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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

**R**ecent 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.



- **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

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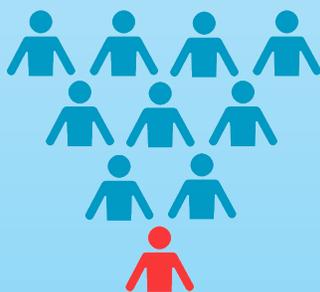
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## taxPOINTS

**Tax Strategies: Transfer cash to your children.** You can save taxes by shifting income producing assets to your children who are in a lower tax bracket and having the income taxed on their tax return. **Caution:** Beware of the Kiddie Tax. Investment income for a child subject to the kiddie tax is taxed at the parent's rate. **Loophole:** The first \$1,050 of investment income earned by a child is not taxed at all and the next \$1,050 is only taxed at 10%.

**Tax Strategy: Defer Income.** Defer the receipt of income and payment of tax to later years. You will benefit by delaying the payment of the tax and the tax that is eventually paid will be less if you are in a lower tax bracket. **Vehicles to use:** Deferred compensation packages, retirement plans, and other tax deferred arrangements.

**Maximize your IRA.** Contribute to your IRA even if it is not deductible, with higher tax rates you will save money by deferring income. **Added benefit:** Contribute to your IRA in January rather than waiting until April. The earlier your contribution, the more income you can tax defer.



## The Danger of Investing A Life Insurance Loan

It's sometimes possible to borrow money against the cash value of a life insurance policy at an interest rate that's lower than you can earn from a bank time deposit. For example, you might be able to borrow against your life insurance at a 2% interest rate and use the money to invest in a bank CD that pays 3%. Although this may appear to be a sure money-maker, it is not.

When you borrow against a life insurance policy, the entire proceeds

from the policy (the face value less the outstanding loan balance) are considered part of your estate since borrowing against a life insurance policy creates an incident of ownership. That means if you die before you repay the loan, estate taxes could wipe out all of your profits. On the other hand, if you do not have an incident of ownership, the proceeds from the insurance that are paid directly to your beneficiaries are excluded from your estate.

## When You Can Deduct Personal Legal Fees

When incurred by a business, legal fees are generally deductible as an ordinary business expense. However, legal fees for personal matters are deductible as miscellaneous itemized deductions only if they are incurred for the following services:

- The collection or production of income.
- The management of income producing property.
- The resolution of tax matters such as tax determination, collection or refund.

In addition, there are certain personal matters for which legal fees may be deductible. Some of these include the following.

**Executor's commission.** An executor who incurs legal fees to obtain taxable income can claim a deduction.

**Probate.** Legal fees paid for probate by an estate are deductible on the estate tax return, but strong substantiation of the legal time involved is necessary.

**Social Security.** Legal fees incurred to collect Social Security benefits are deductible to the extent that the Social Security benefits are taxable. For example, if one-half of the benefits are taxable, then one-half of the legal fees are deductible.

**Alimony.** Legal fees incurred for the receipt of alimony are deductible. To support this deduction, your attorney must give you an itemized bill that shows how the legal fees were allocated to tax and to non-tax matters.

**Personal injury suits.** If damages are awarded for lost wages, the portion of the legal fees attributable to recovery of the wages is deductible.

## Putting A Proper Value On Inventory

**F**urniture retailer John Richard Martin was known as the king of the easy chairs. Comfort was J.R.'s business, and sales were hot, thanks to a new television commercial that featured him lounging on one of his chairs. "Every time I need to relax," he'd say in his best copy of a Texas drawl, "I just ease down into one of these here chairs." Many customers followed enjoying the varied comforts of J.R.'s chairs, which produced handsome profits.



For the year ending December 31, 2017, J.R.'s company, Martin Gallery, Inc., had taxable income of \$95,000 and an inventory valued at a cost of \$260,000 and at \$220,000 when valued at the lower of cost or market. The lower figure reflected the lower market value of his inventory. The company chose to use the cost method of valuing the inventory and paid federal income taxes of \$20,550. J.R., like many business people, wished that his tax bite was not so severe.

### A BETTER SOLUTION

Inventory, like cash, is an asset and is not written off until sold. Consequently, the higher inventory is valued the greater a company's taxable

income will be. In contrast, the lower inventory is valued the less a company's taxable income will be. There are a number of ways to value inventory, but most merchants and manufacturers rely on one of two principal methods. The first values inventory based on its cost, while the second figures an inventory's worth based on its cost or market value, whichever is lower. The advantage of the lower of cost or market method is that it allows a company to take shrinkage and obsolescence into account when determining the value of the materials on hand at year's end. The thinking is that, if the market value of the inventory drops, the selling price of the finished product will be lower as well. By using this method, a company can reduce its taxable income and, of course, its taxes. The savings are noteworthy.

After J.R. Martin became a star, he took to calling his inventory of oak and leather furniture his "vast holdings", but it turned out that the company was holding a fair amount of furniture that was not worth very much. If Martin Gallery had elected to value its inventory at the lower of cost or market, it would have allowed the company to reduce its taxable income by \$40,000, the



reduction in the value of the inventory due to shrinkage. The company's federal income tax bill for 2017 would have been \$8,750, instead of the \$20,550 actually paid.....a savings of \$11,800.....Now to our J.R. partner, "That's buys a whole lotta beef."

## When You're Ready to Retire

**D**elay retirement plan distributions for as long as possible and then withdraw only the minimum required amount.

For cash to live on, deplete non-retirement accounts completely, except for an emergency fund, before cutting into your retirement accounts.

Principal withdrawn from a non-retirement account will not be taxed, while principal withdrawn from a retirement account will be fully taxed at your highest rate.

**Note:** "Qualified" withdrawals of contributions and earnings from Roth IRA and Roth 401(k) plans are not taxed. To be qualified, a withdrawal must take place after the account has been established for five years and the participant is older than age 59 1/2, or upon death or disability of the participant, or if the participant is a first-time home buyer.

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### *The Biggest Blunders You Can Make Starting A New Business (continued)*

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 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 en-

trepreneur 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.



## The Art Of Negotiation

**W**hen you sit down at a negotiating table, the seat you choose can have a real effect on your negotiations. The seat at the head of the table is considered the "power seat" and that's where you should sit if you want to appear to be in command of the discussions.

But think twice before you do it, because some people resent the presumption of authority. After you've sized up the situation, it might be wiser to sit on the same side of the table as

your opponent. This can lessen the adversary aspect of your negotiations and make others feel that you'll be friendly and cooperative.



Make sure price comparisons are fair. When a prospective customer tells you that your price isn't competitive, don't offer a better price until you compare all the details of your offer with the details of what your competitor is offering.

You may be able to point out significant differences that the customer has overlooked such as delivery charges, terms of payment, product specifications, and return privileges. Best way to do it: ask the customer.