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## **Imparting Tax-Planning Strategies to Small Businesses**

By **Howard W. Wolosky**

(April 1, 2007) - Tax-planning strategies that work particularly well for small businesses include the full use of contributions to qualified retirement plans that favor business owners, attention to travel and expense deductions, expensing over depreciation, employment of family members in the business, and entity selection, to name just a few. Let's see exactly the available opportunities, and how practitioners alert their small-business clients to them.

### **The Discussion Contexts**

Clothier & Head, in Seattle, uses the tax preparation engagement to identify clients that might take advantage of the strategies the firm has used historically, and to new ones that have come to the firm's attention since the prior year. Roger Wilkins, director of tax services, explains, "We usually make note of the clients and follow up after our busy season. In many cases, however, we can implement a strategy to save taxes on the current year's return. We may contact clients during the year if we become aware of law changes that create opportunities."

Jay Safier, principal with Rosen Seymour Shapss Martin & Company in New York City, indicates that his firm generally provides tax-planning strategies in two major contexts: (1) when starting up a business, and (2) for those businesses already operating.

"When a client comes to discuss an idea to start a business, we review the various forms the entity can take-sole proprietorship, general partnership, LLC, S corporation, etc. Along with this discussion, the steps that are required to get organized are reviewed, so all of the preliminary matters are in place when business commences. These topics include becoming registered to do business in the state of incorporation/organization, having properly written articles of incorporation (articles of organization), operating or partnership agreement, filing for an employer identification number, making applicable tax elections, and obtaining proper minimum insurance coverages," he explains.

For an operating entity, we are constantly discussing the specifics of their businesses. Within the course of these conversations we will review certain strategies that should be considered either because of a change in the tax laws or due to some other need (e.g., estate planning relative to the business). For those business clients that require interim financial statements, providing the tax-planning advice is an adjunct to the accounting services performed. For those that receive only annual financials, I make a point of getting interim figures, especially towards the end of the third and during the fourth quarters of the year, to review the projected profits to assist them in determining what tax liabilities they will face. Simultaneously, the individuals' personal tax situation will be reviewed to project what income taxes they will be required to meet," says Safier.

Darci Congrove, director, tax and business advisory services at GBQ Partners in Columbus, Ohio, points out that many of her firm clients are small -and middle-market businesses organized as pass-through entities. "Therefore, it is critical for GBQ to have a year-round dialogue with the owners to make sure that there are no tax surprises, and that all

advantageous planning ideas can be implemented in a timely fashion. In the event that there is no specific 'trigger' for discussion, we still like to meet with clients and talk about tax issues at least two to three times per year."

Alisha Cohen, principal in the tax department and cost segregation leader at Hancock Askew & Co. in Savannah, Ga., points out that, "While Hancock Askew has a big surge in the fourth quarter regarding year-end tax planning, we find it much more beneficial to work with clients all year. We sit down with them and do tax projections, and discuss what has changed or is going to change in their business plan/model."

"Our philosophy has always been to tax plan throughout the year. Quite often, small business clients enter into transactions without realizing the tax implications. If we are consulted prior to the transaction, then we can really add value, as opposed to after the taxable transaction at which time we can only report the transaction correctly," explains Jonathan Gorski, manager with Edelstein & Company in Boston.

### The Tax-Savings Opportunities

In discussing a number of tax strategies that Edelstein & Company often suggests, Gorski reports the firm encourages clients to maximize their qualified retirement plan contributions, but is careful to weigh the overall cost of the plan versus the tax benefit received.

With expensing over depreciation, there is strategizing about when to make fixed asset purchases.

### A Real Focus

Hancock Askew & Co in Savannah, Ga., has a small business services division with ten professionals focused on serving the needs of small-business clients. They are certified QuickBooks ProAdvisors and concentrate their CPE training with the needs of small businesses in mind. The division adds value to the firm's small-business clients by knowing QuickBooks, and offering regular QuickBooks training sessions.

The entity selection as a tax-planning tool is revisited with many of the firm's clients prior to the end of each year for consideration as a potential change in the following year.

There are a number of other strategies commonly considered at Edelstein & Company, including:

1. Pre-paying expenses and deferring revenue;
2. Taking distributions versus drawing a salary for the owners of the business;
3. Reviewing existing lease arrangements for those clients that own the building in which they conduct business;
4. Avoiding hidden taxes, such as the built-in-gains tax, for those that converted from a "C" corporation to an "S" corporation in a prior year;
5. Make certain estimates and federal withholdings are correct throughout to avoid any underpayment penalty, while not allowing significant overpayment; and
6. When working with personal service corporation clients (e.g., medical practices) making sure there is no taxable income at the year end for which a flat tax rate of 35 percent would apply.

GBQ's tax planning begins with entity selection and structure. It represents a number of family-owned businesses that have multiple legal entities, such as an operating company for

the business, a partnership or LLC to hold the business real estate, a family partnership to manage family investment assets, and trusts for the benefit of children and grandchildren. "It is critical to consider the tax consequences across the entire family group when providing advice. Many times, we find that the structure as originally conceived has become ineffective from a tax or management perspective over time, so we visit structure and related party issues on a regular basis," says Congrove.

