

Trendlines

New Directions in Business and Personal Planning



Mind, body and soul

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3 hot education-funding tips for 2007

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Moneylines: News briefs for businesses and individuals

*IRS calculator prevents tax overpayments,
Study reveals out-of-touch managers, and more ...*

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Mind, body and soul

The Zen of creating a budget for your business

Having a sound budget is a business fundamental. Yet many owners of small to midsize companies don't create one — or don't update the one they have — typically because they're too busy or simply not focused on “minor” details such as a budget.

The good news is that you probably don't need to do the kind of complex, algorithmic number-crunching befitting a Fortune 500 company. Instead, you can likely take a simple, Zen-like approach to creating a budget. Just think “mind, body and soul.”

Mind: Technology

Of course, the real brains behind your budget should be your own. But it would be foolish not to let the considerable (albeit artificial) intelligence of today's accounting technology build the framework for your company's budget.

Maybe you already have some software you use for budgeting. Is it up to date? An outdated accounting application can hinder you from seeing potential budgeting problems, making timely decisions about whether to cut costs and acting on potential growth opportunities.

An outdated accounting application can hinder you from seeing potential budgeting problems.

A wide range of software is available to help companies of all sizes streamline and automate the budgeting process — as well as integrating it into their strategic planning. The cost depends largely on the size and complexity of your business and the functionality you need.

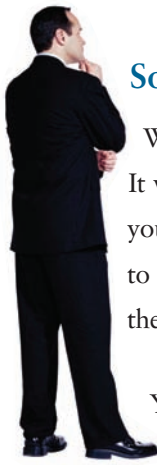


Body: Critical documents

Although a standard budget need not be overly complex, it must include enough information for you to track income, expenses, profits and, most important, cash flow. Thus, the “body” of your budget should spring from three critical documents:

1. Your income statement. This document shows sales, margins, operating expenses, and profits or losses. Naturally, when trying to create a budget, many business owners tend to focus on the income statement — particularly the profit part.

Yet, because it shows only transactions that affect profits or losses, the income statement doesn't give you the whole picture. Specifically, it doesn't reflect cash-related activities such as buying new machinery or borrowing money from the bank.



2. Your cash flow statement. The cash flow statement begins where the income statement leaves off — with your net income. Generally, it's divided into three sections: operating (activities associated with running the business), investing (activities associated with growing the business) and financing (activities associated with obtaining money).

One really can't overstate the importance of this part of your budget. Cash flow problems are the undoing of many small to midsize businesses. So if your budget doesn't factor in the dollars on hand to cover expenses, it could end up doing your company more harm than good.

3. Your balance sheet. Often described as a "snapshot" of the financial condition of a business on a given date, this document typically shows assets, liabilities and shareholders' equity. From a budgeting perspective, your balance sheet can serve as a guide to determining how bold or cautious you should be in setting financial goals.

For example, a preponderance of debt on your balance sheet probably means that now is not the time to allocate substantial sums to discretionary expenses (such as company parties) in your budget.

Business plans: A budget's best friend

Many companies create budgets that appear to be perfectly rational and mathematically sound — and that lead them straight into serious financial trouble. Why? Because, when a *number* drives the budgeting process instead of a *business goal*, problems are often just around the corner.

For this reason, any reasonable budget's best friend should be your business plan. For instance, if your business plan includes buying major assets, adding new employees or relocating (or expanding) your facilities, your budget needs to reflect these moves. Otherwise, your company's strategic goals may never match up with its financial performance.

Soul: Your best judgment

What's the "soul" of your budget? Your best judgment. It would be nice if there were a line at the bottom of your budget telling you exactly how — and how not — to spend your company's money. But this just isn't the case.

Your budget is only as good as your interpretation of it. That means, first and foremost, you must review it regularly. Check your budget against your business's actual financial activity at least monthly — and even weekly if you're engaging in a particularly noteworthy transaction such as a major asset purchase.

In addition, you must apply another Zen principle: humility. You may think your business ideas are the greatest ever and will bring untold fortunes to your bottom line. But, generally, it's better to err on the side of caution. By slightly overestimating expenses and underestimating projected revenue, you're more likely to maintain a balanced budget and avoid cash shortfalls.

That said, you still need to be flexible. If you're too rigid and conservative with your budget, you might miss opportunities to grow your business. For example, say you've exhausted the travel portion of your budget for the year, but you unexpectedly learn of a trade show perfectly suited to your company's niche.

In this case, going slightly over budget may pay off handsomely in new business gained. After all, just one or two lucrative clients could recoup those travel costs several times over.

No incense needed

To create a functional budget, you don't need to fill your office with incense or assume the lotus position. But neither do you need to create something so complex and difficult to understand that it confuses more than it enlightens. Ask your CPA for further assistance in creating a budget or reviewing the one you have in place. ■



Special-use valuations help curtail estate planning disasters

If a business owner dies suddenly, his or her family may learn — too late — of a rather chilling secret: He or she had little to no working estate plan. As a result, they may find themselves on the hook for an estate tax bill so big that it leaves them no option but to sell the company.

