Anne Marie Hanna, CPA LLC

1515 Heritage Lane • P.O. Box 12255
Florence, SC 29505
Tel: 843-673-9700 • Fax: 843-673-0220
Email: admin@amhannacpa.com

CLIENT'S tax & financial UPDATE

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

How to Computerize Your Accounting System

All businesses, regardless of size, should consider computerizing their business systems. The cost of computers has now reached a level that makes them a solid investment in better business management.

Signs that you need a computer or need to upgrade your software

The signals are clear. Your accounting system is bogged down. Invoices go out late. Receivables climb to an uncomfortable level. Discounts for prompt payment are lost. Paperwork piles up. Order processing is delayed. More clerical help is needed.

It's possible that you might be able to solve these problems by improving your operating procedures, but it's much more likely that it's time to computerize or upgrade your software. However, it's a decision you shouldn't make yourself without first getting some expert advice.

It's not good practice to rely solely on salespeople to help you make the right decision. No matter how honest the salesperson or consultant is, the advice you'll get is that you definitely need their products. Instead, consult with your accountant. He's familiar with your business and your accounting system and can give you the objective advice you need.

Many business people think that installing a computer system means that their business has "arrived". Computerize to make your business more efficient and as a useful tool to make it more successful.

What a computer can do

A computer will handle your paperwork so much faster. Invoices will go out on time so your cash flow will be improved. Order processing will be quicker so shipments will be made sooner which will also beef up cash

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taxPOINTS

Avoid the capital gains tax through like-kind exchanges. In the event you have income-producing property with unrealized gains that you want to sell to purchase another income-producing property, if you swap the properties, no capital gains tax will be due on the exchange.

Loophole. Make Roth IRA gifts to children. When a child of any age has earned income, he/she qualifies to contribute to a Roth IRA. And this contribution can be made with funds you provide to the child. **Benefit:** The funds move from your taxable account to earning returns in the Roth IRA that may compound totally tax free for the child's entire life. A Roth IRA contribution made during teenage years that compounds over decades may provide a tremendous payoff.

Loophole. Payroll taxes. For individuals who operate their business as a sole proprietorship wages paid to their children who are under the age of 18 do not have to pay the business social security tax of 7.65% on those wages. **Added benefit:** The children do not have to pay their share of the social security tax, too.

How Rapid Business Success Can Lead to Unexpected Failure

There are times when a rapidly growing business is so successful that it suddenly finds itself in real trouble. As one success follows another, management becomes too risk-oriented and before long, the company discovers that its growth has outstripped its financial resources. The result is a negative cash flow position that makes it virtually impossible to operate.

In the glow of success, some growth-minded entrepreneurs tend to create their own cash flow problems. They offer overly generous credit to customers who don't deserve it. They fail to realize that current expenses – such as payroll – won't wait and are sometimes payable before sufficient receivables have been collected.

The faster the growth, the greater the cash shortfall, and the "successful" company may soon find that it can't pay its bills. If the business is not able to get additional financing, it may be forced to close its doors.

Rapidly growing companies should take steps to prevent this situation before it happens. The impact of extended credit terms should be carefully measured against expenses before credit is granted.

Cash flow projections should be reviewed constantly. Receivables should be closely monitored and strong collection procedures should be consistently enforced. Payment schedules should be negotiated with vendors. And additional sources of capital should be explored before a cash crunch hits, so that operating funds are available when they're needed.

Without these safeguards, rapid success can mean unexpected failure.

For Emergency Help from the IRS Use Form 911

There is now a written procedure to request the IRS to stop imminent action. If you expect the IRS to commence imminent action against you, you can apply to stop that action if it will cause serious hardship.

To get emergency help, use Form 911. It's called Application for Taxpayer Assistance Order. Complete the form and send it to your local Taxpayer Advocate Office. For the address of the Taxpayer Advocate Office in your area, call the National Taxpayer Advocate toll free number 1-877-777-4778.

A Form 911 application is given top priority by the Taxpayer Advocate Office. All enforcement action is halted while your application is being reviewed. The IRS states that most taxpayers can expect action on a Form 911 application within one day.

Deducting the Cost of Taking Your Spouse on a Business Trip

Show that there is a business reason for why your spouse accompanied you on a business trip and you can deduct the cost of his or her trip.

