Running Your Business

Cash Flow - The Pulse of Your Business

Many small business owners do not fully understand their cash flow statement. This is surprising, given that all businesses essentially run on cash, and cash flow is the lifeblood of your business.

Some business experts even say that a healthy cash flow is more important than your business's ability to deliver its goods and services! That's hard to swallow, but consider this: if you fail to satisfy a customer and lose that customer's business, you can always work harder to please the next customer. But if you fail to have enough cash to pay your suppliers, creditors, or employees, you're out of business!

What Is Cash Flow?

Cash flow, simply defined, is the movement of money in and out of your business; these movements are called *inflow* and *outflow*. Inflows for your business primarily come from the sale of goods or services to your customers. The inflow only occurs when you make a cash sale or collect on receivables, however. Remember, it is the cash that counts! Other examples of cash inflows are borrowed funds, income derived from sales of assets, and investment income from interest.

Outflows for your business are generally the result of paying expenses. Examples of cash outflows include paying employee wages, purchasing inventory or raw materials, purchasing fixed assets, operating costs, paying back loans, and paying taxes.

> An accountant is the best person to help you learn how your cash flow statement works. Please contact us and we can prepare your cash flow statement and explain where the numbers come from.

Cash Flow Versus Profit

Profit and cash flow are two entirely different concepts, each with entirely different results. The concept of profit is somewhat broad and only looks at income and expenses over a certain period, say a fiscal quarter. Profit is a useful figure for calculating your taxes and reporting to the IRS.

Cash flow, on the other hand, is a more dynamic tool focusing on the day-to-day operations of a business owner. It is concerned with the movement of money in and out of a business. But more important, it is concerned with the times at which the movement of the money takes place.

Theoretically, even profitable companies can go bankrupt. It would take a lot of negligence and total disregard for cash flow, but it is possible. Consider how the difference between profit and cash flow relate to your business.

> If your retail business bought a $1,000 item and turned around to sell it for $2,000, then you have made a $1,000 profit. But what if the buyer of the item is slow to pay his or her bill, and six months pass before you collect on the account? Your retail business may still show a profit, but what about the bills it has to pay during that six-month period? You may not have the cash to pay the bills despite the profits you earned on the sale. Furthermore, this cash flow gap may cause you to miss other profit opportunities, damage your credit rating, and force you to take out loans and create debt. If this mistake is repeated enough times, you may go bankrupt.

Analyzing Your Cash Flow

The sooner you learn how to manage your cash flow, the better your chances of survival. Furthermore, you will be able to protect your company's short-term reputation as well as position it for long-term success.

The first step toward taking control of your company's cash flow is to analyze the components that affect the timing of your cash inflows and outflows. A thorough analysis of these components will reveal problem areas that lead to cash flow gaps in your business. Narrowing, or even closing, these gaps is the key to cash flow management.

Some of the more important components to examine are:

- **Accounts receivable.** Accounts receivable represent sales that have not yet been collected in the form of cash. An accounts receivable is created when you sell something to a customer in return for his or her promise to pay at a later date. The longer it takes for your customers to pay on their accounts, the more negative the effect on your cash flow.
- **Credit terms.** Credit terms are the time limits you set for your customers' promise to pay for their purchases. Credit terms affect the timing of your cash inflows. A simple way to improve cash flow is to get customers to pay their bills more quickly.
- **Credit policy.** A credit policy is the blueprint you use when deciding to extend credit to a customer. The correct credit policy - neither too strict nor too generous - is crucial for a healthy cash flow.

- **Inventory.** Inventory describes the extra merchandise or supplies your business keeps on hand to meet the demands of customers. An excessive amount of inventory hurts your cash flow by using up money that could be used for other cash outflows. Too many business owners buy inventory based on hopes and dreams instead of what they can realistically sell. Keep your inventory as low as possible.
- **Accounts payable and cash flow.** Accounts payable are amounts you owe to your suppliers that are payable some time in the near future - "near" meaning 30 to 90 days. Without payables and trade credit, you'd have to pay for all goods and services at the time you purchase them. For optimum cash flow management, examine your payables schedule.

Some cash flow gaps are created intentionally. For example, a business may purchase extra inventory to take advantage of quantity discounts, accelerate cash outflows to take advantage of significant trade discounts, or spend extra cash to expand its line of business.

For other businesses, cash flow gaps are unavoidable. Take, for example, a company that experiences seasonal fluctuations in its line of business. This business may normally have cash flow gaps during its slow season and then later fill the gaps with cash surpluses from the peak part of its season. Cash flow gaps are often filled by external financing sources. Revolving lines of credit, bank loans, and trade credit are just a few of the external financing options available that you may want to discuss with us.

Monitoring and managing your cash flow is important for the vitality of your business. The first signs of financial woe appear in your cash flow statement, giving you time to recognize a forthcoming problem and plan a strategy to deal with it. Furthermore, with periodic cash flow analysis, you can head off those unpleasant financial glitches by recognizing which aspects of your business have the potential to cause cash flow gaps.

Travel and Entertainment: Maximizing the Tax Benefits

Don't overpay your income taxes by overlooking expenses that you are entitled to deduct. Use this Financial Guide to ensure you are handling your business travel and meal costs in a tax-wise manner.

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This Financial Guide shows you how to take advantage of all of the travel and entertainment expenses you're legally entitled to and offers guidance on which expenses are deductible and what percentage of them you can deduct. It also discusses the importance of following IRS rules for keeping records and substantiating your expenses in order to avoid an audit.

Travel Expenses

Tax law allows you to deduct two types of travel expenses related to your business, local and what the IRS calls "away from home."

1. First, local travel expenses. You can deduct local transportation expenses incurred for business purposes, for example, the cost of getting from one location to another via public transportation, rental car, or your own automobile. Meals and incidentals are not deductible as travel expenses, although as you will read later in this guide, you can deduct meals as an entertainment expense as long as certain conditions are met.
2. Second, you can deduct away from home travel expenses-including meals and incidentals; however, if your employer reimburses your travel expenses, your deductions are limited.

Local Transportation Costs

The cost of local business transportation includes rail fare and bus fare, as well as the costs of using and maintaining an automobile used for business purposes. For those whose main place of business is their personal residence, business trips from the home office and back are considered deductible transportation and not non-deductible commuting.

> Please see the special section below for the most effective ways of deducting auto expenses.

You generally cannot deduct lodging and meals unless you stay away overnight. Meals may be partially deductible as an entertainment expense as discussed below.

Away From-Home Travel Expenses

Due to the economic devastation caused by the coronavirus pandemic, in 2021 and 2022, you are able to deduct 100 percent of the cost of business meals and beverages purchased from restaurants. Typically, you can only deduct one-half of the cost of meals (50 percent). Lodging expenses incurred while traveling away from home are fully deductible (no pandemic-related change). The IRS also allows you to deduct 100 percent of your transportation expenses as long as business is the primary reason for your trip.

> You do not need to eat the food at the restaurant; you can order take-out and still take the 100 percent deduction.

To be deductible, travel expenses must be "ordinary and necessary", although "necessary" is liberally defined as "helpful and appropriate," not "indispensable." The deduction is also denied for that part of any travel expense that is "lavish or extravagant," though this rule does not bar deducting the cost of first-class travel or deluxe accommodations or (subject to percentage limitations below) deluxe meals.

What does "away from home" mean?

To deduct the costs of lodging and meals (and incidentals-see below) you must generally stay somewhere overnight. In other words, away from your regular place of business longer than an ordinary day's work and you need to sleep or rest to meet the demands of your work while away from home. Otherwise, your costs are considered local transportation costs and the costs of lodging and meals are not deductible.

Where is your "home" for tax purposes?

The general view is that your "home" for travel expense purposes is your place of business or your post of duty. It is not where your family lives (some courts have stated that it's the general area of your residence). Here is an example:

> George's family lives in Boston and George works in Washington, DC. George spends the weekends in Boston and the weekdays in Washington, where he stays in a hotel and eats out. For tax purposes, George's "home" is in Washington, not Boston, therefore, he cannot deduct any of the following expenses: cost of traveling back and forth between Washington and Boston, cost of eating out in Washington, cost of staying in a hotel in Washington, or any costs incurred traveling between his hotel in Washington and his job in Washington (the latter are considered non-deductible commuting costs).

There are some rules in the tax law concerning where a taxpayer's "home" is for purposes of deducting travel expenses that are less clear such as when a taxpayer works at a temporary site or works in two different places.

