

# Trendlines

*New Directions in Business and Personal Planning*



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The right policy can bring peace of mind

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Charity deals on wheels can have much to conceal

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# Don't bet your life — insure it

*The right policy can bring peace of mind*

What if you died suddenly and left your spouse and children to fend for themselves? Could they maintain their lifestyle and pay for future expenses — including estate taxes? No one enjoys pondering this scenario. Yet it's all too possible, which is why you need life insurance — if not now, then eventually.

## Assess your needs

Life insurance isn't for everyone. If you're young, single and without dependents, you may not need it. But as you get older and assume more responsibilities, your need increases. Among the primary justifications for buying a policy are:

- ❏ Other people depend on your income,
- ❏ You have outstanding debts and long-term obligations, such as a mortgage or personally guaranteed business debt,
- ❏ You want to send your children to college, or
- ❏ You wish to ensure that your heirs will be able to pay estate taxes without having to liquidate your assets.

For these reasons, you should review your need for coverage at least annually to determine whether you need to buy or augment a policy.

## Find your flavor

Life insurance generally comes in two basic flavors:

**1. Term coverage.** This is the simplest and most inexpensive type of life insurance — particularly if you buy coverage when you're fairly young. Term policies pay a benefit if the insured dies while the policy is in effect. Their primary benefit is that you can buy a lot of coverage at low cost.

The downsides? When that term expires, your policy has no value. Plus, you'll need to reapply for coverage and your premiums will likely rise — you may even become uninsurable.

On the bright side, term rates are currently quite competitive. Just be sure to review the coverage details — for instance, determine how long the premium is guaranteed. Try to find a policy that secures the premium for the entire term. Check the conversion rules as well. If you're unsure how long you'll want coverage, you may be able to convert a term policy to a permanent one.

**2. Permanent (also known as whole life or cash value) coverage.** These policies combine insurance with tax-sheltered savings. If you die with an active permanent policy, your survivors will receive a death benefit. The policies build cash values, too. So if you decide you no longer need the insurance, you can surrender the policy and take the proceeds.

What's the catch? In a word, cost. Because these policies are guaranteed for life (assuming you pay the premiums), they're more expensive than term policies with the same amount of coverage. In fact, the expense of permanent life insurance may prohibit you from obtaining the coverage you really need. And though permanent policies are an investment, they're not historically known for high returns. You may be better off buying term insurance and investing your money in other ways.

Then again, you can lock in lower premiums when you're younger and not have to worry about



becoming uninsurable. Permanent coverage may also play an effective estate planning role. (We discuss this more below.)

## Determine how much

Once you decide *whether* you need life insurance (or additional coverage) and what type of policy to buy, you can determine *how much* you need.

A rule of thumb for most people is to buy enough to cover five to seven times their annual incomes. And wealthier individuals may want a policy covering up to 10 times that figure.

But, ultimately, how much life insurance you really need depends on your financial picture. First, you must ensure your policy will cover immediate expenses following your death, such as funeral costs and urgent debts. For instance, if you're a business owner, you may have loans that are contingent on your ability to continue running the company. Creditors may call these in if you die.

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Second, you need to replace your income so your survivors can maintain their lifestyle. Suppose they'd need at least \$300,000 to cover immediate costs and then \$50,000 a year thereafter. Assuming your insurance proceeds earned at least 5% a year, your family would require a lump sum of \$1 million to generate the desired annual income without touching the principal. Therefore, you might buy a policy that would pay about \$1.3 million on your death. Of course, you should also factor in Social Security benefits and other income sources.

## Look far ahead

Retirement is another important issue. If you live until 65, for example, you may no longer need life



insurance. Then again, at that point, you may want it less for income replacement and more for estate planning. Many married couples with substantial assets use second-to-die policies to pay estate taxes. The death benefit is paid after the second spouse passes away, when these taxes typically are incurred.

Yet whether insurance proceeds are included in your taxable estate depends on who owns the policy when the insured dies. If the deceased owned the policy, the proceeds are pulled back into the estate at death.

But if someone else owns it, they're excluded. That "someone else" could be another individual (your spouse or children, for instance) or some other entity (such as a trust). Who owns a policy can be just as important as its type and coverage amount.

Should you plan to transfer ownership of a policy on your life that you currently own, note that the transfer must occur at least three years before your death for proceeds to be excluded from your taxable estate. Depending on the circumstances, it may be better to get a new policy than to transfer an existing one.

## Find the right amount

Above all, one size of life insurance doesn't fit all. Finding the right kind and amount is tricky but critical — your loved ones' futures may depend on it. Your financial advisor can perform a comprehensive analysis of your insurance needs, offer you an objective opinion about them and assist you in acquiring a policy that's right for you and your family. □



# Exempt or nonexempt?

*New overtime regulations may update this key employment distinction*

Employers and business advocacy groups have complained for years about the obsolescence and unnecessary complexity of the overtime pay rules. So, in April of this year, the Department of Labor finally modernized its rules.

