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If you're thinking about ways to fund your child's education, the Federal government has provided an incentive—the **Coverdell Education Savings Account (Coverdell ESA)**, formerly known as the Education IRA. Contributions are not tax deductible, but withdrawals for eligible education expenses are tax free.

If you are a parent who wishes to open a Coverdell ESA for your child, keep in mind that there are income eligibility limits. Contributions phase out for single taxpayers with adjusted gross incomes (AGIs) between \$95,000 and \$110,000, and for married couples filing jointly with AGIs between \$190,000 and \$220,000.

You may contribute up to a maximum of \$2,000 annually per child before the designated student reaches age 18. Contributions are subject to the gift tax; the **annual gift tax exclusion** limits are \$13,000 for sin-

gles and \$26,000 for married couples in 2010. Be sure to keep in mind that, if you also contribute to a 529 plan for the same child during the same year, you will need to add these gifts together to determine your gift tax filings.

There is no limit to the number of accounts that may be held in a child's name or the number of people who may make contributions to a Coverdell ESA—as long as total contributions remain within the \$2,000 annual limit per child. If multiple accounts are established and the total contribution



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Business Owners Plan for the Unexpected

Most business owners have **life insurance** to protect their families financially in the event of their death. They also have **property and casualty insurance** to protect the value of their personal belongings in the event of damage, fire, or theft. However, many business owners often overlook, and therefore fail to insure, their most valuable asset—their ability to earn an income.

That Won't Happen to Me!

A lack of awareness about the possibility of sustaining a disability or being diagnosed with a debilitating illness leaves many business owners, as well as their businesses and their families, vulnerable to financial hardship. Despite the risk, many small businesses lack **disability insurance**.

If you were to sustain a disability or an illness that prevents you from working, how would you pay for housing, insurance, food, transportation, clothing, etc.? Would your business be able to continue generating income? Do you have money in savings to support yourself and your family during a six-month disability or an extended illness? Or, if an employee was suddenly disabled, would you be able to fund disability benefits for that employee?

The Cost-Effective Solution

There is a reasonably simple and cost-effective solution to such situations. Business owners may establish a **wage continuation plan** for themselves and their employees. Such plans can help ensure that owners and employees will continue to be paid during a long-term disability. Consider the following advantages:

- If structured properly, the payment of benefits to a disabled employee or owner may qualify as “necessary business expenses.” Under Section 162 of the Internal Revenue Code, they can be tax deductible.
- A **wage continuation plan** can promote loyalty among current employees and attract new employees.
- Policies create the presumption of a plan for tax purposes and establish a proactive company policy. Without the presumption of a plan, the tax deductibility of insurance premiums may be challenged.



Funding the Plan

Once the commitment has been made to establish a wage continuation plan, the next step is to decide how to fund the plan. Possible funding options include current revenue and retained earnings or borrowing. While such funding options may create financial difficulties, a disability income insurance policy can provide distinct benefits, such as the following:

- Policies transfer the risk of salary continuation from the employer to the insurance company. In effect, a potentially open-ended drain on cash flow is replaced with a leveraged, fixed business expense—the premiums.

Tax Consequences

If the business pays the premiums for a wage continuation plan, the business can deduct the premium payments as a regular business expense, provided such contributions are reasonable. Although the premiums are not considered a taxable benefit to the employee, any disability income insurance proceeds received by the employee generally would be taxable income. Disability income benefits received from a plan during the first six months of a disability may be subject to Social Security tax (FICA) and Federal unemployment tax (FUTA).

However, if you are a **sole proprietor**, a **partner** in a partnership, or a more than 2% stockholder in a **subchapter S corporation**, you may not be able to deduct the cost of disability income insurance for yourself as a business expense, but you could deduct the cost of such insurance coverage for your employees.

Customizing a Policy

Generally, disability income insurance policies can be tailored to meet specific needs, often with riders, and cost is generally determined by the type and extent of coverage. For example, “own” occupation coverage (benefits would be paid for a disability that limits one’s ability to work in one’s chosen occupation) is usually more expensive than “any” occupation coverage (benefits would be paid for a disability that limits one’s ability to perform any gainful work).

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Tips for Sealing the Deal When Lending Funds to Your Child

Have you ever considered lending money to your child for a down payment on a new home, to bankroll a business venture, or for some other large expense? Many adult children seek financial assistance from their parents if they encounter difficulty securing a bank loan due to lack of a credit history or collateral. Many parents want to help their children succeed in life and are willing to give them a financial boost if they have the means. Though most parent-child loans do not go awry, if a loan does sour, it can have serious consequences for parents. Here are four points to consider before lending funds to your child:

1. Document the Loan. If you expect the money to be repaid, consider treating the loan as seriously as a banker would by requiring the proper documentation. If you seal the deal with a handshake and the business later fails, you must be able to convince the Internal Revenue Service (IRS) that you made a *bona fide* loan in order to deduct it as a bad debt. To give yourself a sound basis for a tax write-off, request the following:

- A note and *written* loan agreement
- Collateral or other form of security

- A repayment schedule and repayment records
- A plan indicating that the loan will be repaid as scheduled
- Proof that a business was solvent when the loan was made, if applicable

Proper documentation may also help you avoid other complications. For instance, if your child were to divorce, a written loan agreement identifying who is responsible for repayment, and on what terms, could prevent a former spouse from refusing responsibility for the debt or claiming that the money was a gift. It could also keep an ex-spouse from obtaining—through the division of marital assets—a controlling interest in a company you funded.

