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Better Ways to Control Accounts Receivable

With an uncertain economy on the horizon and unpredictable interest rates ahead, improving a company's cash position should be a major priority for any business. In most cases, the answer to this challenge is better control of accounts receivable.

Tuning up your collection system

Too often, companies allow their receivables to age to a point where the business is strapped for cash. It's not uncommon for four or five months to pass before management takes action to collect past due accounts, usually because the company doesn't have a clear collection policy.

Effective receivable control is based on a *regular* review of the company's receivables. Ninety days from the date a receivable becomes past due is the point at which your company should decide whether it wants to continue to do business with a late-paying customer.

If a customer is important, a mutually satisfactory schedule for payment of past due balances should be set up together with an understanding that covers payment for future purchases. It's important to resolve both of these issues at the same time to avoid future problems

while the customer is paying off past due amounts.

If you can't work out a satisfactory schedule for payment of the past due balance within a reasonable amount of time, or if it becomes apparent that the customer is in real financial trouble, it's time to bite the bullet and turn the matter over to a collection agency.

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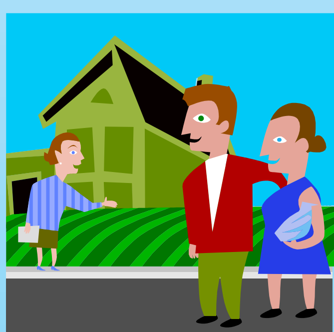
tax POINTS

Paying IRS notices. Always specify on the check what tax you are paying. **Pitfall:** The IRS can apply payments that are not described to any outstanding tax liability that you may have, or that you may not be aware of. The result can be having to pay penalties and interest on a tax that you thought you had paid.

Pitfall: Transferring money from a company pension plan to an IRA. Transfers to an IRA must be completed within 60 days to avoid tax. If more than 60 days pass before you make the transfer, the entire amount is taxable as income, and if you are not age 59-1/2, there is an added 10% penalty.

Trap: Buying a house for all cash when borrowing will be needed later. On any later borrowing that you may do, you will find that the mortgage interest paid is deductible within limits and only up to the first $100,000 of debt. This is treated as equity borrowing. If you're going to need the money, then borrow at the time you purchase the house since you would be able to deduct the interest on the first $1,000,000 of debt. This is treated as acquisition borrowing.



Plan For Tax Savings When You Set Up a Family Business

Family-owned businesses can offer an opportunity for considerable tax savings. Not only can you opt for a corporation, a proprietorship, or a partnership, but you can also combine the various forms of ownership to your advantage.

If you organize the business as a partnership or Subchapter S corporation, for instance, early business losses can be passed through to owners in high tax brackets. When the business begins to show a profit, title or stock can be transferred to younger family members who are in lower tax brackets.

If the business is organized as a corporation, its real estate, machinery, or equipment can be owned by an individual and leased to the company. Rental income will pass directly to the owners without being subject to corporate tax. Ownership of these major assets can also be placed in trust for the benefit of the owners' children to take advantage of income splitting.

Obviously, the business structure that most benefits one family will not necessarily suit another. In addition, the tax laws restricts the deductibility of certain family-owned business losses. So be sure to consult with your tax professional before you choose a structure for a family business.

Cutting Costs

- Buying or leasing company cars for sales or service employees may not be economical. Consider paying employees a monthly stipend plus a mileage allowance to use their own cars. Advantages: no vehicle maintenance headaches, no loss on the sales of used cars, no employee discontent with assigned vehicles.
- Tell your vendors what your budget restrictions are. Give them comparative costs, too. You'll get better prices and suggestions about how you might save money.
- Knowing the purchase order price is only part of your real cost picture. Be sure that you also consider delivery costs, warehousing terms of payment, discounts, shipping, and other "hidden" expenses that determine real costs. An unusually high cost for any of these items can offset what you originally thought was a favorable price.
- For the average business, a 1% savings in the cost of purchased goods and services gives the same profit improvement as a 6% to 8% increase in sales. Challenge any employee who is responsible for purchasing to save 1% on all buying. It's not that difficult to negotiate with most suppliers and it can have a dramatic effect on your bottom line.

What You Should Know about Tax-Free Income

There are many kinds of income that are not subject to federal income taxes. A good understanding of them can help you make many important financial decisions and keep you from paying income taxes when it's not necessary. Here are some of the most attractive opportunities to earn tax-free income.