What many families don't know is that, when a situation like this arises, all hope isn't necessarily lost. If a significant portion of a business owner's estate consists of real property used in a family business or farm, the owner's family may be able to reduce estate taxes with a special-use valuation.

How it works

Real property's fair market value is typically based on its "highest and best use." For instance, a piece of prime real estate in a downtown financial district would likely be valued based on its use for an office building — even if the owner operates a parking lot on the property.



Yet a highest-and-best-use valuation can lead to harsh tax consequences for successors who wish to continue the property's current use. So, if certain requirements are met, the tax code allows real property to be valued based on its *actual* use, rather than its highest and best use.

Let's say a business owner's estate includes a manufacturing plant on the outskirts of a growing suburb. The

land's value, based on its current use, is \$1 million, but its fair market value is \$1.5 million based on its highest and best use as a residential subdivision.

If the property qualifies for special-use valuation, the property's value for estate tax purposes could be reduced by \$500,000. A special-use valuation, however, cannot reduce the gross estate by more than \$900,000, as indexed for 2006. (As of this writing, the 2007 amount was unavailable. Ask your tax advisor for details.)

Qualification requirements

Special-use valuations are intended to help families hold on to their small businesses and farms. Thus, to qualify to use one, strict requirements must be met:

Citizenship and location. The business owner must be a U.S. citizen or resident, and the property must be located in the United States and used for business or farming.

Length of ownership and involvement. The real property, during at least five of the eight years before the business owner's death, must have been owned and used in a qualified manner — that is, used for farming or for the family business, or rented for such activity on a net cash basis — and the business owner or a family member must have materially participated.

In addition, as of the business owner's death, the property must have been used by the business owner or a family member in the business or as a farm, or have been rented by the business owner's spouse or a descendant to a family member on a net cash basis.

Adjusted value. The property's adjusted value must account for 25% or more of the gross estate's adjusted value. Adjusted value is the highest-and-best-use value,

reduced by certain debt, such as mortgages. The adjusted value of all real and personal property used in the business must account for 50% or more of the gross estate's adjusted value.

Allowed recipients. The property must pass to a “qualified heir,” which includes the owner’s spouse, parents, grandparents, children and grandchildren. Moreover, the qualified heir must materially participate in the business or farm operations for at least 10 years after the decedent’s death.

If the heir sells or otherwise disposes of the property or stops operating the business during the 10-year period,

the IRS can collect some or all of the estate taxes that would have been owed absent the special-use election.

A dire predicament

Turning to a special-use valuation isn’t a family’s only option if estate taxes threaten to force them to sell the family business. They may also be able to defer estate tax payments for five years and then pay the tax liability in 10 annual installments. (Ask your financial advisor for details.)

Of course, ideally business owners will prevent any such dire predicament by acting today to create an estate plan that prevents unexpected estate tax consequences. ■



Moneylines: News briefs for businesses and individuals

IRS calculator can prevent tax overpayments. No one can deny the allure of a sizable income tax refund. But, generally, getting back any more than \$50 indicates that you essentially gave the federal government an interest-free loan. Ironically, one easy source for help is the federal government itself — namely, the IRS offers a free withholding calculator on its Web site (www.irs.gov, under the Online Tools menu). With it, you can adjust your W-4 form to withhold a more reasonable amount.

Many managers out of touch with employee sentiment. Do your managers think they’re hot stuff? Your employees may not agree. Although 92% of managers surveyed reported doing an “excellent” or “good” job, only 67% of workers agreed, according to a recent study of U.S. workers conducted by Rasmussen Reports LLC for staffing and outsourcing specialists Hudson. One way to get a better read: Conduct “360-degree” performance reviews, which include feedback from not only the manager’s superior(s), but also his or her peers, employees and even customers.

Social Security benefits higher this year. Do you have family members or friends who depend on Social Security? If so, here’s some good news: The Social Security Administration has increased Social Security and Supplemental Security Income benefits by 3.3% in 2007. Employee and employer rates for Old-Age, Survivors and Disability Insurance (OASDI) and Medicare Hospital Insurance taxes will remain at a combined 7.65% in 2007. (Double that if you’re self-employed, because you must pay both portions.) But the maximum taxable earnings for OASDI purposes will rise from \$94,200 to \$97,500.

Social networking sites pose both threat and opportunity. By now, you’ve probably read about “social networking” sites (such as myspace.com and facebook.com) that let users socialize and share, well, just about anything. For businesses, these sites pose a threat in terms of both lower employee productivity and the potential exposure of company secrets. But they present an opportunity, too. Newer sites, such as visiblepath.com and linkedin.com, hope to do for business networking what MySpace has done for social networking. It’s a relatively new phenomenon, but one that more tech-savvy companies may find worth exploring.



Ease parental caregiving with the adult dependent tax exemption

The baby boom generation, 78 million strong, is heading into its golden years. One of the many ways this will affect our society is that the children of many baby boomers will find themselves caring for their aging parents in one way or another.

