

# focus

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## Year end tax tips for individuals

# There is still time to reduce your 2007 taxes

**T**he year is rapidly coming to a close, but there's still time for some last-minute tax moves to help reduce your 2007 tax bill. The first step is to estimate your income, deductions and marginal tax rate for 2007 and 2008 and, if possible, for future years as well. Your marginal rate is the rate you pay on your next dollar of income. So, for example, if you and your spouse file a joint return and your taxable income in 2007 is \$200,000, your marginal rate would be 33%, which applies to income over \$195,850 and not more than \$349,700.

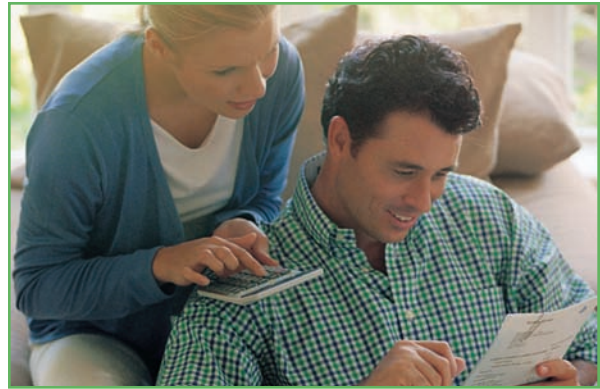
Depending on your projections, you may have opportunities to shift income and deductions from one year to another to minimize your overall tax liability, or at least defer taxes.

### Defer income or accelerate deductions

If your marginal rate remains the same from year to year, generally the best year end strategy is to defer income from 2007 to 2008 and accelerate deductions into 2007. There are many ways to defer income. For example, arrange with your employer to pay your year end bonus in 2008 (provided you receive it by March 17). And, if you're self-employed, consider delaying December invoices until after Jan. 1. Strategies for accelerating deductions include paying property taxes early and increasing your contributions to an IRA or other tax-advantaged retirement accounts.

If you expect your marginal rate to change each year, it's usually best to shift income into years with lower marginal rates and shift deductions into years with higher marginal rates. So if you expect your marginal rate to be higher next year, consider accelerating income into 2007 and deferring deductions to 2008.

Because you must meet certain "floors" before deductions are allowed, you can maximize deductions by "bunching" them into a single year. One example is unreimbursed employee expenses, which are subject to a 2% of adjusted gross income (AGI) floor. If you have some flexibility over the timing of



certain payments (such as for professional dues), grouping them together in one year can maximize the value of the deduction.

Similarly, though it's more difficult to control the timing of unreimbursed medical expenses (subject to a 7.5% of AGI floor), you may have some opportunities to increase your deductions. For example, if you won't reach the threshold this year and you have an elective procedure scheduled for mid-December, you might reschedule it for January to increase your 2008 medical expenses.

### Offset capital gains

Now's a great time to review your investment portfolio and consider "harvesting" losses to reduce your 2007 taxes. If you've recognized capital gains this year, consider selling some of the losers and use the losses to offset them. If you have a net capital loss, you can use it to reduce your ordinary income by up to \$3,000. You can carry over excess losses to future years.

If you want to keep a particular stock, even though its value has declined, you may be able to sell it to generate a tax deduction and then buy it back. You'll need to wait at least 31 days to repurchase the stock, though, to avoid violating the "wash sale" rule. The rule prohibits you from deducting a loss when you sell a stock or other security if you purchase a substantially identical security within 30 days before or after the sale.

## Give it away

If you feel charitable this holiday season, make a donation before year end to accelerate deductions. But you might want to delay your gift until January if you expect your marginal rate to go up next year.

If you're 70½ or older, this is your last chance to make a tax-free transfer from your IRA to a qualified charity. From now until the end of 2007, if you transfer up to \$100,000 directly from your IRA to a charity, there's no tax on the distribution. Plus, you can apply the transfer toward your required minimum distributions for the year.

## Don't lose sight of the big picture

As you review your year end options, it's important to consider whether these strategies might trigger other tax consequences, such as alternative minimum tax liability or penalties for underpayment of estimated taxes.

And never adopt a tax-cutting strategy unless it also fits into your overall financial plan. For instance, you should factor in the time value of money. Deferring income or accelerating deductions might generate tax savings, but you must weigh the tax benefits against the cost associated with losing the use of those funds.

