CPA

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MAY 2004

Client Bulletin

BUSINESS & TAX PLANNING IDEAS *for* OUR CLIENTS *and* FRIENDS

Tips to Improve Your Business Cash Flow

When opportunity knocks, you want your business to be ready to answer. Good cash management involves almost every aspect of your business, from monitoring expenses to renegotiating loan terms. Here are some tips for improving your cash flow by managing your receivables and payables:

Have specific credit approval procedures

Never give credit until you are comfortable with a customer's ability to pay. Before dealing with new customers, always get at least three trade references and a bank reference. Also, consider using a commercial credit reporting service. Your company's credit policy should call for establishing credit limits for each customer, sticking to those limits, and periodically reviewing the limits you set.

Communicate your payment terms

Establish specific payment terms and put them in writing. Let your prospective clients or customers know in advance when and how you expect payment. Be sure your written policy includes deadlines for payments, along with any provisions for interest and penalties. (Check first with your attorney to find out what provisions are legal in your state.) You may also want to consider asking for a deposit, retainer, or partial payment up front, depending on the customer, the job, or standard practice in your industry.

Bill promptly

Whenever possible, mail invoices the day you complete the work or the product ships. If appropriate, bill in stages based on mutually agreed-upon completion dates.

Offer discounts to accelerate collections

Some customers will pay sooner if you provide an incentive. Consider a policy that allows a small discount if a customer pays within a specified short period, such as 1 percent off if payment is made within 10 days.

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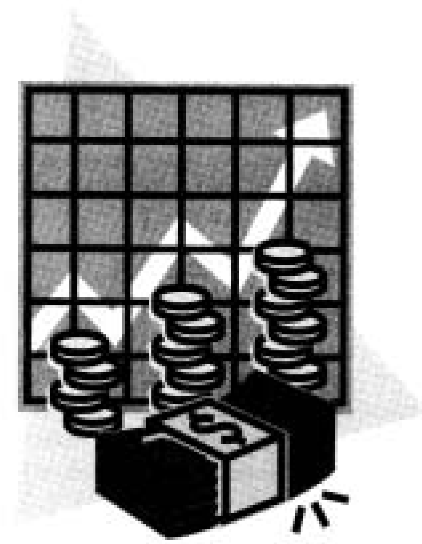
SPECIAL TAX ISSUE

Did You Know?

When the Spanish explorer Hernando Cortes landed in the New World, he brought horses, soldiers—and his accountant, who kept the books for the army. As a reward for excellent service, the accountant was made the first mayor of Veracruz, in what is now Mexico.



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Monitor your receivables

Credit managers agree that the older a receivable becomes, the harder it is to collect. Actively follow up on past due accounts. As soon as a bill becomes overdue, call the customer and ask when you can expect payment. If your own collection efforts fail, promptly turn the process over to an attorney or collection agency.

Manage your inventory

Overstocked inventory can tie up significant amounts of cash, while insufficient inventory may result in lost sales opportunities and delays for customers. Periodically check inventory for old or outdated stock, and consider dropping those products that tie up cash. Replace them with faster moving items. Think twice before taking volume discounts offered by suppliers unless you are sure you can move the merchandise quickly—if your cash is tied up for long periods of time in slow-moving inventory, you will quickly lose the benefit of the purchase discount.

Manage your payables

Take the maximum amount of time allowed to pay your suppliers without incurring late fees or interest charges. Try to coordinate your terms with customers and suppliers so you will have adequate time to collect on receivables without spending money on short-term credit lines in order to pay your suppliers.

Manage your suppliers

Try to negotiate with suppliers for more favorable terms. Periodically get new quotes from multiple sources to be sure your business is getting the best deal. Finally, do not let a supplier tempt you with favorable credit terms into buying more merchandise than you need.

Deducting Combined Business and Vacation Travel

If you're thinking of combining business with pleasure by adding a few days of vacation to your business trip, take the time to understand the tax implications. Here's what you should know before finalizing any reservations.