But the story doesn't end there. As this newsletter went to press, Congress was locked in a heated debate about whether to accept or amend the new rules, which officially take effect in mid-August. Let's look at the basic issues driving this debate — including details about the new regulations.

## Determining worker status

Your obligation to pay overtime hinges on whether employees are classified as “exempt” or “nonexempt.” Exempt employees aren't protected by the Fair Labor Standards Act (FLSA) and, as their employer, you aren't subject to the law's mandates regarding overtime.

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*The new rules most affect white-collar employees, because more than ever they'll likely be exempt.*

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Nonexempt employees are protected by the FLSA, so you must pay them the federal minimum wage of at least \$5.15 per hour for up to 40 hours in a workweek. If they exceed 40 hours in a workweek, you must provide overtime pay at 1.5 times their regular pay rate. (Note: The FLSA exempts some types of workers — including seasonal staff, full-time students and tipped employees who otherwise would be classified as nonexempt.)



## Looking at the highlights

To keep your business out of trouble, you need to understand not only the basic distinctions between exempt and nonexempt employees, but also the updated rules. As of this writing, here are some highlights of where the new regulations stood:

### Higher pay limit for automatic nonexempt status.

Employees who make less than \$455 a week or \$23,660 a year are entitled to overtime pay at 1.5 times their regular pay rates even if they hold positions that typically would be exempt — executive, administrative or professional. Previously, only workers earning \$8,060 or less were guaranteed this protection.

**More highly compensated employees exempt.** Workers performing office or nonmanual work and making

more than \$100,000 are exempt from overtime pay if they regularly perform at least one of the duties of an exempt executive, administrative or professional employee as identified in the new simplified standard test. (See “Getting stiff with white collars” below.)

#### **Fewer professions guaranteed overtime.**

Employees earning \$23,660 to \$100,000 in certain professions that previously would have been nonexempt will now more likely be exempt. These may include pharmacists, insurance claims adjusters, chefs, funeral directors and embalmers, athletic trainers, journalists, and other jobs. For some examples of specific qualifying occupations, visit the Department of Labor’s web site at [www.dol.gov](http://www.dol.gov).

**Bolstered blue-collar protection.** Law enforcement officers, firefighters and other emergency responders are guaranteed overtime protection, as are virtually all blue-collar workers, regardless of how highly paid they might be.

The new regulations also clarify guidelines for positions that have been subject to considerable litigation. For instance, the rules stipulate that a retail store manager or assistant manager can perform concurrent nonsupervisory duties — such as serving customers or stocking shelves — and still be exempt.

### **Getting stiff with white collars**

The new rules most affect white-collar employees, because more than ever they’ll likely be exempt. Workers who typically fall into areas such as executive, administrative, professional (subdivided into “learned” and “creative” categories), computers and outside sales usually are exempt. But job titles alone don’t determine

### **4 typical overtime-pay compliance problems**

The Department of Labor has warned companies of the following four overtime-pay compliance problems:

- 1. Paying a fixed sum for overtime.** Employers can’t offer lump sums for varying amounts of overtime work. They must follow the Fair Labor Standards Act (FLSA) rules, documenting the number of hours worked and paying workers accordingly.
- 2. Defining a workweek as more than 40 hours.** A company that sets a salary for a workweek that exceeds 40 hours doesn’t avoid overtime obligations. It must still adhere to the FLSA.
- 3. Asking employees to work “off the clock.”** Some businesses, often smaller or family-owned ones, may be tempted to simply not record workers’ overtime hours and pay them the additional compensation in cash. Doing so violates the FLSA and may lead to severe punitive consequences.
- 4. Waiving overtime.** An employer-employee arrangement — such as agreeing to count only eight hours a day or 40 hours a week as working time — doesn’t negate the overtime requirement. And companies can’t circumvent the FLSA by prohibiting overtime or refusing to pay it without advance authorization.



exempt status. And though an employee must be salaried to be exempt, being salaried alone doesn’t necessarily make that person exempt.

What does establish exemption? Well, the new regulations eliminated the “long” and “short” tests for determining status and replaced them with a simplified standard test. It includes the salary test alluded to previously — that is, an exempt employee must receive at least \$455 per week or \$23,660 a year.

In addition, duties tests apply to each white-collar exemption area. For instance, to qualify for the administrative employee exemption, primary duties must involve office or nonmanual work directly related to the management or general business operations of the employer or its customers. Moreover, the employee needs to exercise discretion and independent judgment regarding matters of significance.

To be an exempt executive, an employee must (along with satisfying the salary test) manage the enterprise in question or one of its parts, as well as regularly direct the work of at least two or more other full-time employees. He or she also needs to possess the authority to hire or fire others or to make relevant recommendations about hiring, firing or advancement.

Employees who meet these requirements and earn \$23,660 or more annually (such as department managers) don't qualify for overtime, regardless of how many hours they work. Again, for more information on the different duties tests for various occupations, visit [www.dol.gov](http://www.dol.gov).