We'll cover these rules briefly in these two examples:

> **Example #1:** Joe, who lives in Connecticut, works eight months out of the year in Connecticut (from which he usually earns about $50,000) and four months out of the year in Florida (from which he usually earns about $15,000). Joe's "tax home" for travel expense purposes is Connecticut. Therefore, the costs of traveling to and from the "lesser" place of employment (Florida), as well as meals and lodging costs incurred while working in Florida, are deductible.
>
> **Example #2:** Susan works and lives in New York. Occasionally, she must travel to Maryland on temporary assignments, where she spends up to a week at a time. Assuming Susan's employer does not reimburse her for travel expenses, she can deduct the costs of meals and lodging while she's in Maryland, as well as the costs of traveling to and from Maryland. This holds true because her work assignments in Maryland are considered temporary since they will end within a foreseeable time. If an assignment is considered indefinite, that is, expected to last for more than a year, under the tax law, travel, meal, and lodging costs are not deductible.

Here's a list of some deductible away-from-home travel expenses:

- Meals (100 percent in 2021 and 2022; limited to 50 percent in other years) and lodging while traveling or once you get to your away-from-home business destination.
- The cost of having your clothes cleaned and pressed away from home.
- Costs for telephone, fax or modem usage.
- Costs for secretarial services away-from-home.
- The costs of transportation between job sites or to and from hotels and terminals.
- Airfare, bus fare, rail fare, and charges related to shipping baggage or taking it with you.
- The cost of bringing or sending samples or displays, and of renting sample display rooms.
- The costs of keeping and operating a car, including garaging costs.
- The cost of keeping and operating an airplane, including hangar costs.
- Transportation costs between "temporary" job sites and hotels and restaurants.
- Incidentals, including computer rentals, stenographers' fees.
- Tips related to the above.

However, many away-from-home travel expenses are not deductible or are restricted in some way. These include:

Commuting expenses. The costs of traveling between your home and your job are not deductible.

Travel as a form of education. Trips that are educational in a general way, or improve knowledge of a certain field but are not part of a taxpayer's job, are not deductible.

Job search expenses. Tax reform eliminated miscellaneous deductions for tax years 2018 through 2025.

Seeking a new location. Travel costs (and other costs) incurred while you are looking for a new place for your business (or for a new business) must be capitalized and cannot be deducted currently.

Luxury water travel: If you travel using an ocean liner, a cruise ship, or some other type of "luxury" water transportation, the amount you can deduct is subject to a per-day limit.

Seeking foreign customers: The costs of traveling abroad to find foreign markets for existing products are not deductible.

> Starting in 2008, travel (and other) costs incurred in unsuccessfully trying to acquire a specific business are currently deductible.

Meal and Entertainment Expenses

Prior to tax reform, there were limits and restrictions on deducting meal and entertainment expenses, with most deductible at 50 percent. Due to COVID-19 legislation, for tax years 2021 and 2022, the deductible amount for business-related meals is 100 percent. Meal costs must be "ordinary and necessary" and not "lavish or extravagant" and directly related to or associated with your business. They must also be substantiated.

Under tax reform, there were a number of changes, the most notable being that entertainment expenses paid or incurred after December 31, 2017, are not deductible unless they fall under specific exceptions, for example, expenses incurred for social activities primarily for the benefit of your employees. As such, reasonable costs for food and refreshments for year-end parties for employees are 100 percent deductible.

Prior to 2018, if you rented a skybox or other private luxury box for more than one event, say for the season, at the same sports arena, you generally could deduct more than the price of a non-luxury box seat ticket. Each game or other performance counted as one event, and the deduction for those seats was subject to the 50 percent entertainment expense limit. Starting January 1, 2018, however, that deduction is eliminated. Furthermore, even if the costs of food and beverages are separately stated, you cannot deduct these expenses.

Deductions are still disallowed for depreciation and upkeep of "entertainment facilities" such as yachts, hunting lodges, fishing camps, swimming pools, and tennis courts. However, the costs of entertainment provided at such facilities are no longer deductible. Prior to 2018, these expenses were deductible at 50 percent, subject to entertainment expense limitations.

Dues paid to country clubs or social or golf and athletic clubs are not deductible nor are dues that you pay to professional and civic organizations. Prior to 2018, these dues were deductible at 50 percent as long as your membership has a business purpose. Such organizations included business leagues, trade associations, chambers of commerce, boards of trade, and real estate boards.

How Do You Prove Expenses Are "Directly Related?"

The following section applies only to expenses incurred before January 1, 2018.

As noted earlier, most entertainment-related expenses are no longer deductible. Expenses are directly related if you can show:

- There was more than a general expectation of gaining some business benefit other than goodwill.
- You conducted business during the entertainment.
- Active conduct of business was your main purpose.

There is a presumption (in the eyes of the IRS) that events that take place in what it considers places non-conducive to doing business are not directly related to your business. These places include nightclubs, theaters, sporting events or cocktail parties. It also includes meetings with a group of people who are not business associates, at cocktail lounges, country clubs, or athletic clubs. However, you can overcome the presumption by showing that you engaged in a business discussion or otherwise conducted business during the event.

How Do You Meet The "Associated With" Test?

The following section applies only to expenses incurred before January 1, 2018.

As noted earlier, most entertainment-related expenses are no longer deductible. Even if you can't show that the entertainment was "directly related" as discussed above, you can still deduct the expenses as long as you can prove the entertainment was "associated" with your business. To meet this test, the entertainment must directly precede or come after a substantial business discussion. Further, you must have had a clear business purpose when you took on the expense.

For Whom Can You Get The Deduction?

The following section applies only to expenses incurred before January 1, 2018.

As noted earlier, most entertainment-related expenses are no longer deductible. The person entertained must be a business associate. That is, someone who could reasonably be expected to be a customer or conduct business with you, including an employee or professional advisor.

In circumstances where it's customary to entertain a business associate with his or her spouse, and your spouse also attends, entertainment of both spouses is deductible, thanks to the "closely connected rule."

Recordkeeping and Substantiation Requirements

Tax law requires you to keep records that will prove the business purpose and amounts of your business travel, entertainment, and local transportation costs.

Which Records You Must Keep

You must substantiate the following business expenses:

- Travel expenses while away from home (including meals and lodging).
- Business meals and entertainment if allowed under a tax code exception, and
- Business gifts.

To substantiate these items, you must prove:

- The amount.
- The time and place of the travel, entertainment, or recreation, or the date and a description of the business gift.
- The business purpose, and
- The business relationship of the recipient of entertainment or gifts.

The most frequent reason for IRS's disallowance of travel and entertainment expenses is the failure to show the place and business purpose of an item. Therefore, pay special attention to these aspects of your record-keeping.

Keeping a diary or logbook and recording your business-related activities at or close to the time the expense is incurred is one of the best ways to document your business expenses.

Here's how these rules apply to your record-keeping for travel expenses, entertainment expenses, and business gifts.

Away-from-home travel expenses. You must document the following for each trip:

- The amount of each expense, e.g., the cost of each transportation, lodging and meal. You can group similar types of incidentals together, i.e., "meals, taxis."
- The dates of your departure and return and the number of days you spent on business.
- Your destination.
- The business reason for the travel or the business benefit you expect.

Entertainment expenses (exceptions allowed under the tax code) for tax years before 2018. You must prove the following for each claimed deduction for entertainment expenses:

- The amount of each separate expense, though incidentals may be totaled on a daily basis.
- The date of the entertainment.
- The name, title, and occupation (showing business relation) of the people you entertained.

Business gifts. You must keep the following documentation for a business gift to substantiate the deduction:

- The cost of the gift and the date it was made.
- The business reason for the gift.
- The name, title, and occupation of the recipient.
- A description of the gift.

Employees "Fully Reimbursed"

Employees who are "fully reimbursed" by their employer must:

- Adequately account to their employer.
- Receive full reimbursement.
- Return any excess reimbursement.

As a fully reimbursed employee, you must adequately account to your employer by means of an expense account statement. If you are covered by (and follow) an "accountable plan," and your reimbursements don't exceed your expenses, you won't have to report the reimbursements as gross income. Some per diem arrangements (by which you receive a flat amount per day) and mileage allowances can avoid detailed expense accounting to the employer, but proof of time, place, and business purpose is still required.