Clearly, providing such care entails a considerable financial burden. That's why it's important for anyone funding caregiving for a parent to know of an important tax break — the adult dependent tax exemption.

It's all about income

This exemption allows qualifying taxpayers to deduct up to \$3,400 (in 2007) for each adult dependent claimed. So how do you qualify? It's all about income — yours and that of the parent in question.

First, for your parent to be considered a dependent, his or her income must be less than \$3,400 (in 2007). Social Security generally doesn't count toward this amount, though any income from sources such as dividends, interest and 401(k) withdrawals does.

Second, you must contribute more than 50% of your parent's financial support. Here Social Security is a factor in that the amount he or she receives may detract from how much you're contributing. For example, your parent may receive less than \$3,200 in income, but if he or she is using Social Security to pay for medicine or other items, you may not be providing enough support to claim the exemption.

On the bright side, if your parent lives in your home, you can factor the fair market rental value of your residence into how much financial support you're providing. However, your parent does *not* have to live

with you for you to claim the exemption. If he or she stays in a separate residence, or lives in a nursing home or assisted living facility, you can still factor your financial support into the 50% test.

There are alternatives

If you aren't able to qualify for the exemption because your parent has too much

income, you may not be out of luck. You may still be able to deduct combined medical costs that you pay for a parent and your own family in excess of 7.5% of your adjusted gross income.

Another alternative to consider is whether you have a dependent-care Flexible Spending Account (FSA). If you do and you hire someone to provide care for your live-in parent while you're working, you may pay up to \$5,000 of the costs with pretax dollars via your FSA.

Last, don't forget about the child and dependent care tax credit. It allows you to claim only a percentage of your total care costs based on your income level. Still, the credit may let you reduce your tax liability, dollar for dollar, by as much as \$3,000. Ask your tax advisor for details.

Relief is available

It's a curious bit of role reversal — children claiming their parents as dependents. Yet as the makeup of our population shifts, this scenario will become increasingly common. If you're currently in such a situation or may soon be, learn all you can about the associated tax breaks. ■





3 hot education-funding tips for 2007

Jeffrey and Marcene like to stay informed. Yet when endeavoring to learn about how to fund their young daughter's college education, they were quickly overwhelmed by their options. Wisely, they sat down with their financial advisor for help narrowing down some of the hot education-funding tips of 2007.

Their advisor nodded knowingly when Jeffrey and Marcene mentioned how much information they had to wade through when contemplating education funding. Fortunately, she was able to fill the couple in on three important education-funding changes that have made news in the past year or so.

1. 529 plans still tax free

There has always been some uncertainty about whether Congress would allow 529 plans' tax-free treatment to expire. Jeffrey and Marcene's advisor clarified matters: The Pension Protection Act of 2006 permanently extended the Section 529 provisions regarding these vehicles.

The most well known type of 529 plan is the college savings plan, in which they can set money aside to pay their daughter's qualified higher education expenses. The other type is the prepaid tuition plan, with which they can secure future tuition at today's prices, regardless of how much tuition increases.

529 college savings plans tend to be popular because funds invested in them grow tax free. And as long as withdrawals are used for their daughter's qualified college education expenses, they're tax free as well.

2. Education credits continue to increase

With Jeffrey and Marcene focusing so hard on funding vehicles, their advisor urged them not to overlook the Hope credit and the Lifetime Learning credit.

Jeffrey and Marcene may be able to claim a Hope credit for the first two years of their daughter's postsecondary education. For qualified tuition and related expenses required for enrollment on at least a half-time

basis, the maximum credit, adjusted annually for inflation, is \$1,650 per student for 2007 and will likely be much higher by the time their daughter is in college.

Similarly, they may be eligible for the Lifetime Learning credit of up to \$2,000 per taxpayer for an unlimited number of years of postsecondary, graduate and certain other education expenses. If Jeffrey and Marcene's joint income is too high to qualify for either credit, their daughter may be able to claim it.

3. IRS permits tax-free prepaid tuition

Jeffrey and Marcene mentioned that their daughter's grandparents may want to contribute financially to her education, too. This reminded their financial advisor of a recent IRS Private Letter Ruling (PLR), No. 200602002, in which the IRS permitted a taxpayer to prepay tuition for his six grandchildren through 12th grade — without triggering estate, gift or generation-skipping transfer (GST) taxes.

She went on to say that, though a PLR applies only to the taxpayer who requested it and sets no legal precedent, this one provides guidance on how the IRS may rule in similar cases. And many generous grandparents are considering the estate planning benefits of prepaying their grandchildren's college tuitions.

The main disadvantage of the technique, besides its legal uncertainty, is that it tends to be somewhat inflexible. It's vital, therefore, to understand the rules.

For example, there's no guarantee the money will be returned if the child doesn't attend college.

Thinking ahead

When it comes to funding a college education, it certainly pays to stay informed. Jeffrey and Marcene did just that — and you should, too. ■





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