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from the smallest proprietorship to the largest international conglomerate, cutting costs can often be perceived as a “quick fix” for improving the bottom line. However, such cost management decisions may not always be in the best *long-term* interest of an otherwise healthy company.

Many business owners respond to unexpected pressures by reducing costs without a definitive plan of action; their course is *reactive* instead of *proactive*. However, this “strategy” may become random and shortsighted unless it’s based on a company’s **business plan**. While an immediate problem may appear to have been alleviated, in some cases only the *symptoms*—rather than the root of the problem—may have been addressed.

Taking Control

A more visionary plan may focus on *managing* rather than simply *cutting* costs. The difference is more than a matter of semantics. Managing costs is the *proactive* process of consciously choosing to spend in areas designed to produce a positive financial result. On the other hand, cutting costs is a *reactive* process, which typically happens when things seem to be getting “out of control.”

While both strategies strive to eliminate waste, *effective* cost management relates costs to profits, whereas cost-cutting is not necessarily closely correlated to profits. A haphazard approach can result in the illusion of a better bottom line, when in fact productivity and profitability may suffer.

Building Blocks for an Action Plan

Define the Relationship between Costs and Revenues. What are your sources of income? Some businesses are product-based, while others are service-oriented. Or, your business might depend on a combination of products *and/or* services. Once you understand your revenue structure, you must become aware of the costs entailed in generating the revenue stream. Which costs are *directly* related to producing revenue, and which are general overhead?

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The Pros and Cons of a “C” Corporation

In the minds of many people, a corporation is a large, public company whose shares are traded on Wall Street. But a business does not have to be large or public to become a “C” corporation. While you may have started your business as a sole proprietorship or partnership, your firm could benefit from adopting a more complex business structure as it seeks to expand or take on more employees. Although it is the most regulated of the business forms, the corporation nonetheless offers certain tax and legal advantages that could make it a suitable structure for many growing businesses.

The C corporation is a for-profit, state incorporated business, which is considered by law to be a unique entity separate from the individuals who own and run it. A corporation is created when shareholders file articles of incorporation with a secretary of state’s office. If a corporation conducts business outside the state in which it was organized, the company may be required by other states to register as a “foreign” corporation.

The organizational structure of a corporation involves three main groups: shareholders, directors, and officers. A corporation is owned by the shareholders, who are usually not directly involved in running the company unless they also serve as officers or directors. Instead, most shareholders influence corporate decisions by electing and removing directors, voting on amendments to the articles of incorporation, and approving or dis-

approving of other major changes. The corporation’s officers, who manage the company’s day-to-day operations, are appointed by the board of directors. In most corporations, the board has a supervisory role, intervening only in major business decisions.

Corporations, like individuals, are entitled by law to enter into contracts, loan and borrow money, own assets, sue and be sued, hire employees, and pay taxes—all without having to directly



involve the shareholders. Corporations offer shareholders liability protection. While shareholders participate in profits in the form of stock appreciation and dividends, their personal assets are shielded from debt liability and lawsuits against the company.

C corporations pay corporate taxes, and the shareholders pay taxes on the income they receive as dividends. This double taxation can be a disadvantage, particularly for owners who are not in a position to reinvest a significant portion of profits back into their business. On the other hand, corporate Federal income tax rates, which start at 15%, may be lower than the shareholders’ personal income tax rates. Owners who can afford to do so may leave a portion of earnings in the company for future investment or to

reduce their own income tax liability. The amount of corporate tax owed may, in any case, be relatively low after the cost of paying salaries and benefits is deducted.

Compared to other business forms, C corporations have great flexibility in raising money through equity financing. There are no restrictions on C corporation shareholder numbers, and owners are not required to be U.S. residents. C corporations may even be owned by other business entities.

Unlike sole proprietorships and partnerships, which often end upon the death or retirement of the owners, C corporations can last in perpetuity. Ownership in a corporation is easily transferable. When shareholders die or sell their interests, the corporation can continue to exist and do business.

The C corporation is not the appropriate structure for every business. While the independent status of the corporation offers many advantages, there are also some potential drawbacks to choosing this structure. C corporation shareholders cannot, for tax purposes, offset the company’s losses against their personal income. As profits grow, the company will be faced with corporate tax rates as high as 39%. Because of the organizational complexity and regulatory burdens associated with this structure, the corporation is more expensive to establish and maintain than other business forms.

Each business structure has its advantages and disadvantages. Your choice will affect the taxes you pay and your personal liability risk, so it is important to choose the most appropriate entity for your business. For specific guidance, consult your tax professional. ■

Boosting Benefits with Roth 401(k)s

Expanding the tax-advantaged opportunities for retirement saving, Federal legislation took effect in 2006 allowing companies to offer employees the option of contributing after-tax dollars to the “Roth 401(k).” As the name suggests, the Roth 401(k) incorporates elements of both traditional 401(k) plans and Roth IRAs. Included in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), and available since January 1, 2006, the Roth 401(k) allows workers to make Roth IRA-type contributions to 401(k) plans, but without the income restrictions and contribution limits that apply to Roth IRAs.

Contributions to a Roth IRA are nondeductible, but earnings accumulate tax free, and qualifying distributions are also tax free. In 2009, only taxpayers whose adjusted gross income (AGI) falls below certain levels (\$120,000 a year for single filers and \$176,000 for joint filers) are eligible to contribute after-tax dollars to a Roth IRA. These income limits do not apply to Roth 401(k)s.