However, if your employer's reimbursement plan is not "accountable," you must report the reimbursements as income. Prior to 2018, you could deduct these expenses on your tax return as miscellaneous itemized deductions on Form 1040 Schedule A, subject to the two percent-of-adjusted-gross-income floor. Tax reform, however, eliminated miscellaneous deductions for tax years 2018 through 2025.

Auto Expenses

If you are self-employed and use a car for business, you have two choices as to how to claim the deduction for auto expenses. Parking fees and tolls may be deducted no matter which method you use.

1. You can deduct the actual business-related costs of gas, oil, lubrication, repairs, tires, supplies, parking, tolls, chauffeur salaries, and depreciation, or
2. You can use the standard mileage deduction, which is an inflation-adjusted amount that is multiplied by the number of business miles driven.

From 2018 through 2025, employees who use their cars for business but either don't get reimbursed or are reimbursed under an employer's "non-accountable" reimbursement plan can no longer deduct auto expenses on Form 1040 Schedule A.

The standard mileage rate produces a larger deduction for some business owners, while others fare better (tax-wise) by deducting actual expenses. Figuring your deduction using both methods tells you which method is better for you tax-wise.

Expensing and depreciating vehicle costs. Deduction options and amounts depend on the percentage used for business. Also, if the car is used more than 50 percent for business, it can be included as business property and qualify for Section 179 expensing in the year of purchase. The deduction is reduced proportionately to the extent the car is used for personal purposes. If you take this deduction, you can't use the actual mileage for that vehicle in any year.

Depreciation. Assuming the car cost more than the Section 179 limit, or Section 179 is not available or is not claimed, depreciation is also allowed. Several depreciation options are available, but there are limits to the amount of depreciation that can be claimed per year. Depreciation otherwise allowable is reduced by the proportion of personal use. For example, a car used 20 percent for personal use is depreciated at 80 percent of the amount otherwise allowed.

Accelerated depreciation is defined as depreciation that is at a rate higher than normal that results from dividing the vehicle's cost by the number of years it will be used. It is not allowed where personal use is 50 percent or more. If you claimed accelerated depreciation in a prior year and your business use then falls to 50 percent or less, you become subject to "recapture" of the excess depreciation (i.e., it's included in income). Of course, using the standard mileage deduction described below allows you to avoid these limits.

Determining whether to use the standard mileage deduction. If you opt for the standard mileage rate, you simply multiply the current cents-per-mile rate by the number of business miles you drive for the year. Be aware, however, that the standard mileage deduction may understate your costs. This is especially true for taxpayers who use the car 100 percent for business, or close to that percentage.

> Once you choose the standard mileage rate, you cannot use accelerated depreciation even if you opt for the actual cost method in a later year. You may use only straight line.
>
> The standard mileage method usually benefits taxpayers who have less expensive cars or who travel a large number of business miles. To determine which method is better for you, make the calculations each way during the first year you use the car for business.

You may use the standard mileage for leased cars if you use it for the entire lease period. Or, you can deduct actual expenses instead, including leasing costs.

Recordkeeping. Tax law requires that you keep travel expense records and that you give information on your return showing business versus personal use. Not only is keeping good records essential in case of an audit, but it also allows you to make the most of your auto deductions. For example, you won't be able to determine which of the two options is better if you don't know the number of miles driven and the total amount you spent on the car. If you use the actual cost method, you'll have to keep receipts as well. For many business owners, using a separate credit card for business simplifies your record-keeping.

> Don't forget to deduct the interest you pay to finance a business-use car if you're self-employed.

Employee Benefits: How To Handle Them

Many companies offer a variety of employee benefits to their staff in order to keep them satisfied. The types of benefits include, but are not limited to, health insurance, retirement plans, vacation, and sick leave. This Financial Guide provides an overview of the types of benefits that businesses provide for employees and what's involved in offering them.

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Employee benefits play an increasingly important role in the lives of employees and their families and have a significant financial and administrative impact on a business. Most companies operate in an environment in which an educated workforce has come to expect a comprehensive benefits program. Indeed, the absence of a program or an inadequate program can seriously hinder a company's ability to attract and keep good personnel. Employers must be aware of these issues and be ready to make informed decisions when they select employee benefits.

Designing the right benefit plan for your employees is a complex task. There are many issues to consider, including tax and legal aspects, funding, and finding the right vendors or administrators.

> You may want to contact your insurance carrier, broker, or benefits consultant for assistance in designing and implementing your benefit plan.

What Is An Employee Benefit Plan?

An employee benefit plan protects employees and their families from economic hardship brought about by sickness, disability, death or unemployment. It also provides retirement income to employees and their families, and establishes a system under which leave or time off from work can occur should the employee need it.

Mandated Benefits

The employer must pay in whole or in part for certain legally mandated benefits and insurance coverage:

- Social Security.
- Unemployment insurance.
- Workers' compensation.

Funding for the Social Security program comes from payments by employers, employees, and self-employed persons that are deposited into an insurance fund that provides income during retirement years. Full retirement benefits normally become available at age 65. For younger individuals, the date for maximum benefits is being adjusted to age 67. These benefits are discussed in more detail in the Retirement Benefit Plans section of this Financial Guide. Other aspects of Social Security deal with survivor, dependent and disability benefits, Medicare, Supplemental Security Income, and Medicaid.

Unemployment insurance benefits are payable under the laws of individual states from the Federal-State Unemployment Compensation Program. Employers contribute to the program based on total payroll.

Workers' compensation provides benefits to workers disabled by occupational illness or injury. Each state mandates coverage and provides benefits. In most states, private insurance or an employer self-insurance arrangement provides the coverage. Some states mandate short-term disability benefits as well.

Optional Benefits

A comprehensive benefit plan can include the following elements:

- Health insurance.
- Disability insurance.
- Life insurance.
- A retirement plan.
- Flexible compensation (cafeteria plans).
- Leave.

A benefit plan can also include bonuses, service awards, reimbursement of employee educational expenses and prerequisites appropriate to employee responsibility.

Why Offer Your Employees Benefits?

Here are some of the reasons employers offer benefits:

- To attract and hold capable people.
- To keep up with competition.
- To foster good morale.
- To keep employment channels open by providing opportunities for advancement and promotion as older workers retire.

A combination of benefits programs are the most effective and efficient means of meeting economic security needs. For many employers, a benefit plan is an integral part of total compensation, because employers either pay the entire cost of a benefit plan or have employees contribute a small portion of premium costs for their coverage.

Health, Disability, and Life Insurance Plans

Employers might offer medical and dental plans, disability benefits, and life insurance.

Medical and Dental Plans

A serious illness or injury can be devastating to an employee and his or her family. It can threaten their emotional and economic well-being. Thus, adequate health insurance is important to employees and is part of a solid group plan.

Group health plans help attract and keep employees who can make your business a success. They relieve your employees of the anxiety of health care costs by providing the care they need before an illness becomes disabling, thus helping you avoid costly employee sick days.

Group health plans usually cost less than purchasing several individual policies with comparable coverage. Moreover, there are tax advantages to offering health care benefits: your contribution as an employer may be deductible and the insurance is not taxable income to your employees.

As an employer, you can choose either an insured (also known as an indemnity or fee-for-service plan) or a pre-paid plan (also known as a health maintenance organization).

Traditional Indemnity Plans. An indemnity plan allows the employee to choose his or her own physician. The employee typically pays for medical care and then files a claim form with the insurance company for reimbursement. These plans use deductibles and coinsurance as well. A deductible is a fixed amount of medical expenses an employee pays before the insurance plan reimburses any more expenses. Coinsurance is a percentage of medical expenses the employee pays, with the plan paying the remaining portion. A typical coinsurance amount is 20 percent, with the plan paying 80 percent of approved medical expenses. Listed below are the most common types of insurance arrangements (indemnity plans) providing health care to groups of employees.

- A basic health insurance plan, covering hospitalization, surgery and physicians' care in the hospital.
- A major medical insurance plan, usually supplementing a basic plan by reimbursing charges not paid by that plan.
- A comprehensive plan, covering both hospital and medical care with one common deductible and coinsurance feature.

Health Maintenance Organizations. Health maintenance organizations (HMOs) provide health care for their members through a network of hospitals and physicians. Comprehensive benefits typically include preventive care, such as physical examinations, well-baby care, and immunizations, and stop smoking and weight control programs.

