

# Tellone Financial Services, Inc.

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*A tax, business, and financial planning newsletter for our clients and friends*

## How to Improve Your Chances of Getting a Business Loan

Regardless of whether interest rates are high or low, the ability to borrow is an important factor in running a successful business. Whether you need to borrow money now or in the future, it's good business practice to know what information a banker or other lender will need in order to grant your loan request.



This information falls into two broad categories. The first is **general information** about you, your business product or service, and your plans for the business. While some banks will gather this information from a loan application, it's wise to prepare a clear, written presentation of the general facts about you and your business.

The second type of information a lender needs is **financial information**. This includes several key documents, each of which plays an important role in the lender's decision.

### General information

You'll probably be asked to supply some of this information on the loan application form, but you can often provide additional facts that will have a favorable impact on a lender. That's why it's good strategy to prepare a written presentation that gives a lender a clear description of you and the business you are in.

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# CLIENT'S tax & financial UPDATE

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How to Improve Your Chances of Getting a Business Loan

An Easy Way to Reduce Your Income Taxes on Investment Income

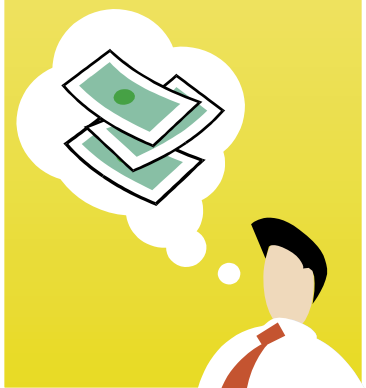
Grantor Retained Annuity Trusts (GRATs)

Like-Kind Exchanges

How Quickly Your IRA or Keogh Will Grow

Management Tips

What You Should Know about Tax-free Income



## taxPOINTS

### An easy way to reduce your income taxes on investment income

is to buy individual stocks rather than stock mutual funds. When you buy individual stocks and hold them, the only income taxes you would pay is from the dividends. With mutual funds, realized capital gains must be distributed and these capital gains distributions are taxable to the shareholders.

### Grantor Retained Annuity Trusts (GRATs)

are a great way to get assets out of your estate at little or no cost. **Technique:** You place assets in a trust for the benefit of your heirs and you receive an annuity for a number of years. The annuity that you receive reduces the taxable part of the transfer. Depending upon the size and length of the annuity, you can avoid paying any gift tax on the transfer.

**Example:** A GRAT is established with a \$1,000,000 transfer and you receive an annuity for five years at \$245,200 per year. Since the value transferred into the trust is equal to the value of the annuity (including an interest factor of 7.2%), there is virtually no taxable gift. If the transfer increases in value to \$5,000,000 after five years, you have in effect transferred \$5,000,000 out of your estate without incurring any tax.

### Loophole: Like-kind exchanges.

No gain is recognized on the exchange of business or investment property (i.e., land, building or equipment) if the property received is of a like kind and is used in a business or for investment. The tax is not due until that time you sell the property received in the exchange.

# How Quickly Your IRA or Keogh Will Grow

Here's a chart that shows how fast \$1 contributed to an IRA or Keogh plan at the end of each year will grow at various compound interest rates over different periods of time. You can use this table to determine the value of your IRA or Keogh plan at a future date. For example, assume that you contribute \$5,000 a year for the next ten years at an 8% average rate of return. Based on these assumptions, the chart shows that \$1 would grow by a factor of

14.486562. Multiply your \$5,000 contribution by that factor to determine that your IRA or Keogh plan would be worth \$72,433.



YEAR	AVERAGE RATE OF RETURN			
	8.00%	9.00%	10.00%	11.00%
1	1.000000	1.000000	1.000000	1.000000
5	5.866601	5.984711	6.105100	6.227801
7	8.922803	9.200435	9.487171	9.783274
10	14.486562	15.192930	15.937425	16.722009
15	27.152114	29.360916	31.772482	34.405359
20	45.761964	51.160120	57.274999	64.202832
25	73.105940	84.700896	98.347059	114.413307

## Management Tips

Speed up collections by sending slow-paying accounts several small invoices instead of one large invoice. Customers who have financial problems may hold up payment of bigger invoices (usually those over \$2,500) but will often approve smaller bills for payment when they are received.



# What You Should Know about Tax-Free Income

There are many kinds of income that are not subject to federal income taxes. A good understanding of them can help you make many important financial decisions and keep you from paying income taxes when it's not necessary. Here are some of the most attractive opportunities to earn tax-free income.

