

Patrick J. McNamara, MSFS
E-mail: pmcnamara@finconcepts.com

Financial Concepts, Inc.

A Member Firm of M FINANCIAL GROUP

617 Detroit Street, Suite 120

Ann Arbor, MI 48104-1112

Tel: (734) 214-9770 • Fax: (734) 214-9771

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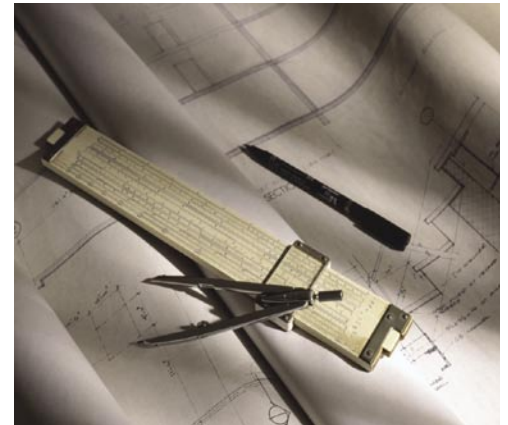
If you are an inventor, author, artist, or owner of a closely held business, you may have already taken steps to ensure the protection of your **intellectual property rights**. Business ideas, visual art, published or unpublished literary and musical works, inventions, computer programs, and designs of clothing and architecture can be protected by law through copyrights, patents, and trademarks. These valuable assets also need to be carefully considered when planning your estate, so that they are transferred to your heirs according to your wishes upon your death.

Issues and Concerns

Intellectual property is a unique asset in that it is an expression of an individual's knowledge and ideas. While not simply a thought itself, intellectual property is an intangible asset that is the direct result of work or trade. Just as no two individuals think alike, each estate owning intellectual property must be handled differently. This area of estate planning is continually evolving, particularly as intellectual "capital" continues to become a greater factor throughout commerce in general.

To begin, it is important to determine if the intellectual property can be passed down to heirs. Certain types of intellectual property may have inherent **renewal** or **termination rights** through copyrights, patents, and trademarks. This can create additional questions as to *when* intellectual property rights become part of the public domain.

To address these concerns, some owners of intellectual property choose a specific executor to handle intellectual property issues in their estates. For example, an author may appoint a family member to oversee the general administration of his or her estate and a second fiduciary just to handle the posthumous publication of additional literary works.



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A Vacation Home: The Ultimate Hideaway

If a mountain getaway or an ocean view has become your American dream, then perhaps you should know that a vacation home can offer some tax savings that may help pay for your hideaway. The tax laws differ depending on whether you use the home solely for enjoyment or mix business with pleasure by renting the property part-time.

As long as the combined debt secured by the vacation home and your principal residence does not exceed \$1 million, you can deduct all of the interest paid on a mortgage used to buy a second home. This advantage is restricted to two homes. If you purchase a third, interest on that mortgage is not deductible. However, no matter how many homes you have, you may be able to deduct all the property tax you pay.

One break enjoyed by homeowners—the right to immediately deduct points paid on a mortgage—applies only to a principal residence. Points paid on a loan for a vacation home must be deducted gradually as you pay off the mortgage.

Personal Residence

Your vacation home counts as a personal residence even if you rent it for up to 14 days a year. In that case, you get to retain the rent tax free and don't jeopardize your mortgage interest and tax deductions. However, you may not deduct any rental-related expenses. If you rent out the house on a continual basis, things may become more complicated. Different rules

apply depending on the breakdown between personal and rental use.

First, if you buy primarily for pleasure but rent for 15 days or more, the rent you receive is taxable. Because the house is still considered a personal residence, you get to deduct all the interest and property tax. You may also be able to deduct other rental-related expenses, including the cost of utilities, repairs, and insurance attributable to the time the house is



rented. In some cases, you might even get to deduct depreciation.

When the house is considered a personal residence, rental deductions cannot exceed the amount of rental income you report. In other words, your second home cannot produce a tax loss to shelter other income. In most cases, the interest and taxes assigned to the rental use of the house, plus the operating expenses, more than offset rental income, limiting your ability to write off depreciation.

