



# FINANCIAL *Planning for Business*

A Tax, Financial, & Investment Report

**WestPoint** *Private client*  
G R O U P



Scott Eckart    Kevin Clasen

501 Congressional Blvd., Suite 200  
Carmel, IN 46032

Tel: 317.805.2955

Fax: 317.805.2956

seckart@westpointfinancialgroup.com

kclasen@westpointfinancialgroup.com

www.wppcg.com

Scott Eckart and Kevin Clasen are registered representatives of and offer securities, investment advisory, and financial planning services through MML Investors Services, Inc., 501 Congressional Boulevard, Suite 200 Carmel, IN 46032. WestPoint Private Client Group is not a subsidiary or affiliate of MML Investors Services, Inc.

## Family Employees Bring Home Tax Benefits

If you are the owner of a small business, employing your children may help reduce both your family's aggregated income subject to taxation and the effective rate at which that income is taxed. This fact applies whether you are running your business as a corporation, partnership, or sole proprietorship. Putting a family member on your payroll makes that person's income—and the proportional costs of his or her employee benefits—deductible business expenses.

As a result, the gross income of your business is lowered. While the total family income may remain essentially the same, the income paid to the family member (assuming he or she is not a spouse) is generally taxed at a lower rate. In addition, certain employee benefits are not taxable to the family member. Under this scenario, the family's overall tax liability is lowered.

### Good News—Now and Later

Suppose that you have a teenage daughter, Susan, who has good computer skills. If you directly pay Susan the going rate for maintaining your database, and keep a record of her hours and the work performed, her salary is tax deductible as a business expense. As long as her wages are less than the standard deduction (\$5,150 in 2006), her income will be non-taxable. Income above that amount will be taxed at Susan's presumably lower tax rate.

Alternatively, imagine that daughter Susan is still an infant. If Jane, your spouse, works in your business, the cost of paying for childcare while she works will be lessened through the allowable childcare tax credit for such expenses.

Looking forward 20 years into the future, having Jane on the payroll could

*(continued on page two)*

## Nonqualified Plans—Baiting the Benefit Hook

Attracting and retaining qualified employees and managers is always a challenge for companies of all sizes. Most employers realize competitive salaries are not the only things desired by the best workers. Sought-after employees also expect compensation packages to include valued benefits.

A qualified retirement plan is a traditional component of many employee benefit packages. As a business owner, you're likely to appreciate the advantages: Your contributions are *tax deductible* and accumulate on a *tax-deferred* basis. However, these plans are difficult to administer and contain many regulations

*(continued on page four)*

## Family Employees Bring Home Tax Benefits

(continued from page one)



help out with retirement planning. Your company's pension plan, or defined benefit plan—which qualifies under the Employee Retirement Income Security Act (ERISA, amended in 1974)—allows Jane to receive an annual minimum distribution of \$10,000, regardless of whether her annual salary ever got that high. Most importantly, during Jane's 20 years of service, your business was able to deduct contributions to the plan on her behalf from gross income.

Perhaps your business offers a qualified retirement plan, such as a 401(k) plan. If so, the contributions made by your business to Jane's account, up to a certain amount, also qualify as a tax-deductible business expense.

### IRAs Are Family-Friendly

If your business does not offer a qualified retirement plan, or family members like Jane and Susan do not participate in such a plan, then an Individual Retirement Account (IRA)—available only to employed individuals or their spouses—is an option. IRA contributions—limited to \$4,000 in 2006—are tax deductible, subject to certain income limits for the employee (but not to the business), and allow for tax deferral on earnings until distributions are taken. Distributions taken before the age of 59½ may be subject to a 10% federal income tax penalty, as well as ordinary income taxes. Certain exceptions may apply.

### In Sickness and In Health

As employees, Jane and Susan are eligible for other

employee benefits your company may elect to provide, such as **accident and health coverage, group term life insurance, and tuition assistance**. The costs of these benefits, assuming they are reasonable, are also deductible business expenses.

You should keep in mind that employing family members means they must actually work in the business for compensation that is reasonable for the type of work they are performing. Also, be aware that the tax status of any retirement account or plan vehicle (and there are many types) is strictly governed by statutes and regulations that cover both employer and employee. Nonetheless, putting family members on the payroll can often offer clear financial and tax benefits. \$

## Retirement Planning and the “One-Man Band”

If you're an “owner-only” business, you may think your retirement planning options are rather limited. On the contrary, you can enjoy some of the same retirement plans available to larger businesses. To qualify for “owner-only” status, your business must fall into one of the following categories:

1. **Sole proprietorship:** no additional employees other than the spouse of the proprietor.
2. **Partnership:** employees are self-employed partners and their spouses.
3. **Corporation:** only one shareholder and no employees other than the shareholder and the shareholder's spouse.

Thanks to special **exemptions** granted by the Internal Revenue Service (IRS), an “owner-only” business can enjoy all the tax advantages of a **pension** or **profit-sharing plan** without being required to complete many of the administratively tedious tax forms and paperwork. In fact, these plans are often as simple to install as an **Individual Retirement Account (IRA)**, and they can be a lot more rewarding.

Some of the best tax planning and wealth accumulation tools available are pension and profit-sharing plans. These plans can help you meet the challenge of income taxes through their

tax benefits, while giving you the opportunity to save for retirement just like the owner of a larger company. Consider the following benefits you may enjoy from implementing the right plan:

1. Contributions are tax deductible to your business.
2. Your contributions, within limits, are made on a pre-tax basis.
3. Earnings on assets accumulate tax deferred.

