

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

When The Unexpected Happens, Will You Have Enough Cash?

Most people realize that they should put aside enough cash to protect themselves against an emergency or a sudden loss of income. If the unexpected happens and an adequate cash reserve is not readily available, you may be forced to sell investments or real estate for less than they might be worth at another time under less pressing circumstances.

That's why it's wise to plan your emergency cash needs carefully. Here's how to go about it.

How Much Cash is Enough

Step 1: Estimate your living expenses.

It's fairly simple to estimate your annual living expenses, but be careful not to forget anything. Rent or mortgage payments, food, clothing, car maintenance, utilities, and monthly debt payments are seldom overlooked, but people tend to forget insurance premiums (car, life, medical, homeowner's, etc.) and payments which are made quarterly or semiannually.

To determine how long your cash reserves should last, a good rule-of-

thumb is to set aside enough cash to pay your expenses for six months if your household has only one wage-earner. If your household has two wage-earners, a three month cash reserve is adequate in most cases.



Modify these time periods by considering how long it might take you to find new employment if you lost your present job, and how long it would take your disability insurance to take effect if you couldn't work because of illness or injury.

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taxPOINTS

When paying a tax bill indicate specifically what tax you are paying. Include the information on the check you are remitting. Pitfall: If you do not indicate for which tax the payment is for the IRS can apply it to any tax liability, which could cause you to incur penalties on a tax you thought was paid.

Roth IRA conversion trap.

Converting a regular IRA to a Roth can increase taxes owed on Social Security benefits. **Why:** The value of the regular IRA (minus non-deductible contributions to it) is taxed as income – and the Tax Court has held that this income is counted when figuring taxes due on Social Security. **Planning:** Make a Roth conversion before you begin taking Social Security benefits.

Loophole: Tax free income: When you pay the premiums for a company-sponsored disability policy, the payments you receive if you become disabled are tax free. If your employer pays the premiums, you will owe income tax on payments you receive in the event of disability. If you and the employer each pay a portion of the premiums, then the proportion of income allocated to the employer's premium payments is taxed.

Home rentals of up to 14 days are tax free.

If you rent out your home or second home for no more than 14 days, you don't have to report to the IRS the rent you receive.

Tactic: If a popular tournament, race, or other attraction is scheduled near you, consider renting your home to an attendee and using the money you receive **tax free** to pay for your own vacation.

Smarter Selling Strategies

Why customers are lost. A recent survey shows that three reasons account for 91% of all lost customers. The chief culprit is lack of attention on the part of the seller's employees (68%). Next (14%) is unresolved customer complaints. The third reason is lower prices from a competitor (9%). The smarter selling strategy is to be sure that your customers are given proper attention after the sale is made.

"Wants" and "Needs": After a sales presentation, you'll often hear a prospective customer say, "It isn't what I want", but the customer really means, "It isn't what I think I need". The smarter selling strategy is to find out what the customers think they need and show them how your product or service satisfies their needs.

Demonstrating a product. There are four smarter selling strategies that will make a product demonstration more effective.

1. Find out what your prospects think are their major wants and needs and repeat them *before* you begin your demonstration.

2. Show your prospects *how* your product will satisfy those wants and needs.
3. Don't talk about price until you've discovered your prospect's wants and needs and demonstrated how your product can fill those wants and needs. When you finally talk about price, present it in terms of *value*, not cost.
4. Be patient. Salespeople often become impatient when their presentation is delayed by prospective customers who ramble on about what they want and need. The smarter selling strategy is to listen patiently because they are providing a valuable picture of their wants and needs.

Prospective customers will only buy if your presentation shows that your product can fulfill their needs. By listening carefully, you can tailor your presentation so it will become more effective.



Better Cash Management

Collecting by telephone

Keep calls short and to the point. It's a proven fact that the shorter the conversation, the more likely the customer will pay.

How to improve your collections

Make sure that order takers (outside salespersons and inside personnel) get all the information necessary for billing to assure that accurate invoices can be prepared immediately. Frequent omissions: zip codes, purchase order numbers, legible item numbers.



What To Do When a Hobby Becomes a Business

Sometimes, what starts out as a hobby becomes a profitable business. However, if the IRS claims that the business is only a hobby, you can find yourself in an unpleasant tax situation:

- You must pay taxes on income from a hobby, but you can't deduct any losses.
- You can't take a home office deduction for a hobby, but you can deduct home office expenses (within limitations) for a business you conduct from your home. The test of whether your activities are a hobby or a business is whether you



intended to make a profit. To prove that you intended to make a profit, you should be able to show the following:

- What you charge should be enough to cover your variable costs (supplies, the value of your time, etc.) even if your charges are not enough to meet your fixed costs (rent, etc.).
- You work regularly at your business, not just when you feel like it.
- Your prospective customers know you're in business.
- Your expectations for profit are realistic because you understand your business.

