Randhir S.Judge F.L.I.A.,LUTCF

Judge For Yourself Inc.
Randhir Judge, F.L.I.A., LUTCF
368 Fairview Way
Milpitas, CA 95035
408-876-6072 x8114
info@jfyfinancial.com
www.jfyfinancial.com

Dear Friends,
This month's issue covers SEP plans, which allow employers to contribute to traditional IRAs (SEP-IRAs) set up for employees. A business of any size, even self-employed, can establish a SEP. The advantages and disadvantages of a SEP are discussed.
Every year, many bypass lawyers and create their own wills, powers of attorney, and other estate planning documents with the help of online tools and books. However, there are risks involved since a self-written will might lead to errors while transferring money to family members. To add to this is the complicated world of estate taxes. While the approach might work for people with relatively straightforward needs, others will have to tread cautiously.
Sincerely,
Randhir S. Judge

December 2011

Simplified Employee Pension Plans (SEPs)

If you're a small business owner thinking about adopting a retirement plan, you should consider a SEP (simplified employee pension plan). A SEP allows you to make retirement contributions to traditional IRAs (SEP-IRAs) set up for yourself and each eligible employee. (If you don't have employees, you can adopt a SEP for yourself alone.) Your contributions are deductible from your business's income, and excluded from your employees' income. Virtually any business owner can establish a SEP.

What are some advantages of a SEP?

- Fairly high contribution limits. For 2012, you can contribute and deduct up to 25% of each employee's W-2 compensation (up to $250,000, $245,000 in 2011). If you're self-employed, the contribution to your IRA can't exceed 20% of your net earnings from self-employment. Contributions can't exceed $50,000 per participant ($49,000 in 2011).
- You don't have to make contributions to the SEP every year. However, if you do make a contribution, you must generally contribute a uniform percent of pay for yourself and each eligible employee.
- You have until the due date of your business's federal income tax return (including extensions) to set up a SEP and make contributions.
- SEPs are fairly easy to set up and inexpensive to operate. You can establish a SEP by using a simple two-page IRS document (Form 5305-SEP), or by adopting a prepackaged prototype SEP from a bank, insurance company, or financial institution.
- Reporting requirements are minimal.
- A SEP doesn't preclude you or your employees from establishing or contributing to a separate IRA. (However, participation in the SEP may impact whether or not annual traditional IRA contributions are deductible.)
- Employer contributions can be made after age 70½.
- Generally, you won't have fiduciary responsibility for your employees' investment decisions.

What are some disadvantages?

- All employees must be included in the SEP except employees who have not attained age 21, haven't worked for you in at least three of the last five years, or earn less than $550.
- Your contributions vest immediately. This can be costly if you have high employee turnover.
- Unlike a 401(k) plan, employees can't make pretax contributions or Roth contributions to a SEP (but a SEP can accept annual and rollover IRA contributions, like any other traditional IRA).
- Plan loans are not allowed.
- A SEP-IRA may provide less protection from creditors outside of bankruptcy than some other alternatives.

What are my options?

A number of other types of retirement plans are available to small business owners, including 401(k) plans, profit-sharing plans, defined benefit plans, and SIMPLE IRAs.

If you have no employees (other than your spouse) and don't anticipate having any in the near future, a solo 401(k) plan may be a better choice, as it may allow a higher deductible contribution than a SEP. For example, if you're incorporated, you can receive an employer contribution of up to 25% of your W-2 income (to $250,000 in 2012, $245,000 in 2011) (like a SEP) but in addition, you can make up to $17,000 ($16,500 in 2011) of pretax employee contributions (plus an additional $5,500 of catch-up contributions if you're age 50 or older). Total contributions (employer and employee) are limited to $50,000 in 2012 ($49,000 in 2011), plus any catch-up contributions (or, if less, 100% of your compensation).

Unlike a SEP, a solo 401(k) can allow plan loans and Roth contributions. And because a solo 401(k) doesn't cover any common law employees, it's simpler to administer than a regular 401(k) plan (because the Employee Retirement Income Security Act of 1974 (ERISA) does not apply).

The Problem with Do-It-Yourself Estate Planning

The one-size-fits-all fill-in-the-blank forms that do-it-yourself estate planning sources provide may be attractive to some individuals because they cost a fraction of what attorneys typically charge. But is saving a few dollars worth the risk and potentially high cost of doing things incorrectly?

As the number of Internet websites and software packages have quickly multiplied, along with the many books and stationery store kits that have always been available, do-it-yourself (DIY) estate planning is on the rise. The one-size-fits-all fill-in-the-blank forms that these sources provide may be attractive to some individuals because they cost a fraction of what attorneys typically charge. But is saving a few dollars worth the risk and potentially high cost of doing things incorrectly?

Cheap, easy, and better than nothing?