The main characteristics of HMOs are as follows:

- The choice of primary care providers is limited to one physician within a network; however, there is frequently a wide choice for the primary care physician.
- There is no coverage outside the HMO network of hospitals and physicians.
- Costs are lower, due to limited choice. Physicians are encouraged to keep patients healthy; accordingly, they often are paid on a per capita basis, regardless of how much care the patient needs.
- The employer prepays HMO premiums on a fixed, per-employee basis.
- Employees do not have to apply for reimbursement of charges, but they may have small co-payments for medical services.

Preferred Provider Organizations. Preferred provider organizations (PPOs) fall between the conventional insurance and health maintenance organizations and are offered by conventional insurance underwriters. A PPO is a network of physicians and/or hospitals that contract with a health insurer or employer to provide health care to employees at predetermined discounted rates.

Some of the key elements of a PPO are:

- It offers a broad choice of health care providers. Because of the broader choice of providers, PPOs are more expensive than HMOs.
- It may have fewer comprehensive benefits than HMOs, but the benefits usually can meet almost any need.
- PPO providers usually collect payments directly from insurers.

Although there is no requirement for employees to use the PPO providers, there are strong financial reasons to do so.

Dental Benefits. Medical insurance frequently includes dental plans. Most plans cover all or portions of the cost for the following services:

- Cleaning, x-rays and oral examinations.
- Fillings.
- Crowns and dentures.
- Root canals.
- Oral surgery.
- Orthodontia (these portion of the cost covered here are generally quite limited, if at all)

Health Savings Accounts. The HSA allows employees to deduct contributions to the HSA even if they do not itemize deductions. The HSA plan allows employees who are covered by a high-deductible health plan to contribute pre-tax amounts that will be used to cover medical expenses or used later for retirement. Qualified amounts contributed to an employee's HSA by an employer can be excluded by the employee. Distributions from the HSA are not taxable as long as they are used for medical expenses.

Disability Benefits

A disability plan provides income replacement for the employee who cannot work due to illness or accident. These plans are either short-term or long-term. They can be distinct from workers' compensation because they pay benefits for non-work-related illness or injury.

- ***Short-Term Disability.*** Short-term disability is usually defined as an employee's inability to perform the duties of his or her normal occupation. Benefits may begin on the first or the eighth day of disability and are usually paid for a maximum of 26 weeks. The employee's salary determines the benefit level, ranging from 60 to 80 percent of pay. You, as an employer, may specify the number of days of sick leave paid at 100 percent of salary. The employee can use these before short-term disability begins.
- ***Long-Term Disability.*** Long-term disability (LTD) benefits usually begin after short-term benefits conclude. LTD benefits continue for the length of the disability or until normal retirement. Again, benefit levels are a percentage of the employee's pay, usually between 60 and 80 percent. Social Security disability frequently offsets employer-provided LTD benefits. Thus, if an employee qualifies for Social Security disability benefits, these are deducted from benefits paid by the employer.

Life Insurance

Traditionally, life insurance pays death benefits to beneficiaries of employees who die during their working years. There are two main types of life insurance:

- Survivor income plans, which make regular payments to survivors.
- Group life insurance plans, which normally make lump-sum payments to specified beneficiaries.

Protection provided by one-year, renewable, group term life insurance with no cash surrender value or paid-up insurance benefit, is very popular. Frequently, health insurance programs offer this coverage.

You should use the same principles for selecting a life insurance program as you do for selecting health insurance. Finding a benefit plan that meets your budget constraints and fills the needs of your employees is crucial. Among the sources to check are:

- Your local chamber of commerce.
- Independent insurance agents.
- Trade associations of your business.
- State departments (or commissions) of insurance.

- Community business leaders.
- Benefit consultants or actuaries.
- Service Corps of Retired Executives (SCORE) (affiliated with the U.S. Small Business Administration).

To reduce risk, select insurance underwriters with top ratings from Best's (Best Insurance Reports: Property-Casualty Ed. and Life-Health Ed. Published annually by A.M. Best Company, Oldwick, N.J.). HMOs and Blue Cross/Blue Shield are not rated by Best but are regulated by state governments.

Check with other users and state regulators on the history of the particular plan you are considering.

Self-Insurance

Rising costs are prompting small business owners to take a look at a form of health care coverage previously considered an option only for big business: self-insurance. With self-insurance, the business predetermines and then pays a portion or all of the medical expenses of employees in a manner similar to that of traditional healthcare providers. Funding comes through the establishment of a trust or a simple reserve account. As with other health care plans, the employee may pay a portion of the cost of premiums. Catastrophic coverage is usually provided through a "stop-loss" policy, a type of coinsurance purchased by the company.

The plan may be administered directly by the company or through an administrative services contract.

The advantages of self-insurance are listed below:

- Programs can be flexible. They are designed to reflect employee needs, including medical and dental care, prescriptions and so on.
- Mandated benefit laws and state insurance premium taxes do not affect these plans.
- The employer retains control over the timing and amount of funds paid into the plan and can manage costs more directly.
- Administration of these plans can be more efficient.
- Over time, these plans can save money.

The drawbacks to self-insurance include the following:

- Health care is costly and heavy claims years may prove extraordinarily expensive.
- Commitment for the long haul is necessary to achieve significant savings.

While insurance can be a viable option for small businesses, it should be undertaken only after careful study.

The Affordable Care Act

The Patient Protection and Affordable Care Act of 2010, in concert with the enactment of the Health Care and Education Tax Credits Reconciliation Act of 2010, resulted in a number of changes that affect smaller business owners. Here are the highlights:

If you have 50 or fewer full-time equivalent (FTE) employees (generally, workers whose income you report on a W-2 at the end of the year) you are considered a small business under the health care law.

As a small business, you may get insurance for yourself and your employees through the SHOP (Small Business Health Options Programs) Marketplace. This applies to non-profit organizations as well.

If you have fewer than 25 employees, you may qualify for the Small Business Tax Credit. Non-profit organizations can get a smaller tax credit. Small businesses and tax-exempt organization that employ 25 or fewer, full-time equivalent workers with average incomes of $50,000 or more as adjusted for inflation since 2014 ($56,000 for 2021 returns), and, that pay at least half (50 percent) of the premiums for employee health insurance coverage are eligible for the Small Business Health Care Tax Credit.

Starting in 2014, the tax credit is worth up to 50 percent of your contribution toward employees' premium costs (up to 35 percent for tax-exempt employers). The tax credit is highest for companies with fewer than 10 employees who are paid an average of $28,700 or less in 2022 ($27,800 in 2021). The smaller the business, the bigger the credit is. For tax years 2010 through 2013, the maximum credit was 35 percent for small business employers and 25 percent for small tax-exempt employers such as charities.

> The credit is available only if you get coverage through the SHOP Marketplace, which opened to employers with 100 or fewer FTEs starting in 2016.

Additional Tax on Businesses Not Offering Minimum Essential Coverage. Effective January 1, 2015, an additional tax will be levied on businesses with 100 or more full-time equivalent (FTE) employees that do not offer minimum essential coverage and employers with more than 50 full-time employees starting in 2016. This penalty is sometimes referred to as the Employer Shared Responsibility Payment or "Play or Pay" penalty.

Excise Tax on High Cost Employer-Sponsored Insurance. Often referred to as the "Cadillac Tax," it was repealed under the Further Consolidated Appropriations Act, 2020.

Balancing Cost, Quality and Accessibility

In summary, when deciding on a health, disability, or life insurance plan, consider what you and your workers want in a plan. Determine all costs associated with the plan and investigate the quality of potential insurance carriers, and examine the quality of each plan, including the benefits and restrictions such as:

- Hospital coverage (inpatient care).
- Outpatient services.
- Physical coverage.
- Substance abuse treatment.
- Mental health coverage.
- Prescriptions.

Questions To Ask Before Signing a Benefits Contract

- Who is the insurance company?
- Is it committed to small business?
- How solvent is it? What is its rating?
- What is the carrier's reputation for customer service?
- What is the choice of doctors and hospitals?
- How does the company manage health care costs?
- Who administers the plan?
- What information must the employer provide?
- How are the employees enrolled?

When Problems Arise

From time to time problems arise with benefit delivery. Patience on the part of the provider, the employer, and the employee usually brings a resolution.

Occasionally, unusually prolonged and difficult problems develop that do not yield to resolution. Such instances should be brought to the attention of your state's insurance department or commission, which is responsible for regulating insurance companies.

