

focus

april/may 2008



Take aim and fire!

How market research can help you focus on the target

A QPRT lets you have your cake and eat it too

3 tips for tax-smart intrafamily loans

Do you *really* have the homeowner's coverage you need?

Why your company needs a travel policy

Take aim and fire!

How market research can help you focus on the target

Researching and understanding your target market is key to knowing where and how to effectively aim your business's marketing efforts. Missing the target and failing to generate a return on your marketing investment can seriously injure your business's financial position. You can avoid this fate, however, by applying a strategic, methodical approach to your marketing efforts, which includes market research.

Define your target market

Begin by defining who you think your target market is — that is, the type of customer who's most likely to buy and benefit from your products or services — based on your experience and knowledge and any customer purchase data you track.

Then create a customer profile that includes relevant demographic traits and describe a typical customer's needs and buying preferences and habits. Also describe the market situation, including trends, economic factors and competition that may impact that customer's purchase decisions.



Validate your strategy with research

With your profile in hand, you should have a pretty good idea of your target market. But, you'll need to validate that conclusion with market research. Market research generally consists of two basic types:

1. Primary research. This is conducted expressly for your business's purpose. It includes conventional, time-tested techniques, such as customer and prospect surveys and focus groups. The key benefit is that you can ask specific questions concerning your business's marketing strategy, such as why

a customer or prospect would or wouldn't buy a product or choose to buy from your business vs. your competition.

Unless you have a large marketing department, qualified to conduct such research, you'll likely need the services of an experienced market research firm. If your marketing budget is tight, consider contacting a local college about having some students gather primary market research for your business as part of a class project.

2. Secondary research. This is targeted at existing research that was originally conducted for another purpose but that also may be useful in validating your target market conclusions. Information available (at little or no charge) may range from demographics collected on a specific population to economic factors to market trend data collected on other businesses and their products and services. Examples of secondary research sources include:

- ◆ Business association surveys, reference materials and news,
- ◆ Trade publication surveys and interviews with industry experts,
- ◆ U.S. Department of Commerce information,
- ◆ Community, business and university library reference materials and databases,
- ◆ Internet searches, and
- ◆ Competitors' and other businesses' Web sites, press announcements and sales literature.

Building on secondary research with primary research can help provide a more comprehensive assessment of a business's target strategy.

Sharpen your aim

Whether you're planning to launch a new product or service, or enhance or cross-sell an existing product or service, market research can help you validate your target strategy. You can then better size up your target and sharpen your aim with the ultimate goal of decreasing your marketing risk and increasing your return on investment. ◆

A QPRT lets you have your cake and eat it too

Most estate planning strategies involve some tradeoffs. Typically, to remove assets from your taxable estate, you must relinquish control over them. For example, with an irrevocable life insurance trust (ILIT), you can shield an insurance policy's death benefits from estate taxes, but only if you give up any "incidents of ownership," such as the right to change beneficiaries.

To maintain QPRT status, you must continue to use the home as a personal residence during the term.

One estate planning tool, however, comes close to letting you have your cake and eat it too: the qualified personal residence trust (QPRT). A properly designed QPRT allows you to transfer your home to your children or other relatives and remove its value from your estate — while you continue to live in it.

How it works

A QPRT is an irrevocable trust that provides you the right to live in your home for a specified term — 10, 15 or 20 years, for example. At the end of the term, your home passes to your children or other beneficiaries, though you can continue to live in it after that by paying fair market rent.

When you transfer your home to a QPRT, you remove its fair market value — as well as any future appreciation — from your taxable estate. The transfer constitutes a taxable gift to your beneficiaries, but the home's value for gift tax purposes is reduced by the present value (based on statutory interest rates) of your right to continue living there. Thus, the longer the trust term and the higher the interest rate, the lower the gift tax value. For a QPRT to work, however, you must survive the trust term.

During the term, you remain responsible for real estate taxes, insurance, mortgage payments and other expenses (but retain the right to deduct these expenses on your income tax return). But if you transfer property subject to a mortgage, each payment you make will be considered an additional gift to your beneficiaries. Thus, it's advantageous to pay off the loan before you transfer your home to a QPRT, so the home can be transferred unencumbered by debt.