## Tips for after Dec. 31

Although most strategies must be implemented before year end, there are some ways you can reduce your 2007 tax bill even after Dec. 31, so long as you are otherwise eligible. For example:

- ◆ Make 2007 contributions to traditional IRAs (of up to \$4,000 — \$5,000 if you're age 50 or older) until April 15, 2008. If you don't have an IRA, you can open one any time before April 15, 2008, and deduct the contributions on your 2007 return.
- ◆ Consider a Simplified Employee Pension (SEP), if you're self-employed. Contributions for 2007 are generally limited to \$45,000 (up to 20% of income) and you can set up and fund the account any time before your filing deadline (including extensions).
- ◆ Work with your CPA to make sure you claim all the deductions and credits you're entitled to in 2007.

Because of such complexities, it's a good idea to consult your tax and financial advisor to discuss what's right for you. ◆

# Benchmarking can help you keep ahead of the competition

**W**ith competitors nipping at your heels, it's not enough for your business to just be good at what



it does. To stay ahead, you must continually focus on getting better. Benchmarking your business's performance is key to helping it successfully make its mark in the marketplace.

## Continuous improvement

Benchmarking is the process of assessing your business's current position in the marketplace relative to where you want to be and identifying any obstacles standing in your way. The knowledge gained will enable you to determine and implement the specific corrective actions needed to surmount those obstacles and reach your strategic business goals.



Benchmarking entails comparing your company's performance against:

- ◆ Business units and departments within your company,
- ◆ Competing companies in your business's industry, and
- ◆ Leading companies from different industries.

The specific performance indicators to use for benchmarking your business will depend largely on your situation and goals, but they will likely include:

**Financial performance indicators.** These include financial ratios, such as net profit to total assets, sales to total labor, total liabilities to total assets, working capital to total assets, and cash to current liabilities.

### *Analyze the comparative benchmark data gathered to identify opportunities for performance improvement.*

**Other key performance indicators.** These include both quantitative and qualitative indicators, such as research and development prototype success and failure rates, production quality and product defect rates, order fulfillment and accuracy rates, market share and share of client, customer satisfaction and loyalty, employee morale and retention vs. turnover rates.

## Getting there

Enabling continuous improvement involves a three-step approach:

**1. Identify where you are.** Gather and compare data on your current performance and standing relative to other companies. Potential methods for gathering data include:

- ◆ Performing company self-assessments using criteria from national quality award models,
- ◆ Conducting interviews, focus groups and surveys,
- ◆ Shopping your competitors' products and services,
- ◆ Participating in or purchasing benchmarking studies conducted by trade associations and private research firms,
- ◆ Leveraging publicly available information about other companies, and
- ◆ Exchanging benchmarking information with suppliers and alliance partners.

Carefully analyze the comparative benchmark data gathered to identify opportunities for performance improvement. If you find that your business's customer satisfaction is relatively low, for instance, you can then focus on identifying the causes or obstacles that your business needs to overcome.

To identify customer satisfaction obstacles, analyze various aspects of customer transaction data that your company maintains, such as order fulfillment rates and accuracy vs. returns. Also, solicit customer feedback and insights on what's working well vs. what's not and needs to change.

**2. Determine where you want to go.** Establish specific performance improvement goals and determine how you'll assess your progress toward them. This is where the use of key performance indicators (KPIs) and metrics come into play. KPIs can help you determine the ratio or relative relationship for how close or far off your business is from achieving its performance goals.

So, for instance, if you find that customer satisfaction is less than satisfactory due to slow order fulfillment, you may set a goal to step up the fulfillment rate by striving to process at least 100 orders of gizmos per

week. The metric used would then be gizmo orders filled per week. If you process 90 gizmo orders between the start of business on Monday and the end of the business day on Friday, the relative KPI for assessing progress would be 90% of goal for the week.

**3. Plan how to get there.** Focus on identifying specific actions aimed at improving performance. Continuing with the same order fulfillment example above, you may implement a corrective action to outsource the gizmo order fulfillment part of your operation.

As part of your service-level agreement with your outsourcing provider, you would then outline expectations for achieving improved fulfillment.

### On your mark, get set, go!

Earning a high mark and making it last in today's marketplace requires a commitment to regularly benchmarking your business's performance. Commit to benchmarking at least annually or, even better, biannually or quarterly. ♦

## The "kiddie" tax comes of age

**T**he kiddie tax isn't just for kids anymore. The tax applies the parents' marginal tax rate to a child's investment income in excess of a specified threshold (currently \$1,700). Before 2006, the kiddie tax applied only to children under age 14, but last year Congress raised the age limit to 18. And, beginning next year, the tax applies to children who qualify as dependents because they are either under age 19, or under age 24 and a full-time student, if their earned income doesn't exceed one half of the amount needed for their support.