**Gain from the sale of your principal house** that you owned and occupied as a principal residence for at least two of the five years before the sale, you can elect a \$250,000 (\$500,000 for joint filers) exclusion from gain on the sale. If due to a job change, illness, or other unexpected circumstance, the homeowner is unable to meet the two year requirement, the law allows you to take a prorated exclusion.

**Municipal bonds.** The interest you earn from a municipal bond is generally free of federal taxes. If you live in the city or state where the bond was issued, the interest is usually free of state and local taxes, too. However, before you invest in a municipal bond, seek expert advice about whether it is subject to the Alternative Minimum Tax.

**Employee fringe benefits.** Many of the benefits you receive from your employer are tax-free. These include medical insurance, premiums for up to \$50,000 in life insurance, meals in your employer's cafeteria if it is located on the work premises.

**Life insurance.** Life insurance proceeds are free from federal income taxes. However, the estate of the in-

sured will be taxed on the proceeds. You can avoid this tax by establishing an irrevocable life insurance trust which you cannot change or terminate.

**Tax-free income for citizens who live abroad.** Up to \$87,600 in foreign-earned income is not subject to federal income taxes.



**Social Security benefits.** If you have no other income, Social Security benefits are tax-free. However, if you do have income from other sources, the tax-free amount of your Social Security benefits is phased out.

**Scholarships.** Scholarships and fel-

lowships received by degree candidates are completely tax-free. The amount received from the scholarships and fellowships must be used for tuition, fees, books, supplies, equipment, and other related expenses that are required at the educational organization.

**Disability payments.** If you paid the premiums for disability insurance, payments you receive from the insurance are tax free. If your employer paid the premium, the payments you receive are taxable.

**Recoveries for personal harms.** Money received from a lawsuit for personal injury which are compensatory, non-punitive recoveries are tax free.

**Payments for child support.** Money received for child support is not taxable. Alimony, however, is generally considered taxable income.

**Inherited property.** There is no income tax on property received by the beneficiary of a will. Income taxes owed by the estate for income earned from the date of death to the date of distribution to the beneficiary are paid by the estate, not by the beneficiary.

**Gifts.** Gift taxes are not paid by the recipient of the gift. They are paid by the giver of the gift. A single taxpayer can give up to \$12,000 tax-free annually to each recipient. Married taxpayers can give up to \$24,000 tax-free annually to each recipient.

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### *Business Loan*

Here's a checklist for the general information you should include in your written presentation:

- Your management background, abilities, and accomplishments as well as those of your key management personnel.
- A general description of the nature of the industry or business you are in.
- The sales potential of your product or service. This should include your short-term and long-term marketing plans and how you intend to handle any problems or opportunities which your business faces.
- An explanation of exactly how the money you are borrowing will be spent, whether the amount is sufficient for your immediate or long-term purposes, and how the borrowed funds will contribute to your firm's well being.

In short, your general information presentation should tell the lender who you are, what your business has done and what you expect to do, how you intend to reach your goals, and, of course, how the money you are borrowing will help you achieve those goals. If you make a logical presentation of this general information, you'll set the table for a clear understanding of your financial information.

### **Financial information**

It's critical that you present all financial information in a formal, professional manner. A sloppy financial presentation is almost certain to result in the

rejection of your loan request. The following financial documents should be prepared by your accountant:



- A personal financial statement for you and other principals of the business or other guarantors of the loan. Be sure that your personal financial statement includes the amount of money that you yourself have at risk in the business.
- A balance sheet which shows your company's assets and liabilities for your most recent accounting period. It's important that the balance sheet includes the amount of the company's present indebtedness and the terms of repayment of any outstanding loans. Copies of recent company tax returns should be attached to the balance sheet as supporting material.
- An income statement which shows the company's profit performance over a specific period of time.
- A cash flow projection which includes the prospective loan funds and other sources of money and shows how the money will be used.

- A sales forecast which projects and preferably allocates sales by type of customer over a given period of time.
- A current ratio position which shows the relationship between the company's current assets and current liabilities.

### **The role of your accountant**

It's important to involve your accountant in both the preparation of all financial documents and in your meetings with the lender. Your accountant can supply whatever degree of assurance about the financial information that your lender may require. The degree of assurance will vary, depending on matters such as the lender's previous experience with you, the size of the loan you've applied for, and how well the bank knows your business.

For example, audited financial statements may be required if you are requesting a large loan and the lender has not had any previous experience with your company. In other situations, a review of the financial information by your accountant may be sufficient, particularly if the lender has had previous dealings with your company.

It's generally recognized that banks credit standards vary among banks, some banks have tighter credit standards than others. But if you're properly prepared and make a solid presentation, your chances of getting that vital business loan will be greatly improved.