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CLIENT'S tax & financial UPDATE

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

How To Cut Overhead Costs For A Better Bottom Line – Part One

Inflated overhead costs are a progressive disease in many businesses. Increases in one small overhead item at a time can add up until they finally gobble up a sizeable portion of profits and create serious cash flow problems.

Preventative medicine is the best way to avoid these problems. A good record keeping system will let you examine overhead costs every month to make sure they remain relatively constant. Payroll and expense accounts, telephone costs, and equipment and supply costs should receive special attention.

But the real key to keeping overhead down is to see that each area that generates overhead costs is under the direction of one individual. When expenses appear to be getting out of hand, you can then meet with the person in charge of a problem area to discuss why costs are climbing and how changes can be made to bring them under control.

Purchasing Practices

The cornerstone of improved net income is to minimize the cost of goods sold to increase gross margin. To achieve this goal, the total purchasing function must be assigned to one person. When several people are involved in buying, there is no ultimate responsibility and wasteful and sloppy purchasing practices develop quickly. In addition, it becomes easy to lose track of what has been bought

and what has been ordered. Chances are also good that purchases will be made from friends rather than from suppliers who offer the most favor-

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taxPOINTS

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 entertainment event.

IRAs and pension plan loophole: Taxpayers sometimes make non-deductible contributions into a retirement plan. These contributions are added to your basis so when you receive a distribution these contributions are not taxed as income to you – only the income earned on it will be taxed.

Lower your Social Security taxes. If both spouses work in a business and one spouse has a high-paying job, that spouse should be listed as the sole owner of the business. $128,700 is the maximum amount of wages for 2018 that Social Security tax is paid on. **Benefit:** If one spouse pays the maximum Social Security tax on their wage from his/her job, then the income earned from the business to that spouse will not be subject to the Social Security portion of the self-employment tax.

SOCIAL SECURITY USA ADMINISTRATION

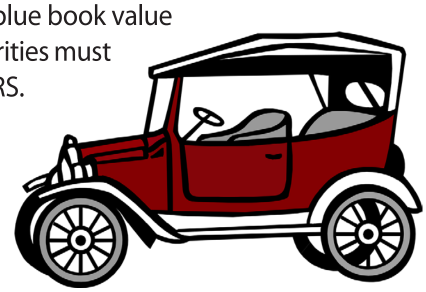
Tax Tip

Auto Donations

If you give your car or boat to charity and the charity or its agent sells it, the value of your donation for tax purposes is limited to the sales proceeds. This rule doesn't apply if the charity uses or improves the vehicle in a substantial way before selling it.

Example: Substantial use is a charity delivering meals to homebound individuals that drives the car 12,000 miles before selling it.

In such situation, donors can rely on the blue book value of the car or other fair market values. Charities must report sales proceeds to you and to the IRS.



Strategy: To maximize your deduction, contribute your car to an organization that intends to use it in its charitable activities – ask the charity about its intentions.

Hidden Danger In Your Accounts Payable System

An unscrupulous supplier might bill you at a price which is higher than the price on your purchase order in the hope that the over-billing won't be noticed because you have a poor accounts payable system. To protect yourself against this possibility, make sure that your accounts payable employees check every incoming invoice against the original purchase order and initial the invoice to show that it has been approved for payment.

If an invoice price is higher than the purchase order price, it's perfectly legal to pay the lower purchase order price. Under the Uniform Commercial Code (UCC), a vendor must abide by the terms of a purchase order if the vendor delivers any portion of the merchandise without objecting to the purchase order terms.

How To Save Tax Dollars By Increasing The Basis Of Assets Acquired

Many taxpayers think they can save taxes by giving property to a close relative before they die. If you're thinking about doing this, you could be making a mistake that can cost your heirs a substantial amount of tax money.

Take Ben Williams, for example. For many years, Ben had been the favored painting contractor in his home town. Inside or outside, from doorsteps to double-deckers. Ben Williams got the call when homeowners wanted a first class paint job at a reasonable price.

Ben wielded a mighty paint brush, but his climb up the ladder of success was modest. As he gave a fresh new look to house after house, Ben wondered when he could touch up his financial affairs and buy a house he could call his own. The opportunity finally came in 1996 when Ben, negotiating from atop his painter's scaffolding, paid $150,000 for a comfortable cottage he was painting. It was a proud moment for Ben and it proved to be a sound investment.

Now, if there's one thing that house painters have, it's plenty of time to think. And as Ben approached retirement, his thoughts turned to how he could save his family from an excessive tax burden and costly legal fees when he finally departed to meet The Great Painter In The Sky.