Gain from the sale of your principal house that you owned and occupied as a principal residence for at least two of the five years before the sale, you can elect a $250,000 ($500,000 for joint filers) exclusion from gain on the sale. If due to a job change, illness or other unexpected circumstance, the homeowner is unable to meet the two year requirement, the law allows you to take a prorated exclusion.

Municipal bonds. The interest you earn from a municipal bond is generally free of federal taxes. If you live in the city or state where the bond was issued, the interest is usually free of state and local taxes, too. However, before you invest in a municipal bond, seek expert advice about whether it is subject to the Alternative Minimum Tax.

Employee fringe benefits. Many of the benefits you receive from your employer are tax-free. These include medical insurance, premiums for up to $50,000 in life insurance, meals in your employer's cafeteria if it is located on the work premises.

Life insurance. Life insurance proceeds are free from federal income taxes. However, the estate of the insured will be taxed on the proceeds. You can avoid this tax by establishing an irrevocable life insurance trust which you cannot change or terminate.

Tax-free income for citizens who live abroad. Up to $99,200 in foreign-earned income is not subject to federal income taxes.

Social Security benefits. If you have no other income, Social Security benefits are tax-free. However, if you do have income from other sources, the tax-free amount of your Social Security benefits is phased out.

Scholarships. Scholarships and fellowships**,** received by degree candidates are completely tax-free. The amount received from the scholarships and fellowships must be used for tuition, fees, books, supplies, equipment, and other related expenses that are required at the educational organization.

Disability payments. If you paid the premiums for disability insurance, payments you receive from the insurance are tax free. If your employer paid the premium, the payments you receive are taxable.

Recoveries for personal harms. Money received for a lawsuit for personal injury which are compensatory, non-punitive recoveries are tax free.

Payments for child support. Money received for child support is not taxable. Alimony, however is generally considered taxable income.

Inherited property. There is no income tax on property received by the beneficiary of a will. Income taxes owed by the estate for income earned from the date of death to the date of distribution to the beneficiary are paid by the estate, not by the beneficiary.

Gifts. Gift taxes are not paid by the recipient of the gift. They are paid by the giver of the gift. A single taxpayer can give up to $14,000 tax-free annually to each recipient. Married taxpayers can give up to $28,000 tax-free annually to each recipient.

Tax Tip

You can lose 100% of your deductions for perfectly legitimate personal and business expenses – such as meals, business driving, and contributions – if you don't have the records specified by the Tax Code and the IRS to prove them.

Improve tax record keeping before the rush of the next tax filing season – and before the auditor calls.

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An ounce of prevention...

Although there's no guarantee that better control over accounts receivable will result in the timely payment of all receivables, there are several other steps that a company can take to reduce the age of its accounts receivable.

- **Credit checking.** It's surprising how many businesses will accept orders from new customers without doing a thorough credit check. It's the obvious way to head off future problems. And it's just as important to make occasional credit checks for large existing customers to make sure that their credit ratings aren't slipping.
- **Applications for credit.** A credit application is another basic technique to reduce collection problems. At the least, a company should know the names of its customers, owners, banks, and major suppliers. Not only is this information useful for immediate credit decisions, but it can be essential if a collection problem arises in the future.
- **Customer communications.** There's no better way to assure improved collections than to make certain that a new customer understands that your company must be paid in a timely manner. If a customer doesn't get a clear message to that effect, you can give the impression that prompt payment isn't really important to your company.

It's just as critical to keep in touch with new customers to find out if they are satisfied with your product. Make every effort to do this before payment is due, to avoid future excuses for delayed payments because of problems you didn't know about.

Invoice discounts and late payment charges

Offering customers a discount for prompt payment usually won't speed up your collection. In fact, it can often backfire because customers take the discount but don't fulfill the terms. It's much better to bill a net amount and clearly indicate terms of payment on the invoice.

Some companies charge a penalty for past due payments, but unless a customer is made aware of this in advance, the customer is not legally obligated to pay late charges. It's best to stick with conventional invoicing and tighten up your internal controls over receivables.

The Art of Negotiation

- When you sit down at a negotiating table, the seat you choose can have a real effect on your negotiation. 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 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.