Here's what to do if your spouse travels with you to a business meeting, a convention, or other business event.

- Make sure your spouse understands your job responsibilities.
- See that your spouse discusses the event's general business purpose with other spouses who attend.
- Be sure that spouses are invited to business event functions such as dinners and seminars.
- Have all your meals with business colleagues and bring your spouse. Be sure that business is discussed at these meals and that your spouse takes part in the discussions.
- Have your spouse write you a memo with business suggestions based on information gained at the business event.

The Tax Benefits of Renting Equipment to Your Business

If your business doesn't have the cash to buy needed equipment, consider the tax benefits of buying the equipment yourself and renting it to your business.

You benefit because you get a deduction for equipment depreciation which reduces the taxable portion of your rental income. And the rental income you receive is passive income so you can offset it with passive losses.

Your firm benefits because it can deduct 100% of the rent as an ordinary business expense.

However make sure that the rent you charge is reasonable and is in line with rents charged by others. If you charge too much or too little, the IRS may not look favorably on your rental agreement and can disallow your deductions.

Management Tips

Preventing Promotion Blues

When employees feel that they can't move up in a company, the result is often a lack of motivation and a decline in productivity. Among the most effective ways to prevent this:

- Use educational and training programs to boost employee enthusiasm.
- Plan work so that employees aren't burdened with repetitive tasks.
- Improve job satisfaction with constructive performance appraisals.
- Make it very clear that not getting regular promotions doesn't mean that an employee is doing poor work.

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flow. Inventory control will be greatly simplified - you'll always know what you need and what you don't need.

You'll get a much clearer picture of your business. You'll be able to judge which customers are profitable, where your costs are out of line, whether sales performance is satisfactory, and much more.

When you plan your computer or software purchase, make sure the system will handle your peak workload, not your average workload. And be sure that the system can be expanded as your company grow.

What to expect: conversion pains

Don't expect the complete changeover to happen overnight or even in a few months. The average conversion time for a relatively simple system is about six months. There's no way to speed it up even prepackaged software programs that seem ideal for your business. So-called "proven" programs may require changes and careful debugging because no two businesses are exactly alike.

Plan to convert your system in stages phasing in one part of your business at a time. For example, changing over your accounting system might take about six weeks or so. You'll need another four weeks for testing. Still another two weeks will be required to run both your current system and the new system simultaneously. When everything is running smoothly, you can consider eliminating the old system.

Avoiding problems

The biggest problem in converting your current system isn't the hardware or software. It's people. If all levels of management personnel aren't involved in the planning and conversion process, you'll wind up with a system that doesn't satisfy your needs. Remember, most of the benefits from a new computer system come from people working smarter and faster.

Even though most of today's managers are familiar with computer jargon, a training program is a must. It's essential that all employees understand the system if it is to be productive.

Service

Whether you buy or lease your system, make certain that the vendor handles the service for all components, even if they come from several manufacturers. Get detailed specifics about maintenance and repairs. Find out who will do the work, when they'll do it, and where they'll do it. And, negotiate for service beyond the initial contract period.

Selling a Business

Loophole: Sell the stock of a C corporation, not its individual assets.

Why: A stock sale generates capital gains taxed at a top rate of generally 15%. In contrast, a sale of assets generates a combination of ordinary income – taxed at a top tax rate of 39.6% - and "recapture" of previous tax breaks. Furthermore, asset sales are taxed twice-first at the corporate level and then again when the sales proceeds are distributed to corporate shareholders.

Loophole: Consider electing S corporation status before selling a business to eliminate double taxation of the proceeds. S corp income flows through to shareholders and is taxed on their individual tax returns.

Caution: Businesses that convert from C corporation to S corporation must value the business's assets on the conversion date. When assets are then sold within 5 years, profits are considered realized to the extent of any built-in gains as of the conversion date. In other words, taxes on such sales are figured as if the company were still a C corporation. The company pays capital gains tax on the built-in gains and distributes the after-tax balance to corporate shareholders in the form of a dividend.

Loophole: Defer tax by selling company stock to an ESOP. When business owners sell at least 30% of their company's stock to an employee stock ownership plan (ESOP), the proceeds aren't currently taxable as long as they're invested in common stock of U.S. corporations. The tax is deferred until the replacement shares are sold.

Key: Structure the sale so that the third – party buyers acquire their shares from the ESOP.