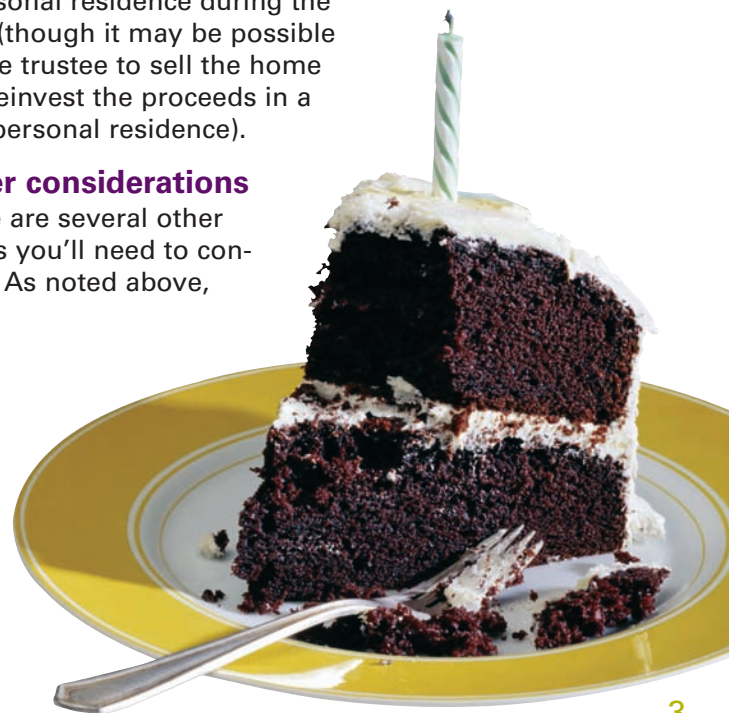
Dot the i's and cross the t's

Pay careful attention to IRS rules on structuring and operating a QPRT. For instance, the trust can't hold assets other than your personal residence, a limited amount of cash and certain insurance policies. And it must provide for any income to be distributed exclusively to you, at least annually. One caveat: If you sell the home during the trust period, you'll need to either return the proceeds to the grantor or use the proceeds to pay the grantor an annuity for the remainder of the trust period.

Also, to maintain QPRT status, you must continue to use the home as a personal residence during the term (though it may be possible for the trustee to sell the home and reinvest the proceeds in a new personal residence).

Other considerations

There are several other issues you'll need to consider. As noted above,



you must survive the trust term to achieve a QPRT's tax benefits, so it's important to select the term wisely. If you're concerned about your life expectancy, one option is to transfer title to the home to a younger or healthier spouse and then have him or her transfer the home to a QPRT.

Also, keep in mind that your beneficiaries will inherit your tax basis in the home, so they'll incur a capital gains tax liability if they sell the home, which could be significant if it has appreciated substantially since you purchased it. You'll need to weigh this potential liability against the expected gift and estate tax savings.

Finally, if you name your grandchildren as beneficiaries (or other family members more than a generation younger than you), consult your tax advisor about potential generation-skipping transfer (GST) tax implications.

A calculated risk

With the ability to shield your home from estate taxes while you continue to enjoy most of the benefits of ownership, QPRTs are unique among estate planning tools. There's a risk, of course, that you'll lose the tax benefits if you fail to survive the term. But if that happens, your family is no worse off than if you had never established the trust in the first place. So it may be a risk worth taking. ♦

3 tips for tax-smart intrafamily loans

At one time or another, you may wish to provide financial assistance to your children or other family members, whether it's to help them pay for college, buy their first home or get out of debt. Often such assistance is offered in the form of a gift, but in many cases a loan is more desirable.

Maybe you're concerned about gift taxes or feel that a loan is the best way to teach your children financial responsibility. Perhaps you simply can't afford to give the money away. Whatever your reasons for lending to a family member, it's important to structure and document the loan carefully. You may trust these loved ones implicitly but, if you handle things too informally, you may bring about some unpleasant tax consequences.