Deducting domestic trips

When traveling within the United States and mixing business and personal activities, you can deduct 100 percent of travel expenses to and from the destination if the trip is primarily related to your business. Lodging, 50 percent of meal costs, and other qualified business expenses also are deductible for the days you spend on business, but only to the extent that they would have been incurred if the trip had been totally for business.

There are no fixed rules for determining whether your trip is primarily for business or pleasure. However, the determining factor is how much time you spend on each activity. For example, if you spend six days on business and three days vacationing, you may deduct the full cost of getting to and from the business destination, even if you spend the last three days on the beach. Travel days count as business days when making your calculation.

Reverse the allocation between business and pleasure (three days on business and six on pleasure) and none of your travel expenses would be considered deductible. However, you could write off any expenses you incur at your destination that would qualify as business deductions. If, for example, while you and your family are vacationing in California, you take a customer out to lunch to discuss business, your transportation to and from the customer's office and 50 percent of the meal cost would qualify as a deductible business expense.

When staying over on Saturday night results in a lower airfare and net cost savings, you may deduct 50 percent of meal costs, lodging, and other business-related expenses incurred for the additional night. This is because the stay has a business purpose of cutting travel costs.

When business takes you abroad

When your destination is on foreign shores, you must allocate your travel expenses in proportion to the number of days you spend on business and personal activities. However, several exceptions to this rule apply.

First, you don't have to follow the allocation rule if you are out of the country for seven days or less (not counting the day you leave the United States, but counting the day you return). That means if you fly to London for a four-day meeting and sightsee for two days, your travel expenses are deductible.

The allocation rule also does not apply if you are out of the United States for more than a week, but spend less than 25 percent of your time on nonbusiness activities. (In this case, both the day of your departure and the day of your return count as business days.) Additionally, you are exempted from the allocation requirement if you have no substantial control over the arrangement of the trip.

When family joins you

Pack the family into the car for the joint business/vacation destination,

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and you can deduct the total cost of driving back and forth, even though others are in the car. However, if you fly with your family to your destination, only your airfare is deductible. When you share your hotel room with family members, you may deduct the cost of what you would have paid for a single, rather than double, room. Just be sure to ask the hotel to note the single rate on your bill.

Record keeping is key

Keep in mind that the IRS pays close attention to deductions claimed for business travel. Maintain a log to substantiate your business activities. Include the dates of departure and return, the number of days spent on business, and the reason for the travel.

Tax Rules for Your Vacation Home

Owning a vacation home gives you a great opportunity to relax and have fun. To add to your enjoyment, a vacation home also can provide significant tax benefits. Here's what all current and would-be vacation homeowners should know.

Deductions for vacation home owners

Most people can fully deduct mortgage interest and property taxes on their vacation homes just as they can with a personal residence. Under current tax law, interest is deductible on the first $1 million in mortgage debt used to buy, construct, or improve a principal residence and second home. If you have more than one vacation home, for tax purposes you'll want to designate as your second home the residence with the largest total deductions for mortgage interest and real estate taxes. Property taxes may be deductible no matter how many vacation homes you own.

High-income homeowners may not get the full benefit of these tax breaks, however, since most itemized deductions, including mortgage interest and property taxes, are reduced once adjusted gross income exceeds certain levels.

If you rent your vacation home, you may be entitled to extra tax benefits. But the applicable rules depend on the use of the home.

Minimal rental brings tax bonus

If you rent your home for no more than 14 days a year, any rental income you collect is tax-free. However, any

rental-related expenses you incur from renting your home for 14 days or less are not deductible.

Combining personal and rental use

If you rent your vacation home for more than 14 days a year and you and your family use the place more than 14 days a year (or 10 percent of the number of days it is rented, whichever is greater), a different set of rules applies. In this case, all of the rental income is subject to tax, but you can deduct rental-related expenses—utilities, maintenance, and depreciation, for example—that do not exceed your rental income after taking the allowable deductions for property, such as real estate taxes and mortgage interest. You also can carry forward to future years expenses for the rental period that cannot be deducted in the current year.

