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CLIENT'S TAX & FINANCIAL UPDATE

A Tax, Business, and Financial Planning Newsletter for our Clients and Friends

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Tax Points

HOW TO SURVIVE AN IRS AUDIT

If you receive notification of an IRS office audit, knowing what to do can be the difference in whether or not you survive it. Here are the critical steps you should take:

- **Don't ignore the notice.** Usually, you are given thirty days to answer an audit notice. If you ignore the notice, the IRS can automatically adjust your tax liability - and it won't be in your favor.
- **Read the audit notice carefully.** The notice will tell you what items are being questioned and what you should bring to the audit. Sometimes, only one or two items are questioned and it's an easy matter to bring the relevant records to the audit to substantiate your return.
- **Bring only what you need to the audit.** If you bring records or documentation of items that are not shown on the audit notice, you run the risk that the audit may be expanded to

other areas of your return. Auditors usually won't be interested in anything beyond what is indicated on the notice unless *you* bring it up. Simply address the relevant matters as quickly and in the most organized way you can. **Suggestion:** Provide adding machine tapes showing totals of checks or invoices that reflect the line items in question.

- **Be prepared.** Carefully review your tax return for the year that is to be audited. Organize your records so that you can easily respond to the auditor's inquiries.
- **Don't argue with an unreasonable auditor.** If you're unlucky enough to find yourself face-to-face with a rude or unreasonable auditor, or if you and the auditor can't reach an agreement, ask to speak to the auditor's supervisor and *calmly* explain the situation. (Use caution, however, because the supervisor - not the auditor - has the authority to expand the scope of the audit beyond the audit notice.)

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- **The estate credit** has increased for 2006. The credit will result in an increase in the applicable exclusion to \$2,000,000.
- **When can I dispose of my personal tax records?** Tax records must be kept for three years. However, if you understate your income by more than 25%, tax returns/records must be kept for six years. If your return is fraudulent or you do not file, there is no limitation. It is also very important to retain all records relating to the following: investments, home, stocks

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Tax Points

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and bonds, collectibles, retirement savings, etc., for as long as you own them in addition to the limitation period.

- **Entertainment deductions.** Entertainment expenses are not deductible unless the entertainment has come before or followed a "substantial business discussion". Have a business meal with an associate before or after the entertainment event. Be sure to keep a record of the date, time, place and the business topic which was discussed. This supports a 50% deduction of the cost of the meal and the entertainment event.
- **When you own a regular C corporation.** Retain the real estate your corporation uses in your own name instead of having the corporation own it. **Benefits:** You receive rental income from the business, which can be partially sheltered from tax by the depreciation expenses you can claim for the real estate. Your corporation can deduct the rent it pays you, which lowers its tax bill, and you can sell the real estate and pay capital gains at favorable capital gain tax rates.
- **Create estate tax savings** by giving a minority interest in your business to family members. For estate tax purposes the value of a minority interest in a closely held business is often discounted 30% to 40% due to the lack of marketability and lack of management control.



The Ten Most Common Failures In Personal Financial Planning

There's a general consensus among financial planners that most people make the same mistakes in planning their personal finances.

1. **Failure to have a family budget.** A few minutes with a pencil and paper can go a long way toward helping you keep your spending under control.
2. **Failure to involve other family members.** It's understandable when one spouse makes most of the financial decisions, but it's much easier to meet financial goals if both husband and wife are involved in the planning process. For example, both spouses should meet with the family accountant and lawyer.
3. **Failure to insure personal property at replacement value.** For a modest sum, you can buy replacement cost insurance for almost all personal property. Discuss possible exceptions with your insurance agent.
4. **Failure to use employee benefits properly.** The two most common examples are inadequate disability insurance (which is relatively inexpensive to augment) and poor utilization of payroll contributions to savings and retirement plans.
5. **Failure to diversify investments.** Mutual funds such as index funds which are not investment-specific offer the best opportunity for diversification.
6. **Failure to use the proper attorney.** For preparing wills and trusts, consult an estate-planning specialist instead of a general-practice attorney.
7. **Failure to have excess liability insurance.** One of the best investments you can make is the very small premium for \$1 million in excess liability insurance.
8. **Failure to have enough cash for emergencies.** The rule-of-thumb to protect yourself against emergencies is to put aside six months of living expenses.
9. **Failure to project taxes.** Without proper tax projections, seemingly good investments can create an unexpected cash shortfall.
10. **Failure to establish financial goals.** Put down on paper exactly what your goals are and what their cost is. Then weed out those which are impractical or unattainable.

Smarter Purchasing

Buyers will often tell a sales representative that a quoted price is too high because it exceeds the company's budget. While this may cause the rep to lower the price to meet the company's budget, it won't necessarily result in the *best* price because the company's budgeted price might be higher than the seller's lowest price.

For example, assume that the company's budgeted cost is \$200. The seller quotes \$220. The buyer reveals the company's budget and the rep reduces the quote to \$200. The buyer is satisfied because the

budget limit has been met, but the company still pays more than it should.

A better negotiating strategy is to tell the sales representative that you'd like to buy, but the price is too high. Ask for a price breakdown and explanation of the components that go into the seller's quote. Have your own pricing information prepared so you can show the rep that his price is too high. If the seller can't explain the quoted price, there's a good chance he'll lower it *below* the company's budget.