Raising the age limit has thrown a monkey wrench at the tax-planning strategies of many parents.

### A capital idea

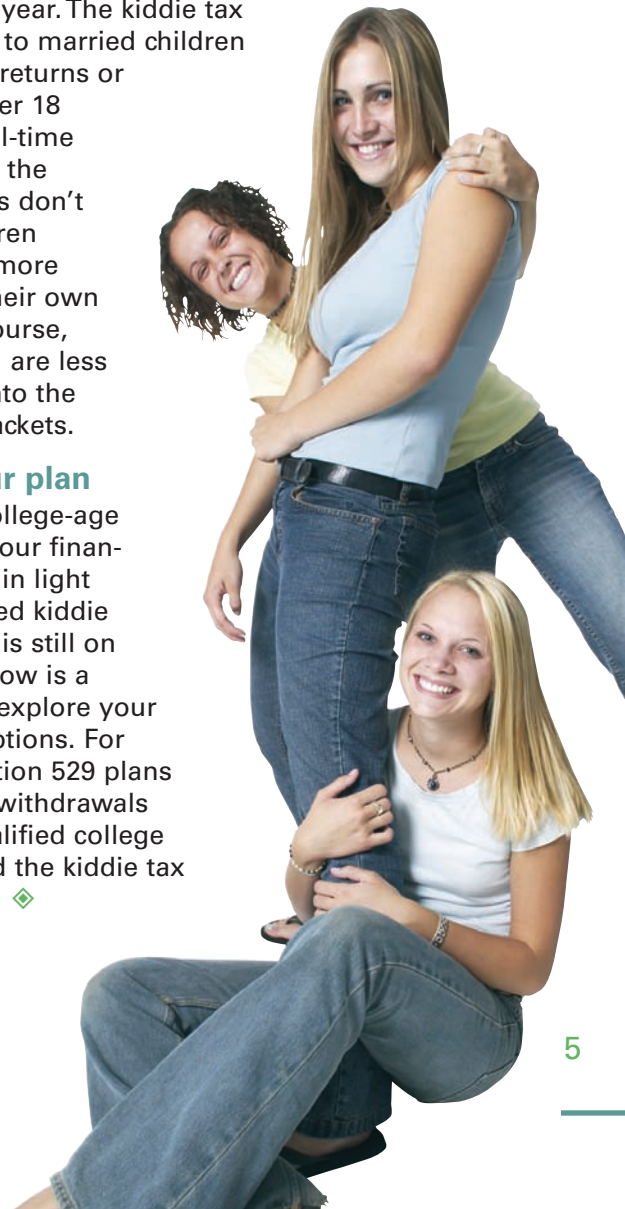
Under the old law, higher-income parents could transfer appreciated assets to their college-age kids, who could then sell them to help pay for tuition and other expenses and owe tax at their own — likely lower — capital gains rate.

Bear in mind that the reduced capital gains rate applies only to the extent that your child's income falls within the lowest tax brackets. In 2007, the cutoff for the 5% bracket is \$31,850. If capital gains bring your child's taxable income over that threshold, the excess will be taxed at 15%. Also, if you plan to transfer appreciated investments to your child to sell before the end of this year, be sure to consider the gift tax implications.

Some families will still be able to take advantage of the low capital gains rate after this year. The kiddie tax doesn't apply to married children who file joint returns or to children over 18 who aren't full-time students. And the new age limits don't apply to children who provide more than half of their own support. Of course, these children are less likely to fall into the lowest tax brackets.

### Review your plan

If you have college-age kids, review your financial plan now in light of the amended kiddie tax. If college is still on the horizon, now is a good time to explore your investment options. For example, Section 529 plans offer tax-free withdrawals to pay for qualified college expenses, and the kiddie tax doesn't apply. ♦



# Work your employees smarter, not harder

**T**oday's business environment is challenged by ever-increasing customer service demands and competitive pressures to improve productivity and reduce operating costs. Consequently, business owners are often forced to try to do more with less. But when it comes to your workforce, requiring them to work more hours can be counterproductive.

## It's a balancing act

Of course, nonexempt employees must be paid for overtime, and this can be a costly expense. But you shouldn't expect your exempt employees to work nonstop overtime just because you don't have to pay them for each extra hour. All work and no play will surely dull their performance and ultimately negatively affect your business's bottom line. Moreover, in time, employees may grow resentful and quit, even if they do receive overtime pay or a higher salary to reflect their extra efforts.