Proponents of DIY estate planning typically have two arguments:

1. It's cheap and easy: A will, for instance, can be completed online in about 15 minutes for about $69. In comparison, working with an experienced attorney to create common estate planning documents (wills, trusts, health-care directives, and powers of attorney) may cost you anywhere from $800 to $3,000 or more, depending on the complexity of your estate.
2. It's better than nothing: The consequences of dying without estate planning documents are that the state will make important decisions for you, such as how your property will be distributed, who will care for your minor children, and what medical care you'll receive if you are unable to make your wishes known.

These points are valid; for those who cannot afford to pay an attorney, DIY may be the only economical alternative available. For others, a poorly drafted will is better than no will at all, especially where the naming of a guardian for minor children is involved. But the chances that DIY estate planning will effectively accomplish exactly what you intend is slim. Here's why.

It's too easy to make mistakes

DIY sources typically only handle simple estates, and can't deal with even the most common complexities such as children from a prior marriage, children with special needs, property that has appreciated in value resulting in capital gains, or estates that are large enough to be subject to estate taxes. And, DIY sources generally fail altogether to take advantage of sophisticated estate planning strategies because they typically can't account for an individual's unique circumstances.

Further, you may make an error by failing to understand the instructions or by following the instructions incorrectly.

The result is that the documents you create could be invalid, ineffective, or contain legal language having consequences you never intended. You might not know if that is the case during your lifetime, but at your death your loved ones will find out and may suffer the lasting consequences of your mistakes.

You're not getting legal advice

DIY sources provide forms but not legal advice. In fact, these sources clearly state that they are not a substitute for an attorney, and that they are prohibited from providing any kind of legal advice.

Estate planning involves a lot more than producing documents. It's impossible to know, without a legal education and years of experience, what the right legal solution is to your particular situation and what planning opportunities are available. The actual documents produced are simply tools to put into effect a plan that should be specifically tailored to your circumstances and goals.

Estate planning laws change

Laws are not static. They constantly change because of new case law and legislation, especially when it comes to estate taxes. Attorneys keep up with these changes. DIY websites, makers of software, and other sources may not do as good a job at keeping current and up-to-date.

Fixing mistakes can be costly

As previously stated, estate planning documents can be obtained from a lawyer for $800 to $3,000 or more, depending on the complexity of your estate. But these costs are minor in comparison to the costs that your loved ones may incur if there are serious errors in your DIY estate planning. Many more thousands of dollars may have to be spent by your loved ones to undo what was done wrong.

The bottom line

There are obvious savings in legal fees by using form wills and trusts, but there are also risks involved. One of them is that problems such as defective forms, violations of state law, or improper witnessing will not be apparent to you when the documents are signed. It may be only after death occurs many years later when the problems are discovered, and at that point it may be very costly, or even worse, too late to revise the documents.

How Much Do You Know about Social Security?

For more information, visit the Social Security website at www.socialsecurity.gov or call 800-772-1213.

Social Security is in the news more and more, as the first wave of baby boomers retire and economic pressures on the program increase. More than 90% of Americans are covered by Social Security,* but how much do you know about this important program?

How is Social Security funded?

Unlike many government programs, Social Security is funded primarily through the collection of payroll taxes. In 2010, 81.9% of funding came from this source, with the rest derived from interest earned on government bonds held by Social Security trust funds and income taxes paid on benefits.* That's why Social Security is known as a "pay-as-you-go" system. However, someone working and paying Social Security taxes today is not funding his or her own benefits, but is funding the benefits of someone who is receiving them now or in the near future--one of the reasons why Social Security is facing a potential funding shortfall. According to the Social Security Administration (SSA), the number of retired workers will double in less than 30 years, but there will be fewer workers paying into the system. And with life expectancies increasing, benefits will be paid for a longer period.*

How are earnings reported to the SSA?

If you work for an employer, your employer will send a copy of your W-2 form annually to the SSA. If you're self-employed, the IRS will report your earnings to the SSA annually after your federal income tax return has been processed.

What benefits are available?

Although Social Security is known as a retirement program, benefits are paid to people of all ages, including surviving family members and disabled individuals. In 2010, 5.7 million people were awarded Social Security benefits. Of those, 46% were retired workers, 36% were survivors or spouses/children of retired or disabled workers, and 18% were disabled workers.*

How do you qualify for benefits?

As you work and pay payroll taxes, you earn Social Security credits. Generally, you need to work 10 years to earn enough credits to qualify for retirement benefits--other benefits have different requirements. Contact the SSA if you have any questions about your benefit entitlement.

Do most people apply for early retirement benefits?

Yes. According to a report by the Government Accounting Office (GAO), 43% of people take early retirement benefits at age 62, while almost 73% of people apply for benefits before they reach full retirement age.**

How much more will you receive if you delay applying for benefits?

For each year past your full retirement age you delay receiving benefits, your Social Security benefit will increase by a certain percentage (8% for anyone who was born in 1943 or later). For example, if your full retirement age is 66 and you delay receiving benefits until age 70, your annual benefit will be 32% higher.

Can you receive benefits based on an ex-spouse's record?

You may qualify for divorced spousal benefits if you were married for at least 10 years, you haven't remarried, you are age 62 or older, and you don't qualify for a higher benefit based on your own work record.