2. Know the Rules. The IRS allows you to deduct bad debts only after you have tried to collect them by legal means, if necessary. So if you want to write off the loan, you must be prepared to take legal action to collect it.

If legal action is appropriate in your situation and you're still unable to collect the loan, you may write it off as a **short-term capital loss** by subtracting the outstanding loan balance from your total short- and long-term

capital gain for the year. If the loss exceeds your total capital gain, you may deduct it in \$3,000 increments each year until it is entirely written off.

3. Treat the Bad Debt as a Gift. Instead of a lawsuit, you may have the option of treating the bad debt as a gift. In 2010, the IRS allows each taxpayer to give up to \$13,000 per person per year free of gift and estate taxes. Thus, both parents together could offset an uncollectable debt with a combined gift of up to \$26,000 per year with no tax consequences. (Any amount exceeding this limit may be subject to gift and estate taxes.)

4. Use Common Sense. Lending money to a child may have certain tax consequences for you, so it's important to be prepared. Consider the odds of a successful follow-through on your child's part. Think twice before lending money for a risky venture unless you are willing to part with it as a gift with possible tax consequences, if needed.

Helping a child to succeed in life can be an exciting and rewarding experience for a parent. However, be aware of potential tax traps and legal pitfalls *before* opening your checkbook, and seek professional advice before sealing the deal. ■

What Are Those Old Clothes Worth?

When you give four bags of your old clothes to a favorite charity, you may receive a receipt for four bags of old clothes. But, the value of the pile as a **charitable tax deduction** is left up to you to determine. How much is too much? The Internal Revenue Service (IRS) has tried to eliminate most of the guesswork. You

should deduct only the **current fair market value (FMV)**, or in other words, what the clothes would fetch in a used clothing store or flea market.

To protect yourself from an IRS challenge, keep records of *what* you contributed to *which* charity, along with a description of the items. If you claim a deduction exceeding \$500,

you must file Form 8283, "Noncash Charitable Contributions." And, if you donate a shoe collection worth more than \$5,000 or other "similar items" amounting to that much—for example, a library of books—you must have a qualified appraiser verify the total using Section B of Form 8283. ■

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exceeds \$2,000, the excess is subject to a 6% excise tax penalty. You can, however, eliminate the penalty by withdrawing the excess contributions (and any earnings) before the due date for the beneficiary's tax return for that year. The withdrawal would be considered income, and it would be subject to taxation.

Coverdell ESA funds can be used to pay for more than just college expenses. Funds can also be used to pay for elementary and secondary school expenses, including the pur-

chase of computer systems, educational software, and Internet access for the child.

A Few Holds Barred

The beneficiary must spend a Coverdell ESA by his or her 30th birthday. If the designated child does not use the funds for educational purposes by that age, the account may be rolled over to another member of the family who is under age 30. Withdrawals from a Coverdell ESA that are not used for qualified

education expenses may be subject to both income taxes and a 10% penalty.

Finally, if you're hoping your child will qualify for financial aid for college, you may want to think twice about setting up a Coverdell ESA, as such an account must be set up in the child's name. When determining how much a family can afford to contribute to the cost of college, assets held in a child's name count more heavily than those held in the parents' names. Therefore, it may be more difficult to obtain financial aid. ■

business owners plan for the unexpected

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The length of the **elimination period** (the waiting period before benefit payments begin) and the maximum benefit provided (stipulated by dollar amount, length of time, or a combination of both) are other significant variables in plan design and cost.

One crucial area often overlooked in business disability planning is the completion of retirement funding for a disabled owner. What happens when there are no earnings (due to disability) to continue funding retirement? This problem may be addressed by purchasing a disability policy

designed to help fund a shortfall in retirement planning.

Other Coverage Options

Key person disability insurance and **disability overhead expense policies** are two other important coverage options. Key person disability insurance (DI) will pay a monthly benefit based on the key employee's pre-disability earned income. The monthly DI benefit can then be used to provide revenue to hire and train a replacement or to strengthen the company's cash flow. The second option, a disability over-

head expense policy, can help pay for overhead expenses should you become disabled under the terms of the policy. Thus, if you are temporarily unable to generate revenue, you can rest assured that the business bills will continue to be paid without interruption.

The key to proper design begins with a realistic understanding of the risks associated with a disability. The appropriate policy can provide financial security for you and your business to help mitigate the potentially devastating effects of a major accident or long-term illness. ■

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