Rental Property

Now consider your tax situation if you buy a property primarily as an investment and limit your personal

use of the property to 14 days a year (or 10% of the number of rental days if that allows you more than 14). Because the house is a rental property in the eyes of the Internal Revenue Service (IRS), your deductions can exceed the amount of rental income you receive.

If your rental income does not cover the cost of renting the house, you may be able to claim a taxable loss. Rental losses are classified as passive and can be deducted only against passive income, such as another rental property that realizes a gain. If you do not have passive income to shelter, the losses have no immediate value (unused losses can be used in future years when you have passive income).

There's an exception to this rule, however, that permits taxpayers with adjusted gross income (AGI) under \$100,000 to deduct up to \$25,000 of passive losses against other kinds of income, including salaries. To qualify, you have to actively manage the property. The \$25,000 allowance is gradually phased out as AGI rises between \$100,000 and \$150,000.

When your vacation home is considered a rental property, the mortgage interest attributable to the time the premises are rented is a business deduction. The rest, though, cannot be deducted as home mortgage interest since the house doesn't qualify as a personal residence.

The tax laws discussed here also apply to homes other than houses, such as apartments, condominiums, mobile homes, or boats with basic living accommodations. Generally, these include a sleeping space, bathroom, and cooking facilities. Hotels, motels, and inns are treated differently. ■

Financing Your Own Business

Starting a new business can be an exciting prospect. In fact, finding a location, formulating a business plan, and hanging the “Open” sign might be one of your long-cherished dreams.

However, securing capital to begin operations can often be frustrating and difficult. There are a number of potential sources of financing to explore. Some entrepreneurs are able to secure bank loans or venture capital. For owners who qualify, the Small Business Administration (SBA) guarantees loans, thus easing the route to financing. Other prospective business owners may turn to family members or friends for support.

Using Personal Funds

Typically, however, personal funds are one of the most common primary sources of start-up capital. Indeed, many successful entrepreneurs believe they are their own best sources of financing. In some cases, they may prefer to finance their start-ups out of their own pockets because they would rather assume the risk than share the equity in their businesses. In other cases, they may simply be unable to raise sufficient capital from outsiders.

Here are some key reasons why business owners may tend to personally finance their ventures:

- **Control.** Entrepreneurs are often willing to assume greater risk in order to retain greater control over their businesses. A dilution in ownership could result in a less focused business direction. Founders who wish to retain control but require start-up capital from outside sources may want to consider including a “**buy-back**” clause in the financing agreement.
- **Speed and Simplicity.** Some small businesses may be started quickly and relatively easily with personal funds. Founders usually have a good understanding of their business needs, are sufficiently able to project the initial costs of doing business, and may thus prefer to avoid the time and intrusion of outside scrutiny.
- **Modest Needs.** Many owners may be able to begin operations with only a modest cash infusion. For instance, some of the most common types of businesses—franchises, start-up operations, and small family businesses—may not require capital-intensive planning for initial operations. In particular, service businesses may tend to have lower initial operating costs and a shorter

“burn rate” (i.e., the length of time before achieving a positive cash flow).

- **Nonfinancial Costs.** Most start-up businesses require specialized knowledge or expertise that enables the owner to personally manage initial operations. Some of the most popular ventures are construction companies, restaurants, cleaning services, automotive repair shops, beauty salons, computer service and repair businesses, and consulting services. In these types of businesses, many of the start-up costs are actually “paid in the trenches” before the company is founded.

Every Endeavor Is Different

The dream of owning your own business may be within your reach. However, if you are contemplating launching your own venture, local banks, business organizations, trained professionals, and, occasionally, family members and friends may be ready to lend a hand. A sound financial plan outlining your capital resources and requirements is a good first step on the road to fulfilling your vision. ■

Deducting State and Local Sales Taxes

The American Jobs Creation Act of 2004 made it possible for taxpayers who itemize their deductions to deduct state and local sales taxes instead of state and local income taxes, but this option expired on December 31, 2005. Thanks to the Tax Relief and Health Care Act of 2006, this deduction has been

extended through 2007. This option holds the most benefit for residents in states with no income tax or for those living in states with low income tax rates but high sales tax rates, provided their earning and spending make the numbers work.

