REGISTERED INVESTMENT ADVISORS

Gordon & Associates Financial Advisors, Inc.

Your Fee-Only Financial Planning & Wealth Management Firm

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Are You Putting Too Much Money Back Into Your Business?

When you started your company, no doubt investment capital was at a premium. Many entrepreneurs borrow from family and friends, tap home equity, and run up credit card balances to the limit. Though risky, that's just the cost of following a dream. But now, with your business humming along, you may face a different risk. Failing to take money out of the company could imperil your long-term personal financial health.

One problem with paying yourself too little and not funding retirement savings is familiar to anyone who remembers the corporate meltdowns early this decade. When erstwhile Wall Street darlings suddenly crashed and burned, employees were left holding virtually worthless company shares. A similar fate could await owners of small businesses who keep most of their net worth tied up in company stock. If you've poured all of the profits back into the business, what will you be left with if it ultimately fails?

And even if it keeps growing, at some point you need to ask yourself exactly what you hope to accomplish. Are you planning to take the business public someday, generating a big, long-deferred payday for you and the company's other investors? Do you hope to hand off the business to another member of your family? Or are you simply plowing money back into the business for growth for its own sake?

In some scenarios, it may make sense to reinvest as much capital as you can. But the road to an initial public offering is long and treacherous, and very few small businesses ever get there. And what if the heir you're counting on to take the reins ends up having other plans? Though there are plenty of other ways to exit a business, including a sale to a competitor or to your own workers through an employee stock ownership plan, those options, too, put off your ultimate payday and assume the company will continue to thrive.

Instead, you could approach your role with the business as if you were leading a major corporation. Though corporate executives may defer some compensation, they also make sure to receive generous salary packages and fully funded retirement plans. They realize that while they may be on top now, that could change overnight. They also want to be able to live well, enjoying the perks of success while still young and healthy.

How much should you take out of your business? And what are your options? You might start with your own compensation. "Pay yourself first" is

(Continued on page 4)

Successful Planning

At Gordon & Associates we understand that one of the keys to successful planning is understanding the client's goals and objectives. Initially, achieving clarity of the goals is sometimes difficult because a client may not have fully outlined his or her objectives, a time horizon or priorities for all goals. Frequently there are competing goals and finite resources. Saving for retirement and funding a college education are examples of two extremely important objectives that may have similar time horizons and both require funding during the same time frame. To assist clients we encourage them to visualize their end in mind. Visualizing the desired end result helps people to better understand what they want to attain, which priorities are the most important to them and what the time horizon is for each goal. It also defines what events and actions must happen during the progression of the plan to meet those goals.

We hope the articles in this newsletter inspire you to think about your financial plan. Please feel free to contact our office if you would like assistance evaluating your goals and objectives, planning for important priorities, or addressing any concerns that you may have.

Horace

Some Home Loans May Not Be Deductible

Have you refinanced, taken out a second mortgage, or used a home-equity line of credit? If you're subject to the alternative minimum tax (AMT), you may not be able to take a tax deduction for all of the interest on such loans.

All taxpayers must calculate their taxes under two sets of rules, for normal income tax and the AMT. You pay the higher tax. Even if you're not subject to AMT rules now, you could be soon. The number of AMT taxpayers soared from about 3 million in 2004 to over 20 million in 2006, and will likely continue to rise throughout the decade.

One deduction not allowed under AMT rules is for interest paid on home-equity loans. Forget what lenders mean by that term—as far as the Internal Revenue Service is concerned, home-equity debt is any loan secured by your residence but used for something other than buying or improving the home. Suppose you've been approved for a line of credit based on your equity in the property, and you draw out money to cover tuition at your daughter's private college. Or you take a second mortgage at today's reasonable interest rates and use the cash to pay down more expensive credit card debt. In both cases, if you pay AMT, you can't deduct the interest, because you didn't use the money to purchase or fix your home. In contrast, the regular rules permit writing off the interest charged on up to $100,000 of home-equity debt, assuming the loan was made after October 13, 1987. All interest on older mortgages is fully deductible for both regular and alternative tax purposes.

Don't set yourself up for a nasty surprise—disallowance of part or all of the tax deduction for a home equity loan

The waters become muddier when refinancing is involved. Suppose you and your spouse borrowed $200,000 several years ago to buy your home. You still owe $160,000, but the property has appreciated substantially and interest rates have fallen. So you decide to refinance $240,000. The first $160,000 of your new loan replaces the remaining debt on your purchase, and interest on that amount is deductible under AMT rules. But what about the other $80,000, which accounts for a third of the refinanced amount? Use it to pay for non-home-related expenses say, a luxury cruise and new automobiles—and a third of your interest won't be deductible in years you pay AMT.