Retirement Benefit Plans

A financially secure retirement is a goal of all Americans. Since many of us will spend one-fourth to one-fifth of our lives in retirement, it is more essential than ever to begin preparations at an early age. Many financial planners report that an individual requires about 75 percent of his or her preretirement income to maintain the same standard of living enjoyed during one's working years.

Social Security, employer-sponsored retirement programs, and personal savings are the three sources of post-retirement income.

Social Security Benefits

Social Security provides retirement benefits for most persons employed or self-employed for a set period of time (currently 40 quarters; about 10 years). Benefits paid at retirement, traditionally at age 65, are based on a person's earnings history. The age at which you can retire at full benefits increases depending upon your current age. For younger individuals, full benefits begin at about age 67. Payments may begin at age 62 at a reduced rate or, if delayed beyond full retirement age, at an increased rate.

For a person with earnings equal to the U.S. average, the benefit will be about 40 percent of pay. For someone with maximum earnings, the benefit would be about 25 percent of the portion of pay subject to Social Security tax.

> Every worker should understand Social Security retirement benefits. By completing the "Request for Social Security Earnings Information" you can receive a projection of benefits. Forms can be obtained through Social Security Online, local Social Security offices or by calling 1-800-772-1213.
>
> **Planning Aid:** To obtain an immediate copy of this form, please click on Request for Social Security Earnings Information.

Employer-Sponsored Retirement Plans

A retirement plan makes good sense and can attract and reward employees. The benefits and tax advantages of supplementing Social Security with a qualified retirement plan are significant.

A qualified plan is one meeting IRS specifications. Currently, such contributions are tax-deductible, and earnings accumulate on a tax-deferred basis. In addition, benefits earned are not part of the participant's taxable income until received, and certain distributions are eligible for special tax treatment.

Whether you are a sole proprietorship, a partnership or a corporation (employing many people or only yourself as the owner/employee), there is a wide range of options available. These can range from simple plans, which you establish and maintain, to complex versions, which require an actuary, attorney or employee benefits consultant. If you are active in the business, you can be included as a plan participant. Accountants, banks, insurance, and investment professionals, as well as other financial institutions, can provide information on retirement plan products.

Employers can benefit from tax credits for start-up costs. You may be able to claim a tax credit for part of the ordinary and necessary costs of starting a SEP, SIMPLE IRA Plans, or qualified plan. The credit equals 50 percent of the cost to set up and administer the plan and educate employees about the plan, up to a maximum of $500 per year for each of the first 3 years of the plan. Employers can choose to start claiming the credit in the tax year before the tax year in which the plan becomes effective as long as:

- You must have had 100 or fewer employees who received at least, $5,000 in compensation from you for the preceding year.
- At least, one participant must be a non-highly compensated employee.

The employees generally cannot be substantially the same employees for whom contributions were made or benefits accrued under a plan of any of the following employers in the 3-tax-year period immediately before the first year to which the credit applies.

- You.
- A member of a controlled group that includes you.
- A predecessor of (1) or (2).

The credit is part of the general business credit, which can be carried back or forward to other tax years if it cannot be used in the current year. However, the part of the general business credit attributable to the small employer pension plan startup cost credit cannot be carried back to a tax year beginning before January 1, 2002.

You cannot deduct the part of the startup costs equal to the credit claimed for a tax year, but you can choose not to claim the allowable credit for a tax year. To take the credit, employers should use Form 8881, *Credit for Small Employer Pension Plan Startup Costs*.

Depending on whether you are a sole proprietor, a partnership or a small corporation, the following plans are available:

- Defined benefit plans - A retirement plan favoring older, more highly paid employees.
- Profit-sharing plans - A flexible plan based on profits and contributions that can be discretionary from year to year.
- Money purchase plans - A method that often favors younger workers. Steady plan contributions are required.
- Individual retirement accounts (IRAs) - A simple plan; allowing modest contributions.

- Simplified employee pension (SEP) plans - A plan for small businesses combining features of IRA and profit-sharing plans, offering flexibility and easy self-administration.
- 401(k) - The most popular plan today for businesses with employees, providing employees with the ability to save for their retirement with pre-tax dollars. Can be at low cost to employers.
- SIMPLE IRA Plans - A new type of plan which combines IRA and 401(k) features.
- Stock bonus - Benefits in the form of company stock.
- Employee Stock Ownership Plan (ESOP) - Another plan based on company stock.

Designing the Right Corporate Plan

Selecting the right pension plan for a corporation results from a process of identifying business needs and expectations, including

- Need for flexibility.
- Current age of key employees.
- Current number of employees and plans for growth.
- Maximization of retirement benefits.

Although there are many different types of retirement plan options available to corporations, they fall into two general categories: defined benefit plans and defined contribution plans:

Defined Benefit Plans. With this plan, the benefits an employee will receive are predetermined by a specific formula - typically tied to the employee's earnings and length of service - and indexed for inflation. The law allows a pension of up to $245,000 a year in 2022 ($230,000 in 2021). The employer is responsible for making sure that the funds are available when needed (the employer bears funding and investment risks of the plan).

Such a plan can generally provide larger benefits faster (through tax-deductible contributions) than other plans. The price of providing a higher degree of tax savings and being able to rapidly shelter larger sums of retirement capital is having to meet additional reporting requirements. Defined benefit plans typically cost more to administer, requiring certifications by enrolled actuaries, and insurance payments to the Pension Benefit Guaranty Corporation (PBGC), which may review plan terminations.

Defined Contribution Plans. Also known as individual account plans, defined contribution plans specify the amount of funds placed in a participant's account (for example, 10 percent of salary). The amount of funds accumulated, and the investment gains or losses solely determine the benefit received at retirement. The employer bears no responsibility for investment returns, although the employer does bear a fiduciary responsibility to select or offer a choice of sound investment options.

Defined benefit plans are typically better for older employees (usually age 45+). For example, these plans can provide the ability to fund for years of employment before the inception of the plan. While some contribution flexibility is available, factors determining the cost of promised benefits (e.g., number and ages of employees, rates of return on investments) will mandate the level of required deposits to the plan.

There are several basic types of defined contribution plans, including (1) simplified employee pension plans (SEPs), (2) profit-sharing plans, (3) money purchase plans, (4) 401(k) plans, (5) stock bonus plans, (6) employee stock ownership plans (ESOP), and (7) SIMPLE IRA plans.

1. ***Simplified Employee Pension Plans.*** A simplified employee pension (SEP) suits many small corporations. It requires no IRS approval, no initial filings, and no annual reporting to the government. Although SEP plans are called "pensions," they are actually IRAs, except that contributions to them aren't subject to the IRA dollar limits. The total deferral per employee each year can be up to $61,000 in 2022 (up from $58,000 in 2021) indexed for inflation or 25 percent of his or her annual earnings, whichever is less. There is also a limit on how much of an employee's earnings may be included in the percentage computation.

Contributions must be made on a nondiscriminatory basis to all employees who are at least age 21 and who have worked for any part of three of the past five years earning a minimal amount. Contributions can vary from year to year - you may even skip entire years. To be deductible for a year, the contribution must be paid no later than the due date of an employer's income tax return for the year, including extensions. Once made, the entire contribution is owned by the employee.

Complete specifications for the plan can be found in IRS Form 5305. The form itself serves as the plan document, requiring only the insertion of a business name, the checking of three boxes and a signature. The form is not filed with the IRS, but rather copied for all employees and then placed in the firm's files. Many employers instead use plan documents provided by financial institutions.

2. ***Profit-Sharing Plans.*** Similar to a SEP, a profit-sharing plan offers the flexibility of making contributions - up to the lesser of $61,000 in 2022 (up from $58,000 in 2021) or 25 percent of compensation.

Alternatively, rather than selecting a percentage, a flat amount (for example, $100,000) could be allocated among eligible employees, generally proportionate to compensation. Historically, contributions could only be paid out of profits; this is no longer required.

Profit-sharing plans differ from SEPs in several distinct ways. An employer can apply a vesting schedule to the company's contributions, based on an employee's length of service with the company after the contribution is made. If an employee is terminated before becoming "fully vested," his or her funds will revert to the plan (reducing future contributions) or be reallocated among the remaining participants. In addition, profit-sharing plans permit the exclusion of part-time employees and can allow participants to borrow from the plan.

Profit-sharing plans, as all other qualified retirement plans, require the preparation of formal master documents as well as annual tax filings. A standardized master or prototype plan will often satisfy requirements and will typically be less expensive and simpler to set up and operate than an individually designed plan.