Here are three tips for making tax-friendly family loans:

1. Put it in writing. Have the borrower sign a promissory note that details the payment terms and interest rate. If you don't, the IRS may assume the loan is a gift, which can trigger gift taxes or reduce your lifetime gift tax exemption (currently \$1 million).

2. Charge appropriate interest. When family is involved, your first thought may be to charge low or even no interest. But generally it's best to charge at least the "applicable federal rate." If you charge less, the IRS will treat the difference as "imputed interest," which means you'll pay income tax on that amount whether you collect it or not. What's more, forgone interest will be treated as a gift to the borrower for gift tax purposes. If you do choose to charge low or no interest, in most cases a "demand loan" is your best bet for minimizing gift taxes. A demand loan — as opposed to a "term loan" — is one with no fixed maturity date or payment schedule; it can be called for repayment whenever the lender chooses.

3. Understand the exceptions. There are two exceptions to the imputed interest rules. First, you can make a low- or no-interest loan of up to \$10,000 to a family member without creating tax problems, provided the borrower doesn't invest the proceeds in income-producing assets (such as securities or rental real estate). Second, imputed interest on loans up to \$100,000 is generally limited to the borrower's net investment income.

However you decide to structure a family loan, follow and enforce its terms to be sure the IRS doesn't challenge the transaction as a disguised gift.

Do you *really* have the homeowner's coverage you need?

You know that your homeowner's insurance policy is designed to cover your home and personal belongings in the case of theft or damage. In addition, your policy can cover extra living expenses if you're forced to temporarily live elsewhere while your home is being repaired or rebuilt. And it can help cover liability claims and medical payments to third parties, as well as legal expenses in the event a lawsuit is filed against you for accidents and injuries occurring on your property.

But do you know whether you really have the coverage you need? If you're not sure, now's the time to review your policy and perhaps buy additional coverage or switch insurers. You may even be able to save some money in the process.

Know what's covered — and what's *not*

First, look at your policy's overall coverage. Don't rely solely on the purchase price or appraised value of your home to determine how much you need. This is merely the minimum amount typically required by mortgage lenders, and it may not be enough to cover the cost of rebuilding your home and replacing your belongings.

Of particular concern is the policy's replacement cost coverage, which reimburses you



for the cost of replacing your home or an item. Check the policy carefully to determine whether there are any caps on the amount offered. If a policy states that it offers the *actual cash value* for an item, it will provide *only* the replacement cost *less depreciation* for the years the item was owned — it won't pay the entire purchase cost.

Next, carefully review the terms and limits of your policy, noting any exclusions. The standard homeowner's insurance policy isn't fool-proof. Read the fine print and you'll likely find that your policy doesn't cover damage resulting from earthquakes, flooding, sewage back-ups, nuclear accidents, acts of war or terrorism, or requirements for rebuilding or updating an older home to comply with modern building codes. Determine whether special riders are needed for your situation and potential risks.

Ask for a better deal

Whether you're talking to your current insurer or shopping around for a new one, you may save on policy costs by asking about:

Deductible vs. premium levels. Choosing a higher deductible will result in a lower monthly premium cost. For instance, a higher deductible of, say, up to \$1,000 or \$2,500 may be more cost-effective overall.

Available discounts. Many insurers offer them on new homes and homes that are built with fire-resistant materials, have exterior deadbolt locks and security systems, or are near a fire hydrant or fire station. Moreover, if you agree to purchase or have purchased other insurance policies, such as for your automobiles, from an insurer, that insurer may provide an additional discount.

Be aware that coverage is also typically limited for high-value possessions, such as large-screen TVs or other electronics. Moreover, to get adequate coverage for valuables such as antiques, fur coats and jewelry (including engagement and wedding rings), get the items appraised and purchase additional coverage as needed.



Shop around

Even if you find you have sufficient coverage, it pays to shop around for the best policy, because costs and terms vary substantially among insurers and may change over time. Request quotes from at least three, if not more, insurers. Then carefully compare the terms and limits of the policy offers, noting any exclusions.