## Minimizing the impact

Whether deliberate or intentional, misclassifying your workers can have severe consequences — including having to pay back wages, attorneys' fees and even liquidated damages for violating the FLSA. And, to complicate matters, Congress may have enacted legislation changing or even negating some of the rules mentioned here since this newsletter went to press. So be sure to get an expert's advice to protect yourself. □



### Moneylines: News briefs for businesses and individuals

**New act grants temporary pension plan relief for employers.** The Pension Fund Equity Act of 2004 was signed into law by President Bush this past April. It replaces — for 2004 and 2005 only — the 30-year Treasury bond rate with a rate based on long-term corporate bonds. Thereby, employers with qualifying pension plans may be able to lower their required contributions during these two years.

**Medicare Web site now rates home care providers.** More than 3.5 million people in the United States require home care every year, according to the federal government. This involves needing assistance with activities of daily living, such as moving about, preparing meals and taking medicine. But, until recently, little information existed about the agencies that provide home care. Fortunately, you can now find rated comparisons of all Medicare-certified providers at the federal Medicare Web site, [www.medicare.gov](http://www.medicare.gov), or by calling 800-MEDICARE.

**IRS audits fewer businesses in 2003.** If you've worried about a tax audit striking your company, you can rest a fraction of a percentage point easier. The audit rate for businesses of all sizes was 2.1 audits per every 1,000 companies in 2003, according to a Syracuse University Transactional Records Access Clearinghouse study. That's a slight decline from the same 2002 analysis, which found the IRS audited 2.2 companies out of every 1,000. The IRS partly blames the drop on the profusion of corporate tax shelters, which make business audits much more complex.

**Online bill paying coming into its own.** Once thought the territory of only the most tech-savvy consumers, online bill paying is catching on fast — and for good reason. Paying creditors via the Web can save you time and money. Compare a few keystrokes and a mouse click to the typical snail-mail bill-paying process. And faster, easier payments may mean fewer late fees and an increased awareness of your finances. It's safer, too, with most Web sites now guaranteeing secure, timely payments. Best of all, you can pay all your bills via a single site (typically your bank's), which boosts convenience even more.



# Charity deals on wheels can have much to conceal

Donna and Fred recently became empty nesters when their twin daughters left for college. Along with having two empty rooms and lots of extra closet space, the couple owned a minivan they rarely used anymore. Fred wanted to trade it in for a sports car, but Donna had other ideas.

She wanted to donate the minivan to charity. “That way,” she said, “we can do some good and deduct it from our taxes.” After some spirited discussion, Fred gave in but insisted the couple discuss the move with their financial advisor.

It's a good thing they did. Their advisor informed them that vehicle donations have been getting quite a bit of attention lately. The IRS issued a consumer alert (IR-2003-139) late last year warning of the “potential pitfalls” of these transactions. The alert cited a General Accounting Office finding that one recent donation of a 1983 truck worth \$2,400 netted the recipient charity only \$31.50 after administrative and advertising costs.

Then, in April of this year, a Senate Finance Committee staff member reported that Congress may impose strict limits on vehicle-donation middlemen. These include the auctioneers and brokers who often pocket “85% or 90% of the [vehicle's] value,” said the staffer.

## 3 steps to a smooth ride

On learning all this, Fred wondered whether he should trade in the minivan for that sports car after all. His advisor replied that the couple could still safely donate their vehicle, and Fred could use the savings from the tax deduction for a down payment on his red-hot roadster — but only if they followed these three steps:

**1. Check out the charity.** To qualify for a tax deduction, Donna and Fred must donate to an eligible charitable organization according to IRS Publication 78. But, equally important, they should verify that their contribution will indeed go to the needy — not administrative costs or a third party.

Some key questions they should ask: Does the charity plan to keep or sell the minivan? If the latter, will it use a broker? And will the organization receive a reasonable percentage of the proceeds or simply a flat per-vehicle fee unrelated to the sales price?

**2. Calculate the vehicle's fair market value.** Donna and Fred were shocked to learn they can't simply deduct their minivan's Blue Book value. Rather, they must estimate its fair market value. Calculating this amount means considering the vehicle's overall condition and its current mileage. IRS Publication 561, *Determining the Value of Donated Property*, contains detailed instructions for doing this properly.

**3. Document the donation.** Before donating their minivan, the couple must document its condition by taking pictures and maintaining written evidence of repairs. (They'd need to show this documentation only in the event of an IRS audit.) After the donation, if the vehicle is worth more than \$500, they must attach a completed IRS Form 8283 to their tax return. If it's worth \$5,000 or more, they need to attach a qualified appraisal to their tax return and have IRS Form 8283 signed by the appraiser and the charity.



## The highway to help

Like Donna and Fred, you may be ready to send your vehicle down the “highway of help” to a qualified charity. Just make sure you're actually doing all the good you think you are — and getting the maximum tax benefit, too. □



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***Keeping up is not enough. We strive to stay ahead and lead.***