A few ways to show you're really in business are to advertise, to purchase business cards and stationery, to keep accurate business records, to open a business bank account, and to register your business name.

If you show a profit in any three of five consecutive years, that's usually enough proof that your activities are primarily to show a profit. But even if you can't meet that test, you can still prove you intended to make a profit.

Tax Planning

Invest In Tax Shelter Annuities

which provide for guaranteed minimum death benefits and allow you to funnel money to your beneficiaries without going through probate. **Added Benefit:** Earnings grow tax free until you begin taking withdrawals at age 59 ½ or later. Early withdrawals are subject to a 10% penalty.



How the IRS Decides What Returns to Audit

It's rumored that only twelve key employees in the IRS know the formula that is used to determine which income tax returns to select for an audit. However, a review of IRS manuals indicates that there are specific characteristics in a tax return that give it "good audit potential".

IRS computers identify more returns for possible audit than IRS auditors can possibly handle, so the final selection of a return to be audited is determined by IRS classifiers. In some cases, these returns are selected at random, but in many instances they are chosen because unusual characteristics in a return indicate further investigation. Here are some examples of "audit potential" characteristics:

- The relative size of a deduction, such as a \$30,000 entertainment deduction for a business with gross sales of \$300,000.
- The nature of a deduction, such as air travel for an electrician.
- Contradictory information, such as a deduction for mortgage interest but no deduction for real estate taxes.
- Missing information or schedules which can imply an intent to mislead.

IRS classifiers are also influenced by the "professional" appearance of a return. Certain borderline deductions might escape an audit if the return looks like it is professionally prepared.

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When The Unexpected Happens

When you calculate how much cash you'll need, don't count on certain kinds of income to provide that cash. For example, you might be tempted to include anticipated dividends from equity investments as part of your cash reserves. That's a mistake because income from stocks is not guaranteed.

Step 2: Establish your inner comfort level. Everyone is different and you should consider whether you'll really feel secure that your cash reserve is adequate. If you're uncomfortable about only having enough money to meet expenses, then put aside a specific amount beyond and above those expenses.

Keep in mind that your needs will vary depending on your circumstances. For example:

- If there's a new baby in your family, you should increase your emergency cash level.
- If you are young, single, and without debt, you may not need to maintain a high level of cash—particularly if you have skills that make you easily employable.
- If you are about to retire, chances are that you'll feel insecure in what will be an entirely new way of life.

A cash reserve that's well above regular expenses may be called for, at least until you feel comfortable about living as a retiree.

- If you've started a new business, don't count on it to produce immediate personal income. Instead, increase your emergency cash until you're certain that the business will generate a steady income. In some cases, this can take a few years.

Put Your Cash in the Right Place

Security and liquidity are the major criteria for where to keep your cash reserves. Put your money where it will be readily available to you when you need it. The two most common choices are:

- **A savings account.** You'll earn a low interest rate, but if you're very conservative you'll know your money is completely safe.
- **A money market fund.** Bank money market funds are federally insured, but other money market funds earn a higher interest rate and are usually quite safe. Look for funds that have check-writing or telephone withdrawal privileges.

Wherever you put your emergency cash, make sure it earns compound interest. It's possible that you may never have to use your cash reserves and over a period of time, the power of compound interest can build a tidy nest egg for you.

4 Ways to Prevent Employee Theft

Almost any business—large or small—runs the risk of employee theft or embezzlement. You can, however, significantly reduce that possibility by taking some basic preventive steps.

1. Reduce opportunities for theft by separating key responsibilities.

For example, the individual who handles cash receipts should not be responsible for billing customers.

2. Put all accounting control procedures in writing.

Be sure that all employees know who has the authority to approve specific transactions.

3. Review internal controls.

A thorough review of your accounting and inventory controls will show up possible weaknesses that could be exploited by dishonest employees.

4. Conduct an annual audit.

An in-depth formal audit is the best way to identify real or potential problems in the company's accounting and operating systems.

Tax Tip: Look into Second-to-die Life Insurance



This type of policy covers you or your spouse—whomever dies second. Because your joint life expectancy is greater than either of your individual life expectancies, the cost of second-to-die insurance is low, and the proceeds can be used to pay estate taxes.



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