Do workers with lower earnings receive more from Social Security?

A worker who has lower earnings will receive a lower monthly benefit than someone with higher earnings because benefits are based on average lifetime earnings (the highest 35 years of earnings are used in the calculation). However, the Social Security benefit formula is designed to ensure that workers with lower earnings receive a greater percentage of their preretirement earnings. For example, a worker with relatively low earnings may receive a benefit that is approximately 55% of his or her preretirement earnings, while a worker with relatively high earnings may receive a benefit that is approximately 25% of his or her earnings.***

Do you have to stop working to receive Social Security retirement benefits?

No. As long as you've reached early retirement age and meet eligibility requirements, you can apply for Social Security benefits even if you decide to continue working. However, if you're younger than full retirement age and earn more than a certain amount, your benefits will be temporarily reduced (once you reach full retirement age, your benefits will be increased to account for the money that was withheld).

***Source:** *Fast Facts & Figures About Social Security, 2011*

****Source:** *GAO-11-400, Retirement Income, June 2011, based on data compiled by the SSA Office of the Chief Actuary*

*****Source:** *SSA Publication No. 05-10045, 2011*

Judge For Yourself Inc.
Randhir Judge, F.L.I.A., LUTCF
368 Fairview Way
Milpitas, CA 95035
408-876-6072 x8114
info@jfyfinancial.com
www.jfyfinancial.com

Ask the Experts

Are hobby expenses deductible?

So, you have a hobby that you enjoy. Lately, you have been viewing the hobby as a possible source of income. Of course, you will have to report that income on your income tax return. But can you deduct your hobby expenses?

If your activity qualifies as a business, you are able to deduct qualified business expenses, even if they exceed income from your business. However, there is a hobby loss rule designed to limit the deduction of losses when an activity is not carried on to make a profit. (The rule does not apply to C corporations.)

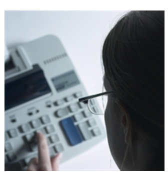
Whether you carry on an activity to make a profit is determined by all relevant facts and circumstances. However, your activity will be presumed carried on for profit if it produces a profit in at least three of the last five years (two out of seven for certain activities involving horses). The IRS can rebut this presumption.

When you first start out, it may be difficult to show a profit. You can elect to have the three out of five years (or two out of seven years) presumption made after you have the five (or seven) years of experience allowed by the test. You do this by filing Form 5213 (generally, within three years of the due date--determined without extensions--for filing your income tax return for the first year of the activity). Filing the form delays the IRS determination of whether your activity was carried on for a profit. It also extends the period of limitations for possible denial of hobby loss deductions until two years after the end of the five- (or seven-) year period.

If your activity is not carried on for profit, deductions from the activity are limited:

1. You can take any deductions that would be allowable for personal purposes, such as real estate taxes or home mortgage interest.
2. Deductions that do not result in an adjustment to basis can be taken, limited to the excess of income from the activity over deductions in (1).
3. Deductions that result in an adjustment to basis (for example, depreciation) can be taken, limited to the excess of income from the activity over deductions in (1) and (2).

Deductions claimed under (2) or (3) are miscellaneous deductions, which are allowable only to the extent all such deductions exceed 2% of your adjusted gross income.



Are business start-up costs deductible?

Generally, costs that you incur prior to the time that you actually begin operating a business are treated as capital expenditures, which are part of your basis in the business. However, certain start-up expenditures may be deducted, either in the first year of business or over time (amortized).

Such start-up costs must be incurred before the business begins operation and be ones that otherwise would be deductible as a normal business expense. Certain syndication costs of marketing or selling interests in a new business cannot be deducted, and must be capitalized.

You may elect to deduct your business start-up costs. If you make the election, you may deduct up to $5,000 of start-up costs in the taxable year in which you actively start the business. The $5,000 amount is reduced (but not below zero) to the extent that start-up costs for the business exceed $50,000. Thus, no first-year deduction is available if start-up costs exceed $55,000. The remainder of the start-up costs are amortized over a period of 180 months. If you do not elect to deduct your start-up costs, you must capitalize them.

You deduct amortized start-up costs in equal amounts over a period of 180 months. You take the total start-up costs, reduced by the amount you deduct in the year you start the business, and divide that amount by the 180 months in the amortization period. This figure is the amount deductible each month. If the business is terminated before the end of the 180-month amortization period, you may be able to deduct as a business loss any remaining start-up costs that have not been previously deducted.

Example: *You incur $52,000 of costs starting up your business before it begins operation and elect to deduct start-up costs. In the year your business actively starts, you can deduct $3,000 of start-up costs [$5,000 - ($52,000 - $50,000)]. You can also deduct the remaining $49,000 ratably over 180 months, or $272.22 a month for 180 months; your deduction for a year with 12 months of amortization would be $3,266.67.*

Tip: *You are deemed to have elected to deduct eligible start-up expenses unless you affirmatively elect to capitalize the expenses on a timely filed federal income tax return.*