Workers also have the opportunity to save far more money in the new accounts than they could using Roth IRAs. The 2009 annual contribution limits for IRAs of all kinds are set at \$5,000 for taxpayers under the age of

50 and \$6,000 for older workers. The Roth 401(k), in contrast, is subject to the more generous elective salary deferral limits that apply to conventional 401(k)s— \$16,500 for taxpayers under the age of 50 and \$22,000 for older workers in 2009.

Contributions to a Roth 401(k) are made through payroll deductions. Because these plans are administered by employers, contributing to them may be more convenient for workers than opening an IRA. An employee who is currently contributing to a traditional 401(k) plan could, for example,

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Evaluating Your Accounting Practices

Managing your books well and maintaining accurate, organized records can help you keep your business in tip-top financial shape. Less-than-stellar accounting practices can cause an otherwise sound business to falter. It can impede cash flow, ruin relationships with vendors and customers, open the door to fraud, and create tax problems. Here are some key areas to assess to determine the efficacy of your company's accounting practices:

Accounts Receivable. Are your daily receivables within industry averages? To get a true picture, mark monthly figures on a run chart to reveal abnormalities or negative trends. Have you benchmarked your bad debt ratio? Is there a process in place for management to review write-offs and refunds? Do you have processes and controls in place to ensure all payments received are promptly deposited in the bank?

Accounts Payable. Are controls in place to avoid double payment when

a vendor sends both invoices and statements? Do you have clear policies that determine valid company expenses, and what documentation is required prior to reimbursing employees or contractors? Are responsibilities delegated so that the person who approves invoices is not the same person who issues and/or ultimately signs the check? Is your company's cycle time fast enough to take advantage of prompt pay discounts?

Accounting Systems. Most companies have dual-entry accounting systems, but not all take advantage of their systems' functionality. Are there enough accounts to obtain a clear understanding of the business's cash flow? Do your employees perform a lot of “off the books” accounting on spreadsheets? While spreadsheets are great for planning and analysis, they lack the all-important audit trail.

Corrections and Revisions. Some corrections or revisions are expected, but if they are becoming the rule rather

than the exception, it's time to look at the overall integrity of the accounting system.

Time to Close. How long does it take to close the books each month? Is it within the typical range for a company of your size? Lengthy closing times can indicate loose and inefficient accounting processes. They also make it impossible to assess the financial state of the business in a timely manner.

Reports. Are you aware of the variety of reports available from your accounting software? Do your monthly reports provide the information you need to run the business? Are data in the reports reliable?

As you fine-tune your practices, choose systems that are most appropriate for your business needs. Take the time now to ensure that your accounting practices are as efficient as possible. It will pay off in the long run. ■

cost management creates a firm foundation

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Reduce Inter-Departmental Complexity. In any company or organization, the operations of one department affect the others. Is the work being accomplished efficiently? Are there unnecessary steps in the process? Are redundant practices eliminated? Are people communicating effectively?

Encourage Employee Involvement. Most employees are experts in what they do because they do it every day. Establish a rapport by seeking their advice and tapping into their creativity. Ask your employees for input into the decision-making process. By soliciting their suggestions on how

to deal with specific cost problems, you will get a new perspective, while also motivating employees to become part of the solution.

Measure Decisions against Your Strategic Business Plan. Cost management decisions should be measured against your long-term business strategy, rather than within the confines of a short-term situation. For example, if one of your suppliers has reduced prices to get rid of excess inventory, what are you accomplishing if you buy more than you need to satisfy your customers? How will

your cash flow be affected? Will you be stuck with excess inventory if the market changes unexpectedly?

Discipline Can Pay Off

In our competitive and unpredictable economy, effective cost management is an important ingredient for developing and fostering a successful long-term business. By knowing your expenses and linking them to the bottom line on an ongoing basis, you will be in a better position to manage your costs effectively, thus creating a firm foundation for your business. ■

boosting benefits with roth 401(k)s

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simply opt to have his or her contributions diverted to a Roth version of the same plan.

Lawmakers have stipulated, however, that matching contributions made by employers must be invested in a traditional 401(k), not a Roth account. This means that, even if employees make all of their contributions exclusively to a Roth 401(k) account, they would still owe tax in retirement on withdrawals from funds contributed on a pre-tax basis by their employers.

Workers should also be aware that the 401(k) annual deferral limits apply to all 401(k) contributions, regardless of whether they are made on a pre-

tax or after-tax basis. If employees contribute to a Roth 401(k), they may have to reduce or discontinue their contributions to their employer's conventional 401(k) plan to avoid exceeding these limits. Provided employees comply with these limits, however, they are allowed to put money into both types of 401(k) plans.

In addition, employees considering the Roth 401(k) option should know that—like the 401(k), but unlike the Roth IRA—the Roth 401(k) requires them to begin taking distributions after the age of 70½.* On the other hand, the Roth 401(k) resembles the Roth IRA in that investors are not be permitted to withdraw

their money tax free until they have held the account for at least five years and are at least 59½ years old. The latter provisions could make the Roth 401(k) less attractive to employees who are currently approaching retirement.

Adding a Roth option to your traditional 401(k) can boost your benefit program. Besides helping you attract and retain quality employees, the Roth 401(k) can help you build retirement security. ■

* The Worker, Retiree, and Employer Recovery Act of 2008 suspends rules for required minimum distributions (RMDs) in 2009. This waiver does not apply to 2008 RMDs, which must be taken by April 1, 2009.

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