Before you go with any insurer, verify its reputation and industry standing with third-party sources. Your state's department of insurance is a good place to start. You can also check the insurer's status with A.M. Best Company, Moody's Investors Service and Standard & Poor's.

Stay current

To maintain adequate coverage, compare your policy declaration terms and limits against your changing needs at least annually and make any necessary adjustments. For instance, you may require additional coverage if you've made home improvements that increase the value of your home or acquired any high-value items. And consider purchasing a policy rider that will automatically adjust your coverage each year based on property values.

Reviewing your policy regularly and shopping around for insurers periodically can help you ensure you're getting the coverage you need at a price you're comfortable with. ♦

Why your company needs a travel policy

If your employees travel regularly for business, it's important to develop a written travel policy. A well-designed policy has many benefits: It provides employees with guidance on appropriate business spending, helps you control your travel costs, and ensures that you have the documentation needed to support income tax deductions and withholding and payroll tax exclusions.

Sweating the small stuff

Many businesses focus on big-ticket items such as airfare and lodging, but the little things — meals, entertainment, phone calls,

cab fare — can add up quickly. Controlling travel expenses doesn't mean imposing draconian restrictions. But unless your employees understand the types and amounts of expenses you permit, costs may spiral out of control.

Your travel policy should provide details about allowable expenses. If you cover in-room Internet access and phone calls but not pay-per-view movies and mini-bar items, for instance, state this policy clearly so employees don't have to guess. Establish price ranges for lodging and meals, so



employees can make appropriate choices. Also, make sure they understand what the company views as acceptable types and amounts of client entertainment expenses.

Cutting costs

There are many tools you can use to reduce or control your travel expenses, including:

Corporate cards. Requiring employees to use a corporate credit card simplifies tracking employee expenses and may also entitle you to travel discounts.

Frequent-flyer programs. If possible, limit air travel to one or two carriers and take advantage of their frequent-flyer reward programs. Similar programs may also be available for lodging, car rentals, dining and other services.

Centralized booking. Use a single travel agent or employee to help ensure you get the best deals.

Per diems. Per diems for lodging and meals, or for meals only, can be an effective way to control and account for travel expenses, though it's important to follow IRS requirements to avoid unpleasant tax surprises. (See "Using per diems to control costs" at right.)

Whatever measures you take to control costs, the key to an effective travel policy is to communicate your guidelines to employees.

Managing taxes

Your travel policy should provide guidance on the documentation employees need to maintain to substantiate travel expense deductions. If you reimburse employees for their travel expenses, it's important to have an accountable reimbursement plan. To qualify, your plan must require that:

- ◆ All reimbursed expenses have a legitimate business connection,
- ◆ Employees adequately account for these expenses within a reasonable time after the expenses are paid or incurred (60 days, for example), and
- ◆ Any excess reimbursements or advances be returned to the company within a reasonable time.

If your plan is accountable, you can exclude those amounts from employees' income for withholding and payroll tax purposes. If the plan is not accountable, reimbursements are included in employee income and subject to FICA and other payroll taxes.

Making your travel plans

Developing a travel policy requires careful planning. To control costs and ensure the desired tax result, your policy should be well thought out and written in terms your employees can understand. ◆

Using per diems to control costs

With a per-diem system, employees receive a flat amount to cover their business expenses, and it's up to them to manage the funds. If you use federal per-diem rates, your payments are deemed to be from an "accountable" plan. Employees still have to document the time, place and business purpose of their travel expenses, but there's no need to detail every amount they spend.

Federal per-diem rates vary from location to location. For domestic travel, you can opt instead to use the "high-low" method, which assigns one rate to "high-cost" locations and another rate to "low-cost" locations. The current high-cost rate is \$237 for lodging and meals, \$58 for meals only. For low-cost destinations, the rates are \$152 and \$45, respectively. Note that these rates are in effect from Oct. 1, 2007, through Sept. 30, 2008.