Limited personal use leads to greater tax benefits

If you use your vacation property for personal use for less than 14 days (or 10 percent of the total rented days, if greater), your vacation home qualifies as a rental property. That status makes it possible to write off more expenses—as much as $25,000 in excess of rental income. This extra deduction phases out when your adjusted gross income (AGI) exceeds $100,000 and is completely unavailable above $150,000. (Note: the phaseout begins at AGI of $50,000 if you are a married person filing separately.)

In general, you can deduct passive losses only from passive income, such as from rental properties that produce income or gains. There are additional rules about the order and limitations for deducting expenses.

The fine print: defining personal use

There are complicated rules for determining what constitutes personal use. According to tax law, days you spend repairing and maintaining your home on a full-time basis do not count as personal use, even if other family members use the home during the same time period for recreational purposes. On the other hand, if you allow family or friends to use your home for free or at a below-market rental rate, be prepared to classify that time as personal use.

Selling your vacation home

When it is time to sell your vacation home, the gain exclusion of up to $250,000 ($500,000 on a joint return) on the sale of a principal residence does not apply. To qualify for the exemption, you would need to make the vacation home your principal residence for at least two of the five years before the sale.

Online Resources for Better Money Management

The Internet has changed the way people do everyday business, from buying books to looking for a job, but it can also serve as a valuable resource for performing common financial tasks. Here are a few suggestions for using the power of the Web to become a more efficient money manager.

Online banking

Online banking allows you to quickly check your account balances, determine which checks have cleared, and transfer funds between accounts. When combined with personal finance software, online banking can help you manage your money through one central location for banking and investment account information and for daily monetary transactions. Personal finance software programs also include tools you can use to create budgets, build reports and graphs, and assemble information for your taxes.

Bill paying

Most online banking services treat bill paying as a separate, add-on function. Setting up your bill payment account can require significant upfront effort. You need to provide account numbers and correct remittance addresses for the vendors you plan to pay electronically. However, if you have many monthly bills, you'll find it worth the initial effort. Be aware that, while convenient, online bill payment is not always timely: it can take from a week to 10 days from when you request payment until the proceeds are actually received by the payee. Banks charge varying rates for bill payment services. Generally speaking, if you pay more than 10 to 15 bills a month, you'll find that the bank's fee is offset by what you save in time and postage.

Financial calculators

Most personal finance-related Web sites have online calculators that make it easy to play out "what if" scenarios. You can access a wide range of calculators from USA Today at **www.usatoday.com/money/perfi/calculators/calculator.htm**

Savings bonds

Want to know how much the U.S. savings bonds in your safety deposit box are worth? Go to **www.savingsbond.gov**, and click on "Savings Bonds Tools." Enter the denomination and issue date to learn the answer and the interest rates they're earning. At the same site, you can download the Savings Bond Wizard™, a Windows®-only program that allows you to maintain an inventory of your bonds and determine their current redemption value, earned interest, and other information.

Tax Calendar

MAY 2004

May 10

Employees who work for tips. If you received $20 or more in tips during April, report them to your employer. You can use Form 4070.

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the first quarter of 2004 only if you deposited the tax for the quarter in full and on time. Otherwise, Form 941 was due on April 30.

May 17

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in April if the monthly rule applies.

JUNE 2004

June 10

Employees who work for tips. If you received $20 or more in tips during May, report them to your employer. You can use Form 4070.

June 15

Individuals. If you are a U.S. citizen or resident alien living and working (or on military duty) outside the United States and Puerto Rico, file Form 1040 and pay any tax, interest, and penalties due. If you want additional time to file your return, file Form 4868 to obtain two additional months to file. Then, file Form 1040 by August 16.

If you are not paying your 2004 income tax through withholding (or will not pay in enough tax during the year that way), pay the second installment of your 2004 estimated tax. Use Form 1040-ES.

Corporations. Deposit the second installment of estimated tax for 2004.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in May if the monthly rule applies.

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