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A tax, business, and financial planning newsletter for our clients and friends

Little-Known Year-End Tax Strategies

Most taxpayers know that the usual way to minimize income tax is to defer income and build up as many deductions as possible before the year ends.

However, you might come out ahead of the game by taking the opposite approach if you know you'll be in a higher tax bracket next year, if you've had a below average year this year, or if you are subject to the Alternative Minimum Tax this year. If any of these situations apply to you, you'll probably be better off to defer deductions and move income into this year.

Here are some little-known year-end tax strategies you should consider.

Remove your spouse from the family business payroll. Your spouse's salary is subject to Social Security tax, but if your combined incomes are paid only to you, some of your salary may not be subject to the tax. For 2009, earnings above \$106,800 are exempt from Social Security tax.

College savings. Some states allow state income tax deductions for contributions to Section 529 college savings plans. If your state does, and you're planning to send a child to college, consider making one.



Make a charitable contribution of appreciated securities. You can deduct the full fair market value of the securities. Furthermore, you won't have to pay tax on the increase in their value.

Write off bad debts. You can deduct bad debts as a capital loss, but only in the year in which they become totally worthless. To substantiate the worthlessness of a bad debt, send a letter demanding payment to the debtor or consider filing a suit against the debtor in small claims court. Be sure to take steps to establish worthlessness before the end of the year.

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taxPOINTS

Prepay deductible state and local taxes not due until 2010. Paying them by the end of 2009 gets you a federal deduction for these taxes this year. **Caution:** Don't prepay if you are subject to the Alternative Minimum Tax. **Examples:** Property taxes... estimated state income tax payments due in January... the final state income tax payment for 2009 due on April 15, 2010.

Loophole: Deduct more losses by properly structuring the company's financing. In general, you can deduct S corporation losses on your personal income tax return only up to the amount of the money you have invested in or loaned to the company (your tax basis). **Trap:** If the company borrows money that you guarantee, the "loan" is not considered part of your tax basis in the corporation. Instead, borrow the money yourself and then lend it to the company.

Loophole: Operate the S corporation as a cash-basis taxpayer. In general, C corporations that are not personal service corporations cannot operate on a cash basis if the company's average annual sales for three years exceeded \$5 million. Instead, they must use the accrual method of accounting. This rule does not apply to S corporations. **Key:** Select taxpayers that don't keep inventory – such as real estate management companies, sales organizations, computer service companies... with sales up to \$10 million – can use the cash method of accounting. **Benefits:** This defers paying tax until income is actually received, not when it is booked as accounts receivable.

Ten Sure Ways to Business Failure

Ambitious Americans start more than half a million new businesses every year. Yet every year, about four out of five of these new businesses fail. Most of the reasons why budding entrepreneurs don't succeed could have been avoided. Here are the ten most common.

1. Inadequate working capital.
2. Poor accounting records.
3. Inattention to controlling costs.
4. Weak understanding of financial statements.
5. Improper training of employees.
6. Failure to plan far enough ahead.
7. Weak internal controls that invite theft.
8. Not selling aggressively.
9. Carrying inadequate insurance
10. Failure to seek professional advice.

Better Customer Service

The purpose of good customer service is to get future sales. It's a mistake to think that customer service exists only to complete a sale.

For example, if you are forced to wait too long in a check-out line, you'll probably put up with it the first time, but not the second. But if check-out service is fast, it's a good sign that a store cares about your convenience and you're likely to return to buy again.



Smarter Purchasing

Buyers will often tell a sales representative that a quoted price is too high because it exceeds the company's budget. While this may cause the rep to lower the price to meet the company's budget, it won't necessarily result in the best price because the company's budgeted price might be higher than the sellers' lowest price.

For example, assume that the company's budgeted cost is \$200. The seller quotes \$220. The buyer reveals the company's budget and the rep reduces the quote to \$200. The buyer is satisfied because the budget limit has been met, but the company still pays more than it should.

A better negotiating strategy is to tell the sales representative that you'd like to buy, but the price is too high. Ask for a price breakdown and explanation of the components that go into the seller's quote. Have your own pricing information prepared so you can show the rep that his price is too high. If the seller can't explain the quoted price, there's a good chance he'll lower it below the company's budget.

When You Can Deduct Personal Legal Fees

When incurred by a business, legal fees are generally deductible as an ordinary business expense. However, legal fees for personal matters are deductible as miscellaneous itemized deductions only if they are incurred for the following services:

- The collection or production of income.
- The management of income producing property.
- The resolution of tax matters such as tax determination, collection or refund.

In addition, there are certain personal matters for which legal fees may be deductible. Some of these include the following.

Executor's commission. An executor who incurs legal fees to obtain taxable income can claim a deduction.

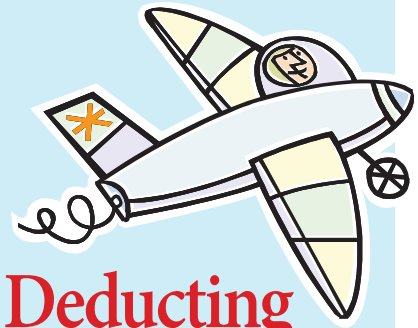
Probate. Legal fees paid for probate by an estate are deductible on the estate

tax return, but strong substantiation of the legal time involved is necessary.