3. ***Money-Purchase Plans.*** With a money purchase plan, the employer is usually committed to making annual contributions equal to a designated percentage of each employee's compensation. This percentage may not exceed 25 percent of compensation, with a maximum contribution per employee of $61,000 in 2022 (up from $58,000 in 2021), indexed for inflation. Contributions must be made even in years in which there are no profits.

4. **401(k) Plans.** These tax-deferred savings plans have become highly popular in recent years. The basic idea of a 401(k) is simple: it is a profit-sharing plan adopted by an employer that permits employees to set aside a portion of their compensation through payroll deduction for retirement savings. The amounts set aside are not taxed to the employee and are a tax-deductible business expense for the employer. Set-asides (called "elective deferrals") for any employee can't exceed $20,500 in 2022 ($19,500 in 2021) indexed for inflation. Elective deferrals don't count in figuring the employer's deduction limits. Thus, the employer's contribution up to the profit-sharing deduction limit plus the elective deferral, are tax-sheltered.

An employer's discretionary matching contribution can provide an incentive for employee participation as well as serve as an employee benefit. Employer contributions can be capped, to limit costs and a vesting schedule can be applied to employer deposits (employees are always 100 percent vested in their own contributions).

For employees, the opportunity to reduce federal - and often state and local - taxes through participation in a 401(k) plan offers significant benefits. While savings are intended for retirement, certain types of loans can provide employees with access to their funds - employees repay borrowed principal plus interest to their own account.

> Special non-discrimination tests apply to 401(k) plans, which may limit the amount of deferrals that highly compensated employees are allowed to make.

To avoid these limits, some employer contribution on behalf of lower-paid employees may be required.

Some employers automatically enroll employees in the 401(k), giving them the right to opt-out. After 2007, automatic enrollment arrangements (with the right to opt-out) can escape the nondiscrimination tests if certain prescribed minimum employer contributions are made and certain prescribed investment types are available.

401(k)s can allow employee deferrals to go into a Roth account (based on a Roth IRA concept). Withdrawals from an account maintained 5 years or more can be tax-free after age 59 1/2. The amount deferred into the Roth 401(k) is currently taxable (unlike amounts deferred into the regular 401(k)).

Tax professionals consider that the Roth 401(k) favors high-income individuals. If that describes you, consult your tax adviser on deferring into a Roth 401(k), where this is offered.

5. ***Stock Bonus Plans.*** This is similar to a profit-sharing plan. The plan invests in employer stock, which is generally distributed to participants at retirement.

6. ***Employee Stock Ownership Plans.*** A special breed of qualified plan - the employee stock ownership plan (ESOP) - provides retirement benefits for employees. In addition, an ESOP can be used as a market for company stock, for financing the company's growth, to increase the company's cash flow or as an estate planning tool.

ESOP funds must be primarily invested in employer securities. ESOPs are stock bonus plans or stock bonuses combined with money purchase plans. Tax-deductible contributions to the plan are used to buy stock for eligible employees. On retirement, the employee may take the shares or redeem them for cash. Complicated rules must be adhered to in the establishment and maintenance of an ESOP plan. Expert advice should be sought.

7. ***SIMPLE IRA Plans.*** Employers with 100 or fewer employees can establish "SIMPLE" retirement plans. The SIMPLE IRA Plan combines the features of an IRA and a 401(k). Employees can contribute to the SIMPLE IRA Plan, pre-tax, and the employer must make either a matching contribution for employees who contribute or a contribution for each eligible employee. The limit on the employee's contribution is $14,000 in 2022 ($13,500 in 2021), indexed for inflation. The penalties for withdrawing money from the Simple IRA Plan before age 59-1/2 can be higher than with other plans.

Plans Available to Non-Corporate Employers

Non-corporate employers can adopt any of the plans listed above that corporate employers can, except, of course, those based on stock in the employer corporation (stock bonus and

ESOP plans). Defined benefit, profit-sharing, money purchase and 401(k) plans sponsored by non-corporate employers - that is, self-employed persons - who participate in the plans, which are sometimes referred to as "Keogh" plans.

Contribution limits for unincorporated businesses are the same as for corporate plans of the same type, except for contributions on behalf of the self-employed owner - sole proprietor, partner or LLC member, who for this purpose is treated as an employee. Contributions for a self-employed owner are based on the owner's self-employment net earnings. The contribution ceiling for money purchase, profit sharing, and SEP plans are the same: in effect, 20 percent of earnings (technically, 25 percent of earnings reduced by the contribution) up to a maximum contribution of $61,000 in 2022 (up from $58,000 in 2021), indexed for inflation. For defined benefit plans, a self-employed owner's benefit is based on self-employment net earnings less deductible contributions.

In plans such as 401(k)s or SIMPLE IRA plans where employees defer part of their salary, self-employed owners are deferring part of their self-employment earnings. For employees, deferred salary is excluded from taxable pay; for self-employed owners, deferred self-employment earnings are deducted.

Keogh plans, like comparable corporate plans, must be established by the end of the year for which you are making the contribution. Once established, you have until your tax return filing date - including extensions - to make the contribution.

SIMPLE IRA Plans generally must be established by October 1 of the year they go into effect.

A SEP may be established by the tax return due date, including extensions, for the year it goes into effect. Thus, a plan effective for 2021 can be created in 2022; contributions to that plan in 2022 will be deductible on the 2021 return if designated as for 2021 and made by the 2021 return due date including extensions.

Employee contributions. These are important elements of many employer plans, allowing employees to make their own tax-sheltered investments within the company plan.

In many cases such contributions are "pretax"-that is, from salary (reducing taxable pay), as in the case of 401(k)s, SIMPLE IRA Plans, and certain SEP Plans, called SARSEPs, formed before 1997. Pretax "employee" contributions can also be made by self-employed owners, in which case they reduce taxable self-employment earnings. The ceilings on such contributions are discussed above (SARSEP and 401(k) ceilings are the same).

Additional pretax contributions are allowed for participants age 50 or over. In 2022 the ceiling amount of such contributions, called "catch-up" contributions (misleadingly, since the amount or lack of prior contributions is irrelevant), for 401(k)s is $6,500 (same as 2021), for IRAs it is $1,000 (same as 2021), and for SIMPLE IRA Plans, the amount is $3,000 (same as 2021).

Employee contributions may also be after-tax. That is, they are not excludable (when made by employees) or deductible (where made by self-employed owners) but still grow tax-free once invested, until withdrawn. The contributions come back tax-free; only the earnings are taxed.

Employee after-tax contributions may be attached to a plan, such as a 401(k), or be to a standalone plan (maybe called a savings plan) for employees' contributions alone, or with some employer match.

Credit for low-income participants. "Lower-bracket" taxpayers age 18 and over are allowed a tax credit for their contributions to a plan or IRA. The "Saver's Credit" is allowed on joint returns of couples (filing jointly) with (modified) adjusted gross income (AGI) below $65,000 (up from $64,000 in 2019). The credit is a percentage (10, 20, and 50 percent) of the contribution, up to a contribution total (considering all contributions to all plans and IRAs) of $2,000. The lower the AGI, the higher the credit percentage: the maximum credit is $1,000 (50 percent of $2,000). Head-of-household dollar amount and the AGI credit percentage ranges are indexed for inflation.

The credit is allowed whether the contribution is pre-tax (credit is in addition to a deduction or exclusion) or after-tax.

Review plan decisions. There have been a number of recent law changes, especially in the already popular 401(k).

Those lacking tax-favored retirement plans should give plan adoption a new look. Those with such plans already should review the options, and what's required to take advantage of them. Professional guidance is essential and, as pointed out above, encouraged by the law.

Individual Retirement Accounts. An employer may establish IRAs for its employees to which the employees contribute though this is not usual. An employer may establish IRAs for employees within an employer plan. But virtually all IRAs are set up by the individual worker, employed or self-employed (occasionally for the worker's spouse) without the involvement of any employer.

An IRA is a tax-favored savings plan that allows workers to make contributions with pre-tax dollars (where a deduction is allowed, see below) and defer taxation on earnings until retirement.

