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Client Information Bulletin

INSIDE

New Law Raises "Kiddie Tax" Age Threshold

Consider ideas for reducing the family tax bill

As part of the new tax law passed earlier this year, Congress extended the reach of the so-called "kiddie tax." Despite its innocent-sounding nickname, the tax might start to affect families with children well into their twenties.

Background: Normally, income is taxed at the tax rate of the person who receives it. However, unearned income received by a child may be taxable at the top marginal tax rate of the child's parents to the extent that it exceeds an annual threshold. In other words, instead of being taxed at the child's tax rate (usually 10% or 15%), the effective rate on the income may be as high as 35%.

The annual threshold is adjusted for inflation. For 2007, the limit is $1,700 (unchanged from 2006). The first $850 is tax-free; the next $850 is taxed at the child's tax rate. **Reminder:** The tax only applies to unearned income (e.g., capital gains, dividends and interest). Any other income your child earns is exempt from the kiddie tax.

Prior to 2006, the kiddie tax applied only to children under the age of 14. Then a major tax law passed last year raised the age limit to 18. Now the new tax law—the Small Business Work Opportunity Tax Act of 2007—extends the kiddie tax to certain older children.

New tax rule: Beginning in 2008, the age limit is increased to age 19 or age 24 for full-time students. These higher age limits apply if the child does not have earned income equal to half of his or her annual support. In other words, you can't avoid the kiddie tax just because you are no longer claiming the child as your dependent.

Keeping this change in mind, here are several possible ways to reduce the impact of the kiddie tax.

- **Monitor your child's investment income.** If you are careful to stay below the $1,700 fault line, you won't have any kiddie tax problems at tax return time. For instance, in 2008 you might invest in CDs that won't mature until 2009 on behalf of the child.

- Emphasize tax-deferred investments. Instead of investments that produce current income, shift more of your child's portfolio into long-range vehicles such as growth stock. Similarly, if you buy U.S. Savings Bonds in the child's name, he or she generally doesn't have to pay any current tax.
- Switch some investment dollars into municipal bonds. Usually, there are no federal tax consequences for investments in municipal bonds or municipal bond funds. **Reason:** The income received is exempt from federal income tax.
- **Hire your child.** Because the wages are earned income, the kiddie tax doesn't apply. Assuming that the child is paid a reasonable amount for the services actually performed, the business can deduct his or her salary.

Although the recent tax law changes have certainly complicated matters, you still may be able to avoid tax consequences with astute advance planning. Contact a tax professional for in-depth advice pertaining to your personal situation.

Connecting with a New Telephone System

Options for your business to consider

How can you determine the best telephone system to buy for your company? It's not so easy. There are a myriad of choices available to business owners these days. However, with proper guidance, you may be able to meet your needs at a cost within your budget.

Make no mistake about it: Your telephone system is your lifeline to clients, vendors and other business associates. It is imperative that they can reach you easily and that you can reach them. In particular, you don't want key business callers to be disconnected, directed to the wrong party or trapped in a series of automated options.

Of course, there are numerous factors to consider. Although the system must meet your current needs, plan ahead to accommodate expected growth. Furthermore, it can be helpful if the system is compatible with other equipment you already own or need, such as voicemail, messaging-on-hold, headsets and conferencing equipment.

One of the main concerns is finding a system that is the “right size” for your company. This often boils down to the number of outside phone lines or “trunks” required by the company and the number of extensions connected to the system. Don’t forget to count extensions for fax machines, credit card terminals, modems and any other type of equipment requiring a phone connection.

Standard Features

Although the exact components will vary, certain features are often offered as part of the standard package. For instance, the system may include an auto-attendant that answers the phone and directs callers to a specific person or department. **Note:** Even if your company experiences a high volume of calls, you may prefer having a “live” person answer each call.

Conferencing features may also be included in a standard offering. Another common feature is music-on-hold. In addition, the system should enable callers to find people and services at the touch of a button.

The telephones themselves may provide a display of the name and extension of an internal caller, the duration of call and, in some cases, caller ID. The ability to put a caller on speaker phone is also standard in most systems.

Voicemail could be included in a standard package. If it is not, it might be possible to use an existing voicemail setup with a new telephone system you are buying. Consult with the vendor.

Advanced Features

For companies that have more sophisticated needs, modern systems offer many high-tech features. **For instance:**

- With automatic call forwarding, you can redirect incoming calls to employees at home or other remote locations.
- Computer telephony integration (CTI) covers a wide range of applications connecting computers to the phone system. **Example:** You might use one-click dialing for an outbound call center. This way, employees can use contact management applications to place calls without entering the number manually.
- Other CTI applications coordinate incoming calls with caller ID. For instance, a customer’s information may be displayed automatically when an employee picks up.
- Automatic call distribution manages incoming calls to maximize efficiency. It can also track calls to help improve responsiveness.

Take your time analyzing your options. Rely on advice from your business advisers.

How to Best Compensate Your Employees

Combine direct and indirect compensation amounts

Have you been asking yourself how much you will have to pay to retain or attract key employees? Of course, salary is an important part of the equation—no one is denying that—but other forms of compensation may also be persuasive. In some cases, you might need to take a more creative approach.