The firm also works with clients to maximize the tax benefits of qualified and non-qualified retirement and deferred compensation plans, as well as tax-advantaged benefit plans like flexible spending accounts, health reimbursement accounts, and health savings accounts. Congrove observes ESOP's are gaining popularity as a tax-advantaged exit strategy for retiring small business owners.

The third area that GBO focuses on is state and local taxes (SALT). "Because many clients are conducting business in multiple states and there are so many different forms of state and local taxation (i.e., income, franchise, personal property, intangible property, sales & use, and excise taxes), we often find considerable savings opportunities. Additionally, for clients who are expanding to other states or localities, economic incentives are often key to the decision when choosing a location. We assist in identifying and taking advantage of incentives, credits, and deductions that may be available because of a client's location or type of business," says Congrove.

Clothier & Head has several tax deferral strategies that it recommends for business clients. Among them are:

1. ***The LIFO method of inventory valuations.*** "This can be quite beneficial to businesses with inventories in times of inflation. The use of the IPIC (Inventory Price Index Computation) method became much more beneficial because of a law change in 2002. This method allows the taxpayer to use government provided indexes to compute the inflation included in their inventory and essentially get a tax deduction for it," says Wilkins.
2. ***Cost segregation studies for real property.*** Wilkins explains, "This provides for faster write-off of buildings used in a business by segregating the cost into smaller components, and using a shorter tax depreciation life for items specific to the use of the building and not merely a structural component."
3. ***Deduction of prepaid expenses that meet certain criteria.*** "This came about because of a law change regarding the deductibility of assets that have a useful life of one year or less." says Wilkins.
4. ***Use of the cash method of accounting versus accrual when possible.*** "Many small businesses report income on the accrual method, which generally accelerates income, when they could use the cash method of reporting for tax purposes," observes Wilkins.

Many strategies that Safier raises with clients relate to retirement plans, compensation, and financial planning.

Some examples are setting up a 401(k) plan in which the client may elect to make tax deductible contributions in addition to the amounts set aside by the employees from their salaries; using a defined benefit pension plan (in addition to a 401(k) plan) when there are significant profits; employing a spouse or children in an unincorporated business because there is a savings on payroll taxes, and there is an ability to start building up the child(ren)'s wealth; consideration of utilizing a defective grantor trust in estate planning; and gifting interests in family businesses to children to reduce the estates of the parents and increase the wealth of the children currently rather than waiting until the parents pass away years later.

Hancock Askew assists clients with some very sophisticated tax saving strategies. Wendy White, a partner with the firm's small business services division, identifies some of them, including cost segregation studies, tax credits, passive activity, Section 179, and production deduction for residential and commercial contractors, and manufacturers.

As with other accounting firms, Hancock Askew assesses clients' retirement needs. What is somewhat unique with this particular firm is it offers retirement plan design, administration, and consultation through a subsidiary, Qualified Plans, LLC.

### **Increasing Awareness**

GBQ employs two full-time people in marketing Rick Kondoff, director of practice growth, and Sara Clunk, marketing coordinator. Kondoff's primary focus is to develop leads for new business, which he does through networking and cold calling. Clunk is responsible for the maintenance of the firm's Web site, marketing collateral material, proposal preparation, and the enhancement of the overall brand.

At Hancock Askew, according to Leigh Ryan, the firm's marketing director, tax-planning services are marketed through the common avenues such as its Web site, written collateral and mailings (e-mail and snail mail) to specific groups as new rulings and tax law changes are enacted that may affect that particular group, but, with that in mind, the firm still prefers personal interaction.

Alisa Morris, director of marketing for Rosen Seymour Shapss Martin & Company, indicates the firm is marketing even during the busy season. "It is an ideal time because of the opportunity for face-to-face appointments with clients.

"We are able to ask-'How comfortable are you with your retirement plan? When was the last time that you conducted a review of your insurance policies?'" she explains.

### **Not an Annual One-Time Event**

"Tax planning shouldn't be viewed as a year-end task only. Rather, it should be viewed as a yearlong project. This thought process on behalf of business owners will eliminate surprises, including any unnecessary tax liabilities," observes Gorski. Safier takes pride that Rosen Seymour Shapss Martin & Company assesses "each situation and goals in relation to the tax environment, which leads us to provide innovative and timely suggestions."

"Any CPA in tax practice is likely to get 95 percent of the numbers in the right places on the tax forms. However, completing accurate tax returns is not really the right goal. Value is created when a business can establish a rapport with a tax advisor that leads to a deep understanding of the client's business. The value in hiring the right tax accountant is demonstrated throughout the year, long before March or April when the numbers hit the forms," says Congrove.

"We believe that we bring the highest value to our tax clients through the provision of tax planning and consulting services. We can't just prepare a tax return once a year to bring value to our clients. They want and expect us to find ways to help them defer or avoid taxes. Many of the strategies are used by large businesses to defer large amounts of taxes. We have to find cost-efficient ways to use these strategies for smaller businesses," concludes Wilkins.

***As seen in the April issue of Practical Accountant magazine.***