

# Trendlines

*New Directions in Business and Personal Planning*



## Summertime ... and the saving's easy

5 midyear tax tips for business owners

Writing an **effective** business plan

Recent changes **strengthen** the  
Hope and Lifetime Learning tax credits



## Plus!

**Moneylines: News Briefs for Businesses and Individuals**

*A new employee benefits option, estate planning  
update and more ...*



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# Summertime ... and The Saving's Easy

## *5 Midyear Tax Tips for Business Owners*

Right now, your company's taxes may be the furthest thing from your mind. And why not? April 15 is long past and year end is many months away. It's summertime — a season when many businesses relax their dress codes, hold picnics and perhaps even occasionally let employees cut out early. But, though year end is indeed the world series of tax planning, you still need to keep your eye on the ball right now. Here are five midyear tax tips worth taking a swing at.

### **1. Assess Equipment Needs**

That laid back summertime vibe may tempt you to let things slide. Instead, step back and determine whether now (or the near future) may be a good time to buy new equipment. The IRS generally treats all newly acquired tangible assets other than real estate as being placed in service at the midyear point. This gives you six months of depreciation in the first year. But if you make more than 40% of the year's asset purchases in the fourth quarter, you may be required to use the generally less favorable midquarter convention. So, if you anticipate needing new equipment between now and year end, be sure to consider the benefits of buying specific items in the third quarter to avoid the midquarter convention.

Also, thanks to the Job Creation and Worker Assistance Act of 2002, eligible companies can now write off an additional 30% in "bonus" depreciation for equipment purchases and leasehold improvements made after Sept. 10, 2001, but before Sept. 11, 2004. Thus, your company can immediately write off 30% of a new asset's



cost and recover the remaining 70% under regular depreciation schedules. You just have to acquire the equipment in 2003 to get the 30% write-off this year.

### **2. Put the Kids to Work**

Do you get irked when you head off to work every morning only to see your teenage children sleeping late and spending their days poolside? Then put those slackers to work. Owners of an unincorporated business can hire their children, pay each one over age 14 as much as \$7,800 and deduct the sum in full. For kids under age 18, you owe no Social Security or Medicare taxes and they will pay zero federal taxes on the \$7,800 wages. Of course, some restrictions apply: Your children must perform actual work for the wages in line with what you would pay nonfamily employees.

If the child earns more than \$7,800, you may deduct the additional wages as long as they are reasonable for the work performed and the child is a bona fide employee. And amounts beyond

the \$7,800 are still not subject to FICA or the Medicare portion, though some tax liability may apply.

### 3. Cook Out With the Company

Generally, companies can deduct only 50% of their work-related entertainment expenses. These include meals and entertainment on business trips; dining or other recreational events with clients; and conventions, meetings and luncheons. The IRS decides what constitutes a work-related entertainment expense case by case, but the basic definition is relatively loose.

Now here's some good news: Recreational expenses for employees are exempt from this rule. So hosting a staff cookout is fully deductible. Bear in mind, you must offer the event at a location available to all employees.

### 4. Combine Business Trips With Vacations

Along with barbecues, traveling is another popular summertime activity. Fortunately, you may be able to mix business with pleasure and enjoy a tax deduction. As long as your trip's primary purpose is business, you may generally deduct your transportation costs — even when



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you take your family and travel by car. (If you fly or ride the train, the deduction is limited to your personal fare.) Your lodging costs are also typically deductible for the entire business trip, and bringing your family shouldn't impair this deduction too much. You can still usually deduct the cost of single occupancy, which often isn't much less than what you would have paid for double occupancy with or without the kids.

So, if you plan it right, you can schedule business on Monday for a trade show that ends on the preceding Friday (or some variation on that theme). In such cases, you can generally write off your living costs for the weekend in between, even if you spent those two days doing the mambo with Mickey Mouse and the kids. Business that ends on Friday may also entitle you to a limited business deduction into the weekend — especially if your layover allowed you to take advantage of a lower airfare Saturday night. But take note: If you bring your spouse or kids, you must be able to prove the trip's primary purpose was business, not personal, or you will lose the deduction.

### 5. Deduct Home Office Repairs

Are you self-employed? If so, here's a tip just for you. Because your home is your business, you probably draw little distinction between "home" and "home office" repairs. Yet whether you may fully or partly deduct a repair depends on whether it's a "direct" or "indirect" expense. For example, if you need to fix an office door warped

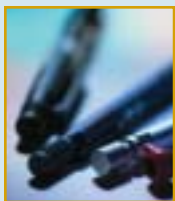
by summer's heat, you can fully deduct that expense. Why? Because it pertains "directly" to your office.

On the other hand, repairing your home's air conditioning (certainly necessary if the heat is warping your doors) is likely an indirect expense, because it affects both your office and the rest of your home. Thus, your deduction depends on what percentage of your house you use for business. If you use 10%, for instance, then you may deduct only 10% of this cost as a home office expense. Don't risk an audit by arbitrarily

choosing this percentage — get a financial professional's help.

