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

The Biggest Blunders You Can Make Starting a New Business

Surveys show that new businesses consistently make the same mistakes. Here are the most common.

- **Underestimating the need for capital.** The majority of new businesses are undercapitalized and are not prepared to find sources for additional capital when it's needed. Undercapitalization is the single biggest cause of problems for a new business.
- **Overestimating sales projections.** New entrepreneurs are invariably overly optimistic about potential sales, particularly for the first year of doing business. When sales reality sets in, it's often difficult to take corrective action.
- **Unexpected cash shortages.** New businesses frequently do not understand the importance of cash flow. They fail to realize that cash flow is the source of most business

growth. By underestimating how much cash is needed to operate, and overestimating how quickly customers will pay, new businesses can find themselves in an unexpected cash flow trap.



- **Incorrect pricing.** Underpricing is always the result of underestimating the costs of product development, production, and overhead. Many new entrepreneurs fail to do their homework by not determining what prices the market will accept.

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taxPOINTS

Shift income by hiring your children or grandchildren in your business. You must pay fair and reasonable wages. **Loophole:** The wages your business pays is deductible at rates up to 35% and your children or grandchildren's tax will be less if they are in a lower tax bracket than you.

Business retirement plan contributions can be deducted for 2007 when paid by the extended due date of the tax return. For calendar year corporations as late as September 15, 2008 and October 15, 2008 for self-employed individuals and partnerships.

Capital gains and qualified dividends, as of January 1, 2008, are tax free to individuals who are in the 10% or 15% tax bracket. This loophole is available to single people with taxable income not exceeding \$32,550 and married persons filing jointly with taxable income not exceeding \$65,100. **Strategy:** If your income is too high to take advantage of this tax break you may be able to gift appreciated stock held for more than one year to a retired parent or adult child in a low tax bracket.

Take advantage of the saver's tax credit. The credit may be as high as \$1,000. The credit may be used to offset part of the cost of the first \$2,000 that an individual contributes to an IRA, 401(k), or other retirement plan. This credit is often missed. For 2007 tax returns, the credit is available to taxpayers filing joint returns with adjusted gross income of up to \$52,000 (\$26,000 for single filers).

Buying Insurance? Eight Worst Mistakes You Can Make



- 1 Not updating your insurance needs. Consult with your insurance agent once a year, preferably in November when you begin to assess your tax situation.
- 2 Setting your deductible too low. Insurance premiums drop dramatically when you raise the deductible. Check it out.
- 3 Not taking advantage of group plans. Business and professional organizations to which you might belong frequently offer group health or disability coverage at substantially lower premiums than anything that's available from an agent.
- 4 Not shopping for the best cost. You comparison-shop for a car, so why not do it for insurance? Just because you've always dealt with one insurance company doesn't mean your getting the best deal.
- 5 Failure to have disability insurance. It's three times more likely that you'll be disabled before age 65 than it is that you'll die. Disability insurance is partic-

ularly important for professionals and self-employed individuals.

6 Not considering insurance as part of your personal financial planning. For example, life insurance can be used to generate interest income or to reduce estate taxes.

7 Doing business with a disinterested insurance company agent. You're much better off dealing with an independent agent who'll shop around for the best coverage at the lowest cost.

8 Buying insurance you don't really need. Examples: life insurance for children, travel insurance that probably duplicates coverage you already have, collision insurance for an old car, and car rental insurance that might be included in your homeowner's policy.

Better Cash Management

SPEED UP RECEIPTS

- Charge interest on late payments
- Require partial advance payment on large orders
- Speed up order processing and billing procedures

SLOW DOWN DISBURSEMENTS

- Renegotiate unit costs and order quantities
- Eliminate slow-moving inventory

UTILIZE CASH BETTER

- Invest temporary excess cash in a money market account



Employees or Independent Contractor: the Rules

Many companies can realize sizeable savings by hiring independent contractors to do work that would otherwise be done by employees. Because of changes in the tax law, these savings can be even greater. However, the law also sets "independent contractor" standards for certain professionals who claim contractor status. If those standards aren't met, it could mean substantial additional costs for the hiring company.

The Savings

By using independent contractors instead of employees, companies do not have to pay for:

- Social security taxes.
- Federal unemployment taxes.
- State unemployment taxes, workers' compensation, and disability insurance.
- Employee benefit costs such as medical plans and contributions to pension plans or profit sharing plans, together with the bookkeeping and administrative costs associated with taxes and benefits.