Even if you refinance only what you owe on your original loan, closing costs could pose a problem. Suppose you take a new loan for the $160,000 balance on your old $200,000 mortgage, and the lender charges $5,000 to process the transaction. If you pay the closing costs out of pocket, you can deduct all of the interest on the new loan, even under AMT. But if you finance those costs, and thus borrow $165,000, AMT rules stipulate you can deduct only the interest on $160,000—because the other money didn't pay for a home purchase or renovation. ●

Hackers Monitor Passwords To Break Into Online Accounts—

Let's give you the bad news first: Hackers have already broken into financial accounts at seven major brokerage firms—and the Securities and Exchange Commission says the problem could get worse. The good news: you can protect yourself from online attacks.

Merrill Lynch, E*Trade, Fidelity Investments, Charles Schwab, TD Ameritrade, Scottrade, and Vanguard Brokerage Services in March 2007 were victims of a massive attack. Hackers broke into investors' accounts, sold the holdings, and, in a "pump-and-dump" scam, used the proceeds to buy the stock of 15 companies. This is a variation on older online schemes that use mass e-mails containing false news alerts to spur buying and drive up prices. In the new version, the wave of buy orders using money from the hacked accounts artificially inflates the value of low-priced, volatile "penny stocks." The hacker owns the target stocks and sells at a big profit— sending the price plummeting—then wires the money to an untraceable account.

In the new pump-and-dump scams, the hacker steals your account user name and password using something known as keystroke monitoring software. This records all keystrokes entered on a computer, then emails the information to the hacker. It's easy for someone to install this software on public computers, such as those in libraries, airports and Internet cafes, but it can also end up on your home computer. A hacker might send you an e-mail message or a pop-up window saying you've won something; when you click to find out more, keystroke monitoring software may install itself on your computer. Then, the hacker just waits for you to enter the address of your brokerage firm's web site and watches the next several keystrokes—likely to be your user name and password.

What Else Should Be In Your Will?

When writing a will, most people focus on big assets—real estate, securities, and bank accounts. Often overlooked are smaller items, such as jewelry, paintings, and family heirlooms, as well as other instructions that have nothing to do with assets—whether you want to be buried or cremated, for example, or who should clean out your house after you're gone. This begs the question: Exactly what, beyond the obvious, should be in your will?

According to Mary Randolph, author of *The Executor's Guide: Settling a Loved One's Estate or Trust* (Nolo, 2006), "you can do pretty much whatever you want in your will." The question is, will what you want benefit your descendants—or only add to the confusion?

Many people writing wills indicate exactly who should receive specific big-ticket items—a car, a boat, the summer house—then stipulate that the rest of the estate be divided equally among all heirs. That's nice and simple, says Randolph, but it could spark family disputes. "Even in families in which everyone gets along fine, in times of stress, disagreements can bubble up," Randolph says.

Your goal should be to leave specific instructions without getting too complicated. Attaching conditions to a gift, for example, can be problematic. Suppose you'd like to provide your daughter with a financial reward only if she attends college—but what does "going to college" really mean? Does she have to attend full time, or can she take night classes? Does she have to enroll in a four-year university, or is a community college or unaccredited online program acceptable? And is there a specific time frame? What if she attends college in 50 years—does the estate have to reserve enough money to pay her then?

Randolph recommends you think about what material goods are particularly important to your family—your grandmother's china, a favorite painting, an 18th century armoire—and make specific bequests of those items. But those instructions don't necessarily have to be in your will. About half of U.S. states accept a "property memorandum"—a list, outside your will, of personal items you want to leave to certain people. If you choose this route, your will can simply indicate that you wish your personal effects to be divided according to the attached memorandum. This approach saves you the hassle of rewriting and re-notarizing your will if you acquire additional items you want to give away or change your mind about who gets what.

For the remainder of your personal effects, try to come up with a way for heirs to divide things up among themselves. For example, you might let each descendant pick one item and then another, until everything is accounted for. Or, you might assign everyone a certain number of points, which can be used to bid on individual items. "That way, your children can decide what's important to them," Randolph says. "John may want to spend his 100 points on furniture, while Mary prefers to spend hers on a snow globe."

You can also make specific instructions in your will—for example, that your son gets the job of cleaning out your house, or that you want to be cremated, not buried. But here you may find yourself in tricky legal territory.

First, you need to make such a request in language suggesting it is legally binding. "Saying, 'I want my son to clean out my house,' is not binding," says Randolph. "But saying, 'I appoint my son as executor and direct that he shall sort and divide my personal belongings as he sees fit' " is.

Next, consider when your will is likely to be read. If you want to be cremated, it's better to make that request in a final arrangements document or a similar form, because your will probably won't be reviewed until after the funeral.

Finally, realize that whether you make such requests in your will or another document, they may not have the weight of law. Most state laws don't say anything about how to make final instructions legally binding. Those that do require a form that must be witnessed and notarized—and even then, the instructions have to be followed only if they're reasonable. "You probably can't say you want to be buried in a Cadillac," says Randolph. "Your best bet is to write down what you want according to the laws of your state, and hope for the best." ●

But You Can Avoid Becoming A Victim

Though investment companies aren't required to reimburse you for losses from fraud, in most cases, they will. But to avoid the hassle of trying to recover your money, it's relatively easy to protect yourself. It makes sense not to visit your online brokerage account from a public computer. At home, don't open email from senders you don't recognize, and don't click on links in pop-up windows. And consider installing anti-spyware software. These programs remove existing spyware—including stroke monitoring programs—and prevent the installation of new spyware.

Anti-spyware software is widely available. You can get Lavasoft's Ad-Aware, for example, both in a free version called Ad-Aware Personal and two retail versions, Ad-Aware Plus and Ad-Aware Professional. Other well-known anti-spyware products include PC Tools' Spyware Doctor, Webroot Software's Spy Sweeper, Trend Micro's Anti-Spyware, and Sunbelt's CounterSpy.

But research these products carefully before you buy. Several anti-spyware companies have incorporated into their programs what may itself be a kind of spyware. This software doesn't steal your personal information, but it does record your online activity for advertising research. ●

Key Questions For Those Nearing Retirement

Life may begin at 40, but the countdown to retirement starts at age 55. Now is the time to take stock of your savings, goals, and timetable for moving into a phase of life that may last 30 years. These questions can help you gauge how you're doing.

When do you want to retire? This is a crucial variable. If you're planning to retire early—say, at age 55 instead of 65—you'll not only have to save more, sooner; you'll also need to have the money last an extra decade. On the other hand, if you expect to work well past normal retirement age, that reduces the burden on your nest egg. Another reason to keep working: While you normally can begin penalty-free withdrawals from an employer's qualified retirement plan at age 55, distributions from an IRA before age 59½ may result in a 10% penalty.

How is your money invested? Though there are no guarantees, a portfolio with most holdings in stocks holds the potential to grow more quickly than one emphasizing bonds or cash. But at this point, you won't have much time to recover from market losses and may need to reduce your allocation to equities. That, in turn, could affect when you'll have sufficient savings to leave the work force.

What will you get from Social Security? Government payments may make up only a small percentage of your retirement income, but this variable, too, needs to be part of your retirement calculations. How much you receive depends on several factors, including when you were born and when you apply for benefits. Payments could start as early as age 62, but if you begin then, your checks will be smaller. Wait a couple more years (if you were born between 1943 and 1954, full retirement age is 66), and your checks will be larger. If you live a long time, the bigger monthly checks will more than make up for the few years you did not collect up front.

How's your contingency planning? An unexpected job loss or serious illness could hurt your retirement plans, draining savings just when you need to be putting away as much as possible. If you have a cash cushion you can draw on in emergencies, it could stem the damage—but if you don't, build your reserves now. And you may want to invest in long-term care insurance.

How much will you need during retirement? Though rules of thumb suggest you'll need 70% to 80% of your current income to live comfortably after you leave the work force, the amount you should set aside depends on several factors, including the age when you expect to retire, your anticipated housing costs and other living expenses, and how healthy you are. To be effective, your retirement plan needs to take into account many interrelated variables. We can help you evaluate many possible scenarios, and if you're in danger of falling short of your goals, we can work with you to get on track before it's too late. ●

Too Much Money Back In

(Continued from page 1)

timeworn advice, but it's also essential, and in developing the annual budget for your company, begin by penciling in competitive compensation for yourself. Once you acknowledge that as a necessary cost of doing business, it will become less of an issue as you chart plans for future growth. And the money you take home will be a tangible reminder of what you've been working so hard to achieve.

For retirement savings, there are many possibilities. If you have done little so far or simply want to pull out maximum cash from your business, a defined-benefit plan could help. Here, you work backward from a specified future benefit to determine how much your annual contribution must be. In most cases, this requires actuarial calculations taking into account years to retirement, life expectancy, and other factors, and you'll need to fund future benefits for a number of your employees as well. Businesses with only a few workers can consider off-the-shelf defined-benefit plans, while plans built around annuities or life insurance might enable you to set aside several hundred thousand dollars a year. And all of the company's contributions are tax-deductible as a business expense.

A wide range of defined-contributions plans, from garden-variety 401(k)s to SIMPLE and SEP IRAs and profit-sharing plans, could also help you pull out money from your business while reducing taxes and providing retirement income. One major advantage of such plans is that, unlike defined-benefit plans for which annual outlays are mandatory, you may be able to contribute less in years when business is slow. And while annual contribution limits are lower for defined-contribution plans, your business could use both kinds of plan to maximize tax-advantaged savings. Moreover, 401(k)s and most other defined-contribution plans offer relatively broad investment options that can help diversify your retirement savings.

We can work with you to sort through the many options for funding your current and future compensation and will gladly answer whatever questions you may have on these topics. ●

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