### Soak Up the Sun

As you can see, getting a head start on cutting your tax bill doesn't mean missing out on any summertime fun. You can still soak up plenty of sun while shading your business from costly tax liability. And come year end, when temperatures cool and the pressure to lower your tax bill heats up, you'll be well ahead of the game. Need a coach? Please call us for year-round assistance with these important matters. □



## What's the (Business) Plan?

### *Conciseness, Completeness Count in This Critical Document*

Many people find journaling therapeutic. Why? Because writing about ourselves often leads to wonderful epiphanies about how to better succeed at our daily lives. Similarly, as a business owner, you can benefit from some inwardly directed composition. But instead of rambling, quasipoetic rants about your existential woes or prospective romantic partners, you should write a concisely worded and thoroughly detailed description of your company. In other words, you need to create a business plan. Let's examine what makes up this critical strategic document.

#### 5 Parts to a Better Whole

Business plans serve many functions. (For a few examples, see "Business Plans: Not Just for Startups Anymore" on page 5.) But they must all have one thing in common: a practical structure. To that end, these documents typically comprise five parts:

**1. A mission statement and business description.** Many people believe only nonprofits

need mission statements. Not true — every company needs a clear declaration of why it exists and how it intends to meet that primary objective. Think of your mission statement, which needn't be much longer than a few sentences, as the heart of your business plan. All your goals and activities should flow from it.

With your mission statement set forth, next comprehensively describe your company. Provide a brief history (unless it's a startup, of course)



## Business Plans: Not Just for Startups Anymore



Many people think business plans are for only those brave, ambitious souls who start their own companies. But what about owners who rise to power as internal hires or recruited talent? These executives need business plans, too. Unfortunately, they may never realize a plan's absence — and this oversight's effects can be devastating. For example, many experts believe Kmart's decline into Chapter 11 bankruptcy was at least partly because of an ignored (and obsolete) business plan that underestimated competitors such as Wal-Mart and Target.

So, besides soliciting startup funds, why else should companies create and maintain a business plan? Well, growth financing, for starters. In an uncertain economy, lenders need more than a halfway decent profit history to approve a loan. A well-written business plan demonstrates that your company knows its past and has mapped out a decisive path to its future.

Another useful purpose for creating a business plan is strategic planning. Your company won't develop by itself — you must nurture growth through winning strategies and smart decisions. And creating new objectives, let alone staying focused on your original ones, isn't easy. A business plan can keep you grounded when challenges arise and help you craft new ideas that will bolster your bottom line, not bankrupt it. Plus, having a tangible document allows you to easily share your goals and values with employees, which keeps everyone on the same page.

and then explain what it does, identify the marketplace niche it fills and assert why you'll succeed. You might also reveal why your business chose its location and how you benefit the surrounding community.

**2. A management profile.** People matter — not only in real life, but also in your business plan. Potential investors, lenders and even employees aren't interested in a faceless, soulless corporate entity. They want to know that competent, experienced people are steering the ship.

So illustrate your organizational structure and management team. An organizational chart showing your structure followed by brief bios of key employees can work particularly well. If you're a small company, you may even be able to describe every employee and what he or she does.

In any case, enhance your basic description with some solid reasons why your staff has the expertise to succeed.

### 3. A financial portrait and strategy.

Although prospective investors, lenders and other business-plan readers definitely want to know your company's personal aspects, they also want to know its financial ones. So include basic data such as a current and pro forma balance sheet, an income statement and a cash flow analysis. And don't cut corners with these calculations — get a financial professional's assistance or, at the very least, verification. If you're a startup, project this information as accurately as possible.

Above all, make sure your numbers demonstrate that you and your management team have considered the key drivers that will determine your success or failure. Don't pad the business plan with overly optimistic financial projections that could ultimately depict your company in a bad light.

### 4. Sales and marketing objectives.

Of course, expertise and past success mean little without an up-to-date strategy for bringing your products or services to the public. So describe your intended market, giving specific details on its size and how much of it you intend to serve. What is your market's growth potential? What specific geographic, economic and perhaps even political factors play a role?

Another important aspect of your marketing objectives is your competitive intelligence. Name your five biggest competitors and convince business-plan readers that you can serve your market better than these rivals. Don't conceal your weaknesses, either. Recognizing the challenges you must still overcome conveys that you and your management team are in touch with reality.

**5. An executive summary.** Many companies write decent business plans that no one ever reads, because they forget to provide an executive summary. Truth is, busy venture capitalists and loan committees will often initially look *only* at this section. That's not to say they'll never read your entire business plan — it only means a concise, readable executive summary may be necessary to getting your foot in the door.

True to its name, your executive summary should hit the highlights of each business-plan section. Don't slam readers with a lot of numbers or technicalities here. Just give a clear, confident synopsis of who you are, what you do and where you're headed.