The total of these savings can be substantial—thousands of dollars per employee just for Social Security taxes. That's a pretty penny, but if the IRS determines that by their standard the independent contractor is really an employee, the company is liable for back Social Security and unemployment

taxes, unpaid income taxes which the company should have withheld, and the IRS penalties and interest. Obviously, it's important that companies be certain that their independent contractors satisfy IRS requirements.



Who is an independent contractor?

There is no single rule that automatically classifies a worker as an independent contractor. Instead, the IRS wants to know general things about an alleged contractor. Therefore, companies should try to establish that their independent contractors (1) can do similar work for other firms, (2) can set their own hours, (3) are paid by the job or the hour rather than by salary, (4) provide their own supplies and tools, (5) can employ others to work on a job, (6) pay their own work-related expenses, and (7) are not eligible for company benefits that cover employees.

Although companies may not be able to establish all of these criteria, the more they can establish, the greater

the possibility that the IRS will consider a worker to be an independent contractor.

A Safe Haven

Until legislation is enacted classifying workers as independent contractors or employees, a taxpayer can treat a worker not as an employee if:

1. a "reasonable basis" exists for not classifying the individual as an employee;
2. the taxpayer does not treat an individual as an employee;
3. the taxpayer files all required tax returns on the basis that an individual is not an employee.

To satisfy the "reasonable basis" test, the taxpayer needs to rely on one of the following types of authority:

1. judicial precedent, published rulings or a technical memorandum advice ruling, or a letter ruling issued to the taxpayer-employer;
2. a past IRS audit of the taxpayer and the IRS did not assess employment taxes where the circumstances were similar;
3. a long-standing recognized practice of a significant portion of the industry in which such individual works.

To be certain that a worker can be classified as an independent contractor, business owners should contact their accountant for the professional advice you need.

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Starting a New Business

- **Poor business plans.** A good business plan is not only a necessity for raising capital, it's also a detailed road map for running a successful business. A sound business plan includes a timetable for achieving specific business objectives, a complete review of the competitive situation, and a description of the business's operating and administrative systems.
- **Premature product introduction.** Too many new products are rushed to market before they have been tested, often with disastrous results. It's almost impossible to recover from the damage a defective or poorly designed product can cause. In addition, many would-be entrepreneurs fail to do any market testing. The positive opinions of friends and relatives are a poor substitute for researching the real marketplace.
- **Failure to seek professional advice.** Almost every prospective entrepreneur needs objective professional advice about some aspect of starting and operating a new business. It's rare that any individual can develop a sound business plan, project financial needs, and formulate an effective marketing program. The successful entrepreneur realizes this and seeks the advice and assistance of objective experts.
- **Ego and failure to delegate authority.** These two problems go hand-in-hand. The natural enthusiasm of the budding entrepreneur

can have a very positive effect on a new business. However, a strong ego is often the cause of failure to delegate, because the entrepreneur thinks no one can perform any task, no matter how trivial, as well as he can. This can delay or even prevent growth, because no entrepreneur can handle everything without help.

- **Lack of effective employee incentives.** Too many entrepreneurs don't establish strong and attainable employee incentives. In start-up situations, employee salaries are usually not high. So unless bonuses, profit sharing, or other realistic incentives are offered, the new business won't be able to attract—or keep—the best employees when it needs them the most.

Avoiding the Deduction Limit on Automobile Business Expenses

Under the tax law rules, your taxes could be unexpectedly higher when you use a car for business, whether you or your company own the car. With proper planning, however, you can maximize your car expense deduction and minimize income taxes on your personal use of the car.

The key to this strategy is to keep detailed records of your business use of the car. This can save taxes in two ways. First, it can avoid the rule that prohibits the deduction of car expenses on a personal return to the extent that they do not exceed 2% of your Adjusted Gross Income. Second, it can keep the value

of the vehicle from being included in your personal taxable income.

Here's what do do: Car expenses should not be paid to you as allowances. They should be paid only as reimbursements for specified business expenses. This means you must give your company an itemized report of your business driving that includes mileage, tolls and parking costs, the cost of gas and oil, and all other costs. The company must then either reimburse you for actual costs or pay you at a rate that does not exceed \$.505 per mile.

Under this arrangement, you avoid the 2% of Adjusted Gross Income limit

because the payments are expense reimbursements and are not included on your return as business deductions. Furthermore, because you have established the exact amount of the business use of the car, only the personal use portion of the car's value can be considered as income.

Caution: to use this strategy, regular and accurately detailed expense reports are a must.