Social Security. Legal fees incurred to collect Social Security benefits are deductible to the extent that the Social Security benefits are taxable. For example, if one-half of the benefits are taxable, then one-half of the legal fees are deductible.

Alimony. Legal fees incurred for the receipt of alimony are deductible. To support this deduction, your attorney must give you an itemized bill that shows how the legal fees were allocated to tax and to non-tax matters.

Personal injury suits. If damages are awarded for lost wages, the portion of the legal fees attributable to recovery of the wages is deductible.



Deducting Your Spouse's Travel Costs

If there is a legitimate business reason why you take your spouse with you on a business trip, you can deduct his or her travel costs. In addition, some of your spouse's travel costs may be deductible even if there is no business reason for the spouse's travel. Some examples:

- **Hotels.** If the rate for a single room is \$140 and the rate for a double room is \$180, you can deduct \$140 of the \$180 of the double room rate.
- **Entertainment.** If you and your spouse entertain a customer, 50% of the cost is deductible.
- **Travel.** If the cost of your single regular fare is \$600 and you are able to purchase special tickets for \$400 each for a couple, you can deduct the regular \$600 fare if you take your spouse.
- **Meals.** As is true of all business meals, 50% of the cost is deductible if your spouse and you have a meeting with a customer and business is discussed.

Home Office Deductions

Having your own business can enable you to have a qualified home office – and deduct expenses for your home that otherwise would be non-deductible.

Examples: Depreciation, insurance, maintenance, repairs, and utilities allocable to the part of your home used as an office.

The office must be a part of your home that you use exclusively for business on a regular basis. It must be either your principal place of business or needed for essential business record keeping.

Strategy: Take photos or a video of your

office space to show how it is used, to be available in case you are ever audited – even after you may have sold the home.



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If your child works for your business, pay your child a salary. Your child can earn up to \$8,350 free of federal income tax. In addition, the child's wages are a deductible business expense. And if the child is under age 18 and your business is not incorporated, the child's wages are not subject to Social Security tax.

Open a Keogh account if you have self-employment income. You have until December 31 to set up a Keogh account that will give you tax deductions for 2009. However, you can open the account with a small amount of money and make additional tax deductible contributions right up to the date your 2009 tax return is due.

Increase your withholding to compensate for estimated tax underpayment. The IRS considers taxes withheld from your paycheck as payments made evenly throughout the year. Therefore, earlier underpayment of estimated tax can be covered by extra withholdings.

Tax-saving strategies for investors

Use capital losses to offset capital gains. Capital losses are deductible against capital gains on a dollar for dollar basis. In addition, you can deduct capital losses which are in excess of capital gains to offset as much as \$3,000 in ordinary income.

Annual minimum distributions. Take any annual minimum distribution you are required to receive from your IRA, Keogh, or other retirement savings plan. If you are age 70 ½ or older, you are subject to such distributions – and failure to take them by year-end results in a 50% penalty.

Early withdrawals. Penalties incurred on early withdrawals of savings (such as time deposits and CDs) are deductible



– so if you are planning to make such a withdrawal soon, doing so before year-end will accelerate the penalty deduction into 2009.

Consider buying put options to defer taxes. A put option gives you the right to sell a stock at a pre-determined price (the "exercise price") before a specific date. If you buy puts on a stock you own that has appreciated in value, you can protect your gain and defer taxes on it until next year. Buy puts that you can exercise next year.

Take a loss on a worthless security. You can deduct losses from the worthlessness of a security in the year in which the security becomes worthless. To establish a loss and the date of the loss, sell the security to a friend for a dollar. Some stockbrokers will also purchase the security for a dollar.

Real estate strategies to lower taxes
Determine the best way to report income from an installment sale. If you sold real estate on an installment sale basis in 2009, you can report the total income from the sale this year or you can spread the income over a period of time. For tax return filing purposes, you can choose either of these methods. Pick the one that's best for you.

Lower your Adjusted Gross Income (AGI). You can partially deduct losses from rental real estate if your AGI is less than \$150,000. Lower your AGI by deferring income into 2010 and accelerating deductions into 2009.

Investment Tip: How to Tell When To Sell Stock

Although many factors can lean you to sell a stock, it's a good idea to have some kind of numerical rule of thumb for ridding your portfolio of stocks that are losing or will become losers.

Many investors tend to sell a stock when it is high in value. If a stock starts falling in price, they hesitate, wanting to wait until it recovers. This strategy can leave an investor with a portfolio full of poor stocks.

A better strategy is to set guidelines for when you will sell, and stick to them. Decide ahead of time which contingencies will cause you to dispose of a stock. Two rules of thumb used by investors are: 1) sell when the company's earnings for a 12-month period go below the earnings for the previous 12-month period; and 2) sell when a stock's price falls by more than 10%.

Another contingency that might cause an investor to sell is that the reason a stock was bought no longer applies.

For instance, suppose you bought shares of Plum Software because it was launching a new product that promised growth for the company. You find out a few months down the road that Plum's plans have fallen through. That is the time to sell. You bought the stock for growth, and no growth is in the offing, so there's no reason to keep it.

Although rules of thumb cannot guide you unequivocally through the stock market, they may save you from taking some big losses.