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### **An Ongoing Process**

Like keeping a journal, writing a business plan is an ongoing process. Yours must adapt to changes in your company, its market and the economy. And that means, no matter what its purpose, your business plan requires regular care. For help with this important task, please call us. ☐



## **Moneylines: News Briefs for Businesses and Individuals**

**IRS overcharges taxpayers, blames computers.** Imagine if, following an IRS audit or dispute, you learned that the agency had overcharged you interest and penalties. This nightmare has been a reality for thousands of taxpayers, according to the Treasury

Department. Turns out, an 18-month limit exists for some returns on how long interest and penalties may accrue on a taxpayer's account following an audit or dispute (unless the IRS takes specified actions). But the IRS has occasionally flouted this rule, blaming faulty computers for the oversight. ☐

**Qualified plans may now include IRAs.** Despite their similar objectives, qualified retirement plans and IRAs have long lived in parallel universes. Well, no more: Employers may now set up both traditional and Roth IRAs within their qualified plans. This will enable workers to use payroll deductions for IRA contributions. If this sounds like something for your company, check out the IRS's model amendment and see Rev. Proc. 2003-13. ☐

**Important estate planning numbers are in.** Have you checked to see whether your estate plan accounts for the 2003 estate and gift exemptions, exclusions and tax rates? Uncle Sam indexes certain key tax numbers to account for inflation. Two examples: 1) The generation-skipping transfer tax exemption, which adjusts to \$1.12 million this year, and 2) The annual gift tax exclusion, which holds steady at \$11,000. But the estate tax exemption and gift tax exemption remain unchanged at \$1 million. Remember, the estate tax rate and gift tax rate aren't indexed for inflation. Nonetheless, thanks to the 2001 tax act, they drop one percentage point to 49% this year. ☐

**New guidance issued regarding stock option reporting.** To ensure accurate reporting of stock options, the Financial Accounting Standards Board (FASB) published Statement No. 123 in October 1995. Under it, companies must choose to either count stock options in their income statements or include the options in their annual reports' footnotes. The problem? These adjustments often appear to investors as sudden expense rises. So the FASB amended Statement No. 123 this year to provide transitional guidance to companies. The amendment is intended to help businesses avoid or minimize the accounting change's ill effects. ☐

# Educate Yourself About Recent College Tax-Credit Changes

Andy and his daughter Anita are approaching a strange juncture. He's been taking work-related continuing education classes at a local university for a couple of years now and, come this fall, she will matriculate to that very same school as a freshman. Although Anita is far from thrilled at this arrangement's social peculiarities, Andy is looking forward to claiming not one, but two education tax credits. To make sure he can do so, Andy visits his financial professional.

Andy's advisor begins by reviewing the two credits in question — the Hope credit and the Lifetime Learning credit. If you, your child or your spouse is a student, you can claim a Hope Credit of up to \$1,500 per student annually for the *first* two years of postsecondary education in a degree or certificate program. (This amount is now adjusted for inflation.) The credit is available on a per-student basis and only for those enrolled at least half time.

On the other hand, if you, your spouse or child has already attended college for a couple of years, you may qualify for the Lifetime Learning credit. It's based on expenses incurred for the *second* two years of undergraduate study as well as graduate or continuing professional education. The maximum annual Lifetime Learning credit is 20% of the first \$10,000 in qualified expenses (up this year from \$5,000) paid to a maximum of \$2,000 annually.

Bear in mind, you can't claim both credits for the same student in the same year. But if, like Andy, you pay qualified expenses for more than one student in the same year, you may claim the Hope credit for one student and the Lifetime Learning credit for another.

## Restrictions and Revisions

Both credits begin to phase out when your modified adjusted gross income (AGI) is between \$41,000 and \$51,000 (\$83,000 and \$103,000 for joint filers). You may not claim either credit if your modified AGI exceeds \$51,000 (\$103,000 for joint filers). These limits increased this year from the

previous amounts. If your AGI exceeds the limits, your child may be able to claim one of the credits; you simply have to forgo claiming him or her as a dependent on your tax return.

The credits have changed in other ways as well. For instance, the Job Creation and Worker Assistance Act of 2002 clarified that qualifying families may claim either the Hope credit or the Lifetime Learning credit in the same year they withdraw funds from a student's Coverdell education savings account (ESA). But families can't spend ESA withdrawals on the same expenses for which they claim either credit.

Another recent development: The IRS issued final regulations regarding these credits late last year. Among other things, these regulations:

- ☞ Define an academic period as one that "includes a semester, trimester, quarter or other period of study (such as a summer school session) as reasonably determined by an educational institution,"
- ☞ State that medical expenses include student health fees, and
- ☞ Explain the treatment of third-party payments — for education credit purposes, the IRS generally considers the *student* to have paid qualified expenses if a third party pays the student's tuition directly to the educational institution.

The regulations also shed light on the treatment of general (or "bundled") fees and the use of loan proceeds for payments. In addition, they more specifically define student eligibility, including the requirement that a student be "free of any federal or state felony conviction for possessing or distributing a controlled substance" as of the end of the year for which he or she claims the credit.

## A Smart Value

If you qualify, the Hope credit and the Lifetime Learning credit provide a smart education value. If any aspect of Andy's situation reminded you of your own, please call us. We can further explain how to qualify for either — or perhaps both — of these beneficial tax-savers. ☐

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