Rather than driving your employees to work longer and harder, teach them to work smarter — that is, more efficiently. The potential benefits include:

- ◆ Higher productivity,
- ◆ Higher quality work,
- ◆ Fewer errors and accidents, and
- ◆ Improved employee morale and well-being.

Moreover, employee turnover will likely go down.

## Ask some hard questions

While it may be tempting to point the finger at employees, their work habits may not be at fault. For example, if you find they're habitually putting out fires, the source of the problem may be a lack of strategic business planning. So proactively identify potential challenges and implement plans to address them.

If employees are missing deadlines regularly, the company may be creating plans that aren't realistic. To help ensure plans and associated deadlines are achievable, include employees in the planning process and seek their input and buy-in.



If employees frequently must work extra hours to respond to unexpected requests, you may need to re-examine your company's priorities. When such a request arises, consider whether it's a true emergency before you pull an employee off another project or require him or her to work late.

For example, ask yourself whether delaying action will put you at risk for:

- ◆ Losing a valued client or other business relationship,
- ◆ Missing out on a major business opportunity,
- ◆ Damaging your company's reputation, or
- ◆ Losing essential revenue.

Most likely, you'll find that most things can wait awhile, and the business will generally survive just fine until then.

## Re-examine work habits

Ask employees to periodically assess their day-to-day work routine and how their time is typically spent. For starters, have them track the time they're spending on e-mail or instant messaging in a given day. While these communications tools can be essential, they can also become a black hole, swallowing up precious time. Advise employees to, for instance, designate certain times for checking e-mail, so they can stay focused on core project tasks.

Also ask employees to be more conscious about disrupting each other. Encourage them to take advantage of structured breaks, such as grabbing a cup of coffee or taking a healthy walk with co-workers.

Sitting in company meetings also can eat up valuable work time. For regular meetings, consider whether you can meet less often, such as twice a month rather than weekly. Provide employees with guidelines for calling meetings, such as requiring a written agenda outlining the meeting's purpose, involving only those employees who are integral to the matter

and designating a time keeper to keep the meeting on schedule.

Finally, re-examine overall work processes to identify opportunities to automate or streamline tasks using software tools.

### **Measure results, not face time**

To drive home the business's goals for working smarter and maintaining a healthy personal life outside of work, change the way you assess productivity and reward your employees. Measure results delivered, not how much time employees spend in the office outside of regular hours. ♦

## **Should your company offer a Roth 401(k)?**

Since 2006, employers have been permitted to offer Roth 401(k) plans. The Roth option can be a relatively simple way to provide your employees with a valuable benefit.

### **Roth vs. traditional**

Like a Roth IRA, a Roth 401(k) allows participants to contribute after-tax dollars to the plan but withdraw contributions and earnings tax free, subject to certain limitations. A traditional 401(k) plan is more like a traditional IRA: Participants contribute pretax dollars, but contributions and earnings are generally subject to income tax when they're withdrawn.

Essentially, the choice between Roth and traditional comes down to whether an employee wants to pay the tax now or later. The decision can be complicated, but, generally, employees who expect their marginal tax rates to be higher in retirement are better off with a Roth 401(k), and those who think their tax rates will decrease will do better with a traditional plan.

Despite the similarities, Roth 401(k) plans have some big advantages over Roth IRAs. Perhaps most important, they're not subject to income limitations that prevent high-income earners from taking advantage of the Roth IRA option. In 2007, for example, Roth IRA eligibility is phased out once modified adjusted gross income reaches \$114,000 for single filers or \$166,000 for joint filers.

In addition, Roth 401(k) contribution limits are higher. In 2007, employees can make combined contributions to traditional and Roth 401(k) accounts of up to \$15,500 (\$20,500 for those who turn 50 by the end of the year). Roth IRA contributions are generally limited to \$4,000 this year (\$5,000 for those age 50 or older).

### **Potential drawbacks**

Despite its appeal, a Roth 401(k) increases your administrative burden because you'll need separate accounting systems for Roth and traditional accounts. And employer-matching contributions can be made only to traditional 401(k) accounts.

Also, the Roth option makes employees' investment decisions more complicated, so there may be some risk that overall participation rates will decline.

### **Gaining a competitive edge**

A Roth 401(k) can be an attractive benefit that can give you an edge as you compete for star employees. If you're considering a Roth 401(k), be sure to discuss the pros and cons with your CPA.