There are two ways to determine the amount of your deduction:

1) calculate the actual amount of sales tax you paid, which would require your having saved receipts to substantiate the amount of your deduction in the event of an audit; or 2) use a standard IRS table, which will figure an amount based on your adjusted gross income, dependents, filing status, and state of residence. ■

estate planning for intellectual property

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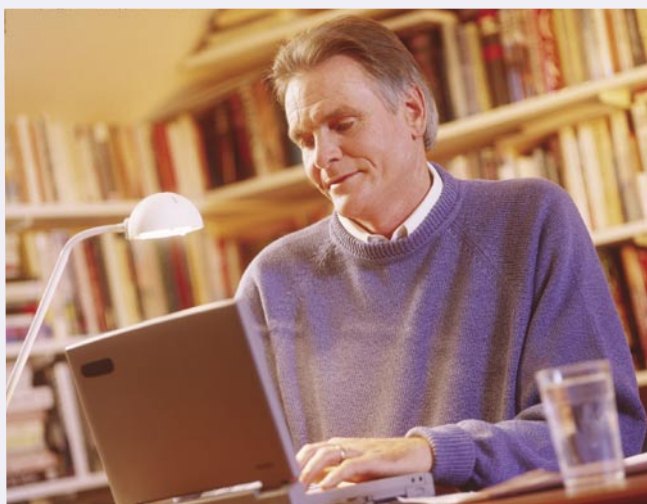
The valuation of intellectual property also poses a challenge to estate planning. The Internal Revenue Service (IRS) offers guidelines for some, but not all, types of intellectual property. For instance, the valuation of literary work is based on the copyright's future earnings potential reduced to its present value. Theoretically, this valuation methodology may apply to other types of intellectual property, as well. However, the question may remain as to how far into the future the potential for earnings may exist.

It may be possible to engage the services of a professional appraiser to help determine the current value of intellectual property and how future trends may affect this value. In this case, it is important to choose someone with special training and expertise in handling intellectual property.

Estate Taxation

The issue of estate taxation is one that affects anyone with substantial assets, regardless of the type of property that is included in his or her estate. However, intellectual property sometimes creates additional con-

cerns. Just as an executor might be hard-pressed to sell a family vacation retreat solely for the purpose of raising cash for estate taxes, a best-selling author may be uncomfortable with the thought that after his or her death, the future publication rights to an unpublished work will be sold for a similar purpose. This feeling can be further multiplied if a large portion of an individual's assets is "intellectual" in nature.



Life Insurance

Life insurance can play a pivotal role in keeping intellectual property in a decedent's family. A life insurance policy purchased and owned by an **irrevocable life insurance trust (ILIT)** (created for the benefit of the decedent's family) can provide cash at death to satisfy any estate tax obliga-

tions. This use of life insurance can help solidify the estate plan and secure the future rights and ownership of intellectual property in accordance with the wishes of the decedent.

Charitable Giving

Also, the **charitable giving** of intellectual property may mitigate the effects of estate taxes. For gifts of intellectual property during the donor's lifetime, the charitable income tax deduction is generally insignificant, because such a deduction is based on cost basis rather than **fair market value (FMV)** at the time of the gift.

However, the charitable bequest of intellectual property through a will may yield a better result. In this case, the estate of the decedent would receive a charitable contribution deduction against estate taxes based on the fair market value of the gift at death.

One Step at a Time

Estate planning for intangible assets such as intellectual property involves an array of complicated considerations. A basic understanding of the issues involved merely underscores the need for appropriate planning to help ensure the ultimate distribution of your assets according to your desired wishes. Be sure to consult your estate planning team, including financial, legal, and tax professionals. ■

The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any Federal tax penalties. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.