There are several limitations to IRAs:

- The maximum contribution that you can make to a traditional or Roth IRA is the smaller of $6,000 or the amount of your taxable compensation for 2022 (same as 2021). This limit can be split between a traditional IRA and Roth IRA, but the combined limit is $6,000. If you are 50 years of age or older before the end of 2022, the maximum contribution that can be made to a traditional or Roth IRA is the smaller of $7,000 or the amount of your taxable compensation for 2022.
- Contributions may be made only up to age 70 1/2.
- The account holder may not use funds to purchase life insurance or collectibles (except gold or silver coins issued by the U.S. Government).
- IRA contributions up to the ceiling are deductible if neither the taxpayer nor his or her spouse is covered by a corporate or unincorporated retirement plan. The deduction is limited (phases out) at prescribed income levels (which increase each year) where the taxpayer is covered by a plan or where (using higher levels) the taxpayer's spouse is covered although the taxpayer is not. A nondeductible contribution is allowed in other cases, and nondeductible contribution is allowed to Roth IRAs subject to income limits. Also, low-income taxpayers are allowed the up-to-$1,000 tax credit described above (under Employee Contributions) for IRA contributions.

Where to Get Pension Information

The variety of plans and related regulations are numerous. You should consult with your professional advisors regarding which options are available to you and which one best first your company's needs.

Questions To Ask Before Finalizing a Pension Plan

1. Does the plan require a given level of contribution each year?
2. Do the plan provisions (eligibility, hours of service and vesting of employer contributions) meet current and future needs?
3. What are the costs of establishing and administering a plan and trust, including providing annual employee reports?
4. What investment options are offered?
5. Are there any loads (charges) associated with deposits (front-end charges) or surrenders (rear-end charges) from the plan?
6. Can - and should - employees make individual investment selections? What types of reports do participants receive?

Leave

The old concept of "two weeks with pay" has given way to a wide variety of paid and unpaid leave plans for all businesses. Typically, these include:

- Annual leave.
- Holidays (national and state).
- Sick leave.
- Personal leave (birthday, other reason of choice).
- Emergency leave.
- Compassionate leave (funeral, family illness).
- Religious observance.
- Community service (voting, jury duty, court witness, National Guard, Civil Air Patrol, volunteer fire department).
- Education/training.
- Leave without pay.
- Leave of absence (paid or unpaid).
- Parental (formerly maternity) leave.

In a strict sense, paying people for not working is a costly, unprofitable concept. However, time off from the grind is a tradition of the American workplace, and rightly so. Benefits can far outweigh costs. Among the many benefits for the employee are rest, relaxation, a new perspective, travel, pursuit of hobbies and release from daily tensions. The employer also benefits - the employee returns refreshed from the break in the daily routine, possibly with new ideas and renewed energy for doing a better job. Employers also can observe the performance of employees in new situations, as they fill in for their vacationing coworkers, potentially leading to better allocation of workforce talents.

Eligibility for Leave

In determining employee eligibility for leave, an employer must find the answers to many questions, including the following.

- How much paid leave time can the company afford per year?
- How many categories of leave should there be?
- Can employees carry over unused leave from one year to the next? If so, how much?
- Are there leave rights during probation?
- Who gets first choice of dates in scheduling annual leave? How are conflicts resolved? By seniority?
- Can employees borrow leave in advance?

- At what point does extended/borrowed paid leave become unpaid leave and extended/borrowed unpaid leave become unemployment?
- Are employees eligible for more leave after a certain number of years with the company?

Employers must determine when eligibility for leave begins: Immediately? After the first year? Many employers establish a paid annual leave schedule by declaring employees eligible for so many hours leave after they have worked a specified number of hours; for example, two hours leave for every 80 hours worked or one day for so many weeks worked.

> Limits on sick and other leave are vital. You should restrict sick leave to illness or medical examinations and treatment. It must not become an extension of annual leave. Accordingly, it is wise to reserve the right to require physician certification of an illness.

Although the vast majority of employees will not abuse time allowed for compassionate, emergency or other leave categories, clear policies should be established on requesting such leave and on its duration.

Budget Considerations

Granting paid or unpaid leave is a costly benefit. Depending on the nature of an employee's work, you may need to require overtime from other employees or hire temporary employees to cover the absence. Extended leave situations pose special problems.

Questions To Ask Before Finalizing a Leave Plan

1. Is the business open on all holidays? If not, on which ones?
2. If the business is open on holidays, do you work with full or limited staff, paying them double time as may be required by law?
3. How many hours/days are allowed as leave for voting, jury duty, religious observance, funerals, etc.?
4. How are insured benefits handled during unpaid leave?
5. Which state laws affect leave?

Perquisites

While all employees are usually eligible for benefits such as health and other insurance, retirement plans and leave, key employees have come to expect certain additional benefits related to their increased levels of responsibility. Among the perquisites or perks employers may want to consider for top performers and key or even all, employees are:

- Company automobile.
- Extra vacation.
- Special parking privileges.
- Personal expense accounts.
- Spouse travel on company business.
- Sabbaticals (with pay).
- Professional memberships.
- Professional publications.
- Loans/mortgages.
- Estate planning.
- Legal services.
- Medical expense reimbursement.
- Physical examinations/health screening.
- Physical exercise facilities.
- Executive dining room.
- Matched donations to universities, colleges and/or charities.
- Tuition programs.
- Dependent day care (on- or off-site).
- Merchandise discounts.
- Holiday gifts.
- Employee assistance programs (EAPs) (substance abuse, debt, interpersonal relationships, psychological, financial, other types of counseling).
- Service awards.
- Credit unions.

Like basic benefits, perquisites help attract and keep good employees. You can balance the far higher cost of providing some perquisites with expectations of increased production from the employees who benefit.

Key employees responsible for generating contacts for new business should receive consideration for company automobiles, personal expense accounts, professional memberships, and publications, club memberships, spouse travel on company business, credit cards, home entertainment allowances, end-of-year bonuses, and sabbaticals.

Sales staff responsible for keeping current customers satisfied should receive consideration for company automobiles (if needed for their duties), credit cards, personal expense accounts, professional memberships and publications, sales commissions, spouse travel on company business and end-of-year bonuses.

All employees should receive consideration for EAPs, physical exercise facilities (if you have them), parking, tuition programs, dependent daycare, holiday gifts, service awards, credit unions, matched donations to universities, colleges and/or charities, physical examinations or health screenings when offered and merchandise discounts.

Offer legal services and loans and mortgages on a case-by-case basis. Some perquisites, such as extra vacation, should be given only as a reward for extraordinary service to your company.

You may want to consider employer-employee cost-sharing of such pre-requisites as physical exercise facilities, dependent daycare, parking and, perhaps, some health screening services.

Before beginning any program of perquisites, check current tax law for treatment of each item:

- Can you, as the employer, deduct it as a business expense?
- Will it become taxable income for your employee?

Flexible Compensation or "Cafeteria" Plans

To accommodate today's many variations in family relationships, lifestyles, and values, flexible compensation or "cafeteria" benefit plans have emerged. In addition to helping meet employee needs, cafeteria plans also help employers control overall benefit costs.

The idea behind cafeteria plans is that amounts which would otherwise be taken as taxable salary are applied, usually tax-free, for needed services like health or childcare.

Example: Employee John earning $60,000 allocates $4,000 of salary to cover health care costs through a cafeteria plan. John is taxed on $56,000; the $4,000 is tax-free. Had John taken the full $60,000 and paid $4,000 of health care costs directly, he would have paid tax on the full $60,000, probably with no offsetting medical expense deduction.

Besides saving employee income and social security taxes, salary diverted to cafeteria plan benefits isn't subject to social security tax on the employer. With a cafeteria plan, employees can choose from several levels of supplemental coverage or different benefits packages. These can be selected to help employees achieve personal goals or meet differing needs, such as health coverage (family, dental, vision), retirement income (401(k) plans) or specialized services (dependent care, adoption assistance, legal services (legal services amounts are taxable).

Careful planning and communication are the keys to the success of flexible compensation. Employees must fully understand their options to make the choices of greatest benefit to them and their families. Both employers and employees must fully understand the tax consequences of the various options.

Keeping Current on Benefit Plans

The government has certain requirements for qualified pension or profit-sharing plans, as well as for most health and welfare plans. It is essential for you to stay current on developments that may affect your plan. Even small changes in tax laws can have a significant impact on your plan's ability to help you and your employees achieve your goals. Information on these requirements is available from the IRS and from qualified accountants and financial advisors.

Communications

Once you've implemented a benefits program, you'll want to tell your employees about it. Good communication is important in enabling employees to use the plan effectively and to appreciate the role of benefits in their total compensation.