Regardless of the size of your business, a qualified financial professional has the tools and the know-how to assist you in implementing a retirement plan that best suits your needs and goals. \$

## Improving Employee Performance with Regular Evaluations

When your business is running smoothly, it is easy to neglect the potentially time-consuming and uncomfortable task of sitting down with employees on a regular basis to conduct individual evaluations of their contributions to the organization. Owners of smaller companies may believe they give sufficient feedback to staff on an informal basis and do not need an evaluation system. But when employee performance or morale shows signs of flagging, or a particular staff member presents problems, you may find evaluation records provide useful background information for addressing the situation.

Conducted properly, performance reviews help managers build an effective and motivated team of employees. These meetings—usually held annually or every six months—are an opportunity not just for critiquing an employee's work, but also for recognizing exceptional efforts and reminding staff of how each individual contributes to the organization's broader goals. In businesses that link pay to performance, these formal evaluations also provide a structure for rewarding superior work with increases in compensation.

### What Do Performance Evaluations Measure?

To ensure individual performance assessments are carried out as fairly and objectively as possible, you should draw up a standard evaluation form applicable to all staff members, covering essential tasks performed in your organization. Job per-

formance evaluation forms generally measure quality of work, quantity of work, work habits, skill levels, and attitude. Have your attorney review the form before you use it in formal performance evaluation sessions to ensure it meets federal and state guidelines.

Generally, each evaluation is based on your own knowledge of the employee's work, observations of the



employee's immediate supervisor, and any pertinent objective measures, such as the amount of work completed and the number of days the employee was tardy or absent. If certain tasks are not currently being measured—such as the number of customers served or the number of phone calls answered promptly—it may be necessary to implement procedures to do so.

In assessing an employee's skill level, evaluate whether the employee appears to have the knowledge and abilities to perform effectively. It is more difficult to assess an employee's attitude objectively, so consider supplementing your own assessment with feedback from co-workers and customers who deal directly with the staff member.

### Meeting with Employees

Using the evaluation form as a reference, meet with the employee and discuss whether he or she is meeting expectations. If the assessment identifies weak areas, you should consider together ways in which the staff member may improve. Where appropriate, set a timeline for correcting poor or inadequate work. If the

employee is performing well, you may want to ask if he or she would like to take on additional responsibilities. After your meeting, attach a memo to the evaluation outlining details of the conversation, including future goals and changes in pay. For legal reasons, have the employee sign and date the evaluation, confirming that he or she is aware of its contents.

While you may feel tempted to go easy on an employee who is performing below expectations, keep in mind that failure to document shortcomings could lead to difficulties if you later choose to terminate the employee. At the same time, do not hesitate to praise and reward good work. \$

## Nonqualified Plans—Baiting the Benefit Hook

(continued from page one)

restricting employee eligibility, participation, vesting, and contributions.

What's the alternative?

**Nonqualified plans** offer the flexibility to selectively choose *whom* you'll cover and *how much* you'll contribute

a **life insurance** policy on the selected employee, and your company pays the premiums.

The simplicity of this approach may be very appealing to you as a business owner. It benefits the selected

employees as well, since their families receive additional protection over what your company's group life insurance plan offers. The employee can also look forward to having access to the policy's cash value, which can be used to help supplement future college costs or retirement income.

yourself—while retaining some measure of company control over plan assets.

(*Note:* Using such restrictions may cause your company to be considered a **beneficiary**, since you exercise control over the policy and may have access to cash values. This could affect your company's ability to take a tax deduction for your contributions to the plan. It may be best to discuss this issue with your tax professional.)

### Deferred Compensation Plans

With a deferred compensation arrangement, you agree to continue an employee's salary for a specified period of time after retirement. Although your company's contribution to the plan is not currently tax deductible, deferrals grow tax free provided your company uses a tax-deferred funding vehicle, such as life insurance. One advantage of a deferred compensation plan is that it gives your company control over the funding vehicle. However, it is up to you to decide whether you'd rather have a *current* tax deduction or one that's *deferred*. This is another issue you may wish to discuss with your tax professional.

In today's competitive job market, highly qualified employees are not always easy to find. When "fishing" for the best workers, the lure of nonqualified plans with their selective benefits can help you bait your benefit hook. \$



for each individual. Many companies use them to supplement or replace their qualified plans. Although there is a wide range of nonqualified plans from which to choose, **executive bonus plans** and **deferred compensation plans** are among the most popular.

### Executive Bonus Plans

If you're seeking a plan that provides a current tax deduction, consider the executive bonus plan. This strategy may make sense when your company's tax bracket exceeds your personal tax bracket. Here's how it works: You choose *which* workers you wish to reward with a bonus. The bonus comes in the form of

### Executive Restrictive Bonus Plans

A twist on the preceding plan is the executive restrictive bonus plan. This plan resembles a regular bonus plan, except that your company retains greater control over the life insurance policy. This is accomplished by attaching a **special endorsement** that prohibits the employee from surrendering, loaning, or withdrawing the cash value from the policy. Control of this agreement is spelled out in a contract that defines your company's rights and the vesting terms for the employee. Restrictive bonuses provide an effective means for rewarding key employees—including