By the time he retired, Ben's strategy was clear to him. His estate was modest - a little cash, some personal effects, and the house he had bought which had appreciated considerably in value. So Ben made a gift of his residence to his only son, George, and spent his remaining days thinking that he had painted a better tax picture for his family.

Ben Williams remained in the house until his death in 2017. Within a few months, George sold the property for $370,000 - its fair market value - for a gain of $220,000. But when George Williams filed his 2017 individual income tax return, he discovered that for tax purposes, the cost basis of property acquired by gift is that of the last preceding owner who did not acquire the property as a gift. Since the last preceding owner was George's father, who had paid for the house with his own hard earned money, the cost basis for the property will be what Ben Williams paid for it - $150,000. Consequently, when George files his 2017 individual income tax return he will need to include the $220,000 gain from the sale of the house and pay a substantial tax on the gain. – a hefty tax burden that Ben Williams thought he had avoided.

A BETTER SOLUTION

The income tax cost basis for property acquired from a decedent is generally the fair market value of the property on the date of the decedent's death. This is called, "the stepped-up basis rule" and, if Ben Williams knew about it, he could have protected his family from paying any taxes on the gain from the sale of the property.

Under the stepped-up basis rule, the basis for property acquired by inheritance is increased from actual cost to the fair market value of the property at the time of the owner's death. This shields beneficiaries from paying income taxes on the appreciation of the property prior to the death of the owner.

Therefore, if Ben Williams had retained ownership of his house, its estate value would have been its fair market value when Ben died. George's stepped-up basis for tax purposes would then have been $370,000. Because George sold the property for its fair market value, he would have had to report no taxable gain on his 2017 federal income tax return and his income taxes on the appreciation would have been reduced to zero. That's a huge savings, which is enough to paint quite a few houses.

Ben Williams was a professional painter, but he should have brushed up on his knowledge of the tax law by consulting with a professional accountant before he gave his house to his son. Just as in painting, a little preparation can go a long way toward getting the best possible result.

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How To Cut Overhead Costs For A Better Bottom Line - Part One (continued)

able prices, the best quality, and the most reasonable terms.

When the purchasing function is centralized, the responsible individual gains leverage with suppliers and is able to apply experience and expertise to every purchasing decision. In addition to immediate cost benefits, centralized control over inventory levels and reorder points greatly facilitates future planning.

Receiving Practices

Profits can evaporate very quickly unless one person is responsible for receiving all purchased goods. The receiving function not only involves seeing that goods are received in the proper quantity and condition, but that they are subsequently stored in the proper place as well.

Purchased goods that are left lying around are subject to damage. Even worse, the risk of their being stolen or pilfered is greatly increased. And improperly stored goods can result in costly duplicate purchases and wasted time by employees looking for merchandise.

Planning and Scheduling Practices

Thoughtful planning is the key to receiving inventory on time and to supplying goods and services according to schedule. Every step of your business - from purchasing through sales and collections - must be worked into the plan. Ultimately, the "where, when, and what" of each element in the plan will indicate the best possible use of manpower, equipment, inventory, and cash. Good planning makes a substantial contribution to reducing overhead.

Quality Control

In a manufacturing firm, quality control is an integral part of the production process. In other types of businesses, quality control means scrupulous attention to detail in every area of business operations.

Defective or damaged products are a major cause of increased overhead costs. Additional expenses for employees time and materials add up very quickly. And the expense of poor customer relations contributes significantly to ultimate costs.

When damaged or spoiled goods are detected, they should be isolated immediately and sold at reduced prices if necessary, but never mixed with regular inventory. Efficient quality control not only lowers overhead costs, but it improves customer relations as well.

Part Two of this article will appear in the next issue of Client's Tax and Financial Update.

Choosing The Best Sales Compensation Plan

There are three basic ways to compensate sales personnel. Picking the one that's best for your company can make a real difference in sales productivity.

1. Straight salary is often used for lower echelon sales personnel. Its major drawback is that it offers no incentive to perform beyond a routine level. Straight salary can be useful, however, when employees are involved in both sales and other jobs because it establishes parity within the workforce.

2. Straight commission is most effective when a salesperson is dependent (such as a manufacturer's representative) or when a salesperson is essential to closing a sale. It works best when there's enough demand in the marketplace to assure sales.

3. Salary plus commission provides incentive to sales personnel, but to use it effectively, companies must find the right balance between salary and commission.