Benefits orientation should be part of the orientation of a new employee. You can use newsletters, staff memos or employee meetings with audiovisuals to announce plan changes or answer employees' questions.

Planning Pointers

Before you implement any benefit plan, you should ask yourself some questions:

- How much are you willing to pay for this coverage?
- What kinds of benefits interest your employees? Do you want employee input?
- What do you think a benefits plan should accomplish? Do you think it is more important to protect your employees from economic hardship now or in the future?
- Is a good medical plan more important than a retirement plan?
- Do you want to administer the benefits plan, or do you want the administration done by an insurance carrier?
- What is your employee group like today? Can you project what it might look like in the future?

You now have some basic benefits information as well as the basic questions that need answers before you go benefit shopping for your employees.

> If you are serious about offering your employees a satisfactory benefit plan, the next step may be to contact an insurance broker or carrier, the local chamber of commerce or trade associations. There may be off the shelf products that will suit your needs. A benefit consultant or actuary can help you design a specialized benefit program.

An adequate benefit program has become essential to today's successful business, large or small. With careful planning, you and your employees can enjoy good health and retirement protection at a cost your business can afford.

Document Locator System: A Handy Aid For Keeping Track of Your Records

Are you able to locate insurance contracts, wills, and other important personal records quickly and easily? With this simple document locator system, you no longer need to wonder where to file a paper or where to find it.

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The Document Locator System

Most people have no idea where to start searching for their important records. They usually keep them scattered in various locations - tax records in a file cabinet, savings bonds in a home safe, wills at an attorney's office, some contracts or deeds in a bank safe deposit box.

There's a reason many people do not have an organized recordkeeping system: Organizing your records is stressful and confusing.

The Document Locator System is effective because it takes away that stress and confusion. This simple recordkeeping system provides an easy way to keep track of your important personal (not business) records, keeping them organized and available. You will not miss out on a tax deduction because you did not keep the necessary receipt. More importantly, the document locator system will help a spouse or executor locate your documents in case of death or disability.

Set Up Tabbed Sections

Set up tabbed sections in your files with the following captions (customizing sections as appropriate to your particular situation):

1. Banking
2. Children
3. Credit and Loans
4. Employment
5. Estate Planning [including wills and post-mortem matters]
6. Important Personal
7. Insurance
8. Investments
9. Major Assets
10. Professional Residences
11. Tax Records
12. Vehicles [including boats]

File the Documents

File the documents and other records listed in Column 1 in the file sections recommended in Column 2 of the Document Locator. Where the original or a copy is filed elsewhere, note this location in Column 3 of the Document Locator. You can also use Column 3 for any notes regarding the document (such as Passport - "Renew by October 12, 2022" or IRA - "Take first distribution by December 31, 2022"). Where your filing system suggests a file section other than that recommended in Column 2, just substitute your location for the recommended one. For items other than those named here, use the blank spaces at the end of the Locator.

This Document Locator is shown at the end of this Financial Guide.

Put a photocopy of the Document Locator, which will contain the locations of all your important documents, in a fireproof safe or safe deposit box.

In addition to the Document Locator System, prepare a post-mortem letter to a spouse or executor. This is also an essential part of helping your heirs and family members get your affairs in order in the event of death or disability. The purpose of such a letter is to provide them with the information needed to locate records or assets. This will prevent erosion of your estate by unnecessary taxes, unfounded claims, or just plain loss of assets.

The key is to develop and follow some type of recordkeeping system, not necessarily the one recommended here. If you have any questions, contact your financial advisor.

Cull your records every so often. By getting rid of the papers you no longer need, you minimize the ever-encroaching mountains of paper we all have to handle.

Documents You Should Be Able To Locate Easily

Certain documents, records, and other information should be easily locatable in an emergency. These include (1) your personal records, (2) a list of your assets, (3) your estate planning records, and (4) your financial records.

Personal Records

- Birth certificates of family members
- Death certificates of deceased family members
- Marriage license
- Divorce decree and custody agreement (if divorced)
- Passports (updated)
- Social Security numbers for family members
- The names and addresses of family members, close relatives, and any persons mentioned in a will
- Military records
- List of previous employers
- List of government employers
- Medical records and health insurance cards for family members

In most cases, the reason these documents are needed is self-explanatory.

List of Your Assets

- Description of all major assets that you own separately or jointly with your spouse or other person, together with the approximate values and location of deeds, titles, stock certificates, or other evidence of ownership.

  Include cash, realty, investments, IRAs, retirement plan benefits, life insurance policies, interests in partnerships or other business entities, jewelry and other luxury items, automobiles, boats, antiques, coin collections, collectibles, art objects, and debts owed to you by others.

- Appraisals of valuable items
- Description of the approximate amounts of pension, military, and/or other benefits you or your spouse may be entitled to on retirement or death
- Insurance policies (including group life, individual life, health, casualty, auto, etc.) and identity and phone numbers of insurance agents

Estate Planning Records

- The whereabouts of your will and codicils, along with the name and address of the attorney who prepared them
- Title to cemetery plot or other burial arrangement
- Post-mortem letter to spouse or family members, to be opened after your death
- Living will or other directions in case of disability

Financial and Other Records

- Location of all safe deposit boxes, keys, and passwords
- Important canceled checks
- The names and addresses of your CPA, attorney, and any other professionals concerned with your financial affairs
- Photographic or video record of house and its contents (for homeowners' insurance purposes)
- One statement for each bank account, IRA, mutual fund, broker, or other account you own, along with the name and telephone number of the primary banker, broker, or other contact person for each account
- Brokers' confirmation slips for purchases
- A statement or other reference for any bank account that is not in your name
- One statement or payment stub for each credit card, line of credit, or outstanding loan
- Income tax returns for at least six prior years (including all supporting records for the past six years), and all prior gift tax returns

- Records showing the original cost of any realty owned, cost of all improvements that can be added to tax basis, and depreciation taken (for business or rental property)
- Bills of sale or receipts for major items
- Equipment and appliance manuals and warranty information

Where to File What

Document Locator		
DOCUMENT	**WHERE TO FILE**	**OTHER LOCATION/NOTES**
Accident reports	Insurance	
Adoption records	Important Personal and/or Children	
Accountant	Professionals	
Address book	Important Personal	
Alimony records	Tax Records	
Apartment - records for	Residences	
Annuity	Investments	
Antiques	Major Assets	
Appliances - receipts, warranties, and contracts for	Major Assets	
Appraisals of assets	Major Assets	
Assets - list of	Major Assets	
Attorney	Professionals and/or Estate Planning	

Auto insurance	Vehicles and/or Insurance	
Auto loans	Credit and Loans	
Auto mileage logs	Tax Records	
Automobile title	Vehicles	
Bank account statements	Banking	
Bills of sale	Major Assets	
Birth certificates	Important Personal and/or Children	
Boat insurance	Insurance	
Boat records	Vehicles	
Broker account statements	Investments	
Business interests	Investments	
Canceled checks - general	Banking	
Canceled checks - insurance	Insurance	
Canceled checks - tax related	Tax Records	

Casualty loss records	Insurance	
CD	Banking and/or Investments	
Cemetery plot	Estate Planning	
Charitable gifts	Tax Records	
Checking account statements	Banking	
Child support papers	Important Personal and/or Children	
Claims - insurance	Insurance	
Coin collection	Major Assets	
Collections	Major Assets	
Confirmation slips - from broker	Investments	
CPA	Professionals	
Credit cards - list of	Credit and Loans	
Credit card statements	Credit and Loans	
Credit report - from credit reporting agency	Credit and Loans	
Credit union papers	Banking and/or Credit and Loans	

Custody agreement	Important Personal and/or Children	
Day care records	Children	
Death benefits	Employment	
Death certificate	Important Personal	
Debts owed to you	Investments	
Debts you owe	Credit and Loans	
Deeds to homes	Residences	
Disability insurance	Insurance	
Dividends - records of	Investments	
Divorce decree	Important Personal	
Doctors	Professionals	
Dues - professional or union	Tax Records	
Employee benefits - description of	Employment	
Employers - list of	Employment	
Equipment - business use of	Tax Records	

Equipment - warranties for	Major Assets	
Expenses	Tax Records	
Fees - deductible	Tax Records	
Financial statement - your personal	Credit and Loans	
Forms - tax	Tax Records	
Funeral arrