own portfolio should reflect your risk tolerance, but it also should be tempered by an awareness that both extreme caution and excessive risk-taking can be pathways to ruin. In general, no one stock or other single investment (excluding mutual funds, which are bundles of investments) should comprise a major part of your portfolio. Varying the types of assets in your portfolio (foreign vs. domestic stocks, bonds, mutual funds, Treasury bills) can provide an additional margin of safety.

You can't escape risk in the world of investments, but you should try to choose the investments that fit both your risk comfort level and your personal financial situation.

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