For starters, consider the amounts paid to employees as either "direct" or "indirect" compensation. Direct compensation is essentially an employee's base wages. This could encompass an annual salary, an hourly wage or some other performance-based pay (e.g., commissions). On the other hand, indirect compensation can take on many other forms ranging from health insurance to retirement plans to child care and maternity leave.

In addition, indirect compensation includes nonmonetary compensation. These are benefits that do not necessarily have a tangible value such as job security, flexible work hours and the opportunity for recognition of performance and camaraderie in the workplace.

To increase the chances of success, you should appeal to the needs and desires of your employees through the proper mix of direct and indirect compensation. Here is a quick checklist of the items you may consider for:

1. Direct compensation amounts

Basic salary: This speaks for itself. Naturally, offering a higher wage can provide a competitive advantage in your industry.

Incentive pay: This includes bonuses that are paid out when certain objectives are met. Incentive pay may inspire employees to exceed previous performance levels.

Stock options: This is a way to reward top employees with a small piece of the business. Certain qualified stock options (called incentive stock options) have tax advantages.

Bonuses: Additional cash compensation may be paid to employees (typically around the end of the year). An unexpected bonus can show employees that you value their services.

2. Indirect compensation amounts

In some cases, indirect compensation is required by law. For instance, employees may be entitled to receive Social Security, unemployment or disability payments upon the happening of an event. At other times, an employer can step forward and deliver a meaningful message.

This is just a partial list of the possibilities:

- Flexible working schedules;
- Eldercare benefits;
- 401(k) or other retirement plan;
- Moving expenses;
- Insurance (health, dental, vision);
- Paid leave (sick days/holidays/personal days, etc.);
- Tickets to events (ballgames, theatre, concerts, etc.);
- Company party or picnic;

- Cell phones/pagers and other electronic devices; and
- Child care services.

When the labor market tightens, indirect compensation becomes a more important part of the package. Even if your business is not offering the highest salaries, it may still be able to offer benefits that meet the needs of those people you want to continue to employ.

Tax Keys to Swapping Vacation Homes

The tax break for "like-kind exchanges" of real estate may apply to vacation homes, but only if the homes are held for business or investment purposes.

New case: A couple who owned a vacation home used it mainly for recreation. Then they swapped it for another home, but they never rented out, or offered to rent out, either of the vacation homes.
The couple had an expectation that they would receive a huge profit from an eventual sale, but this was not enough to qualify the homes as investment properties.
Result: The exchange is subject to current tax.

Should You Consolidate Your Debts?

How to benefit from better money management

Taking on debt is often viewed as a calamity. But that can be an oversimplification. For instance, it may be sensible to incur debt to help buy a new house or finance your child's education. However, that doesn't mean you should allow debt to get out of hand.

In fact, if you are not careful, poor debt management could lead to financial ruin. This is especially true if you utilize every loan opportunity that arrives in the mail.

One idea for long-term saving is to consolidate multiple debts into a single debt with a relatively low interest rate. The savings may be increased if you take out a home equity loan (where permitted by state law) or credit line.
Reason: Interest paid on a qualified loan may be deductible on your federal tax return.

Furthermore, consolidating your outstanding debts may give you more time to straighten out your financial affairs. All things considered, it is generally a sound approach.

There are two main types of loans that allow you to tap the equity built up in a home.

1. A home equity loan usually has a fixed rate of interest and a set term of

years. The payments due under the loan are level. Depending on the lender, you may have to pay an application fee and certain standard closing costs (e.g., attorneys' fees, title insurance, recording and filing fees, points, etc.).
It might make sense to pay a higher interest rate if you can avoid some closing costs. Compare the numbers.

2. As an alternative, if you are eligible, you may be able to obtain a revolving line of credit using your home as collateral. The interest rate generally is variable. Some lenders charge no application fees or closing costs, while others charge an annual fee.

Key point: Any loan that is secured by your principal residence must be considered very carefully. You do not want to spend sleepless nights worrying about your main asset. In addition, there are a number of other factors that should enter into your decision.

Some debts are not prime candidates for consolidation. For instance, you may want to continue your normal routine for bills that carry no interest (e.g., payments to your doctor or dentist). When you consolidate your debts, you lose the flexibility of being able to decide which debts should be paid in times of a cash crunch.

Once you consolidate multiple loans, you may be tempted to resume old spending habits. In a word—don't. Consider debt consolidation as a means for helping to reduce debt, not put yourself (and your family) in deeper.

Caution: *This approach is not necessarily right for everyone. Whether you decide to consolidate debts, monitor the situation. Spending more than you can reasonably afford could jeopardize your financial security in the future.*

Facts and Figures

Timely points of particular interest

- **Wrap Account Fees—**As a general rule, expenses incurred in connection with buying, holding or selling property are capitalized and added to the property's basis. This can reduce the taxable gain when you sell the property. But now the IRS says that fees paid for consulting and advisory services in wrap accounts offered by brokerage firms don't qualify for this tax break. The fees must be treated as miscellaneous expenses subject to the usual 2%-of-AGI floor.

- **Progress Reports—**How can you stay on top of the progress of your employees? One way is to use a "cheat sheet" for each employee. Jot down questions about their jobs and review them with your employees on a monthly basis. If the list is short in a particular month, keep a list of core questions you can fall back on. **Example:** What was your biggest hurdle last month and how did you overcome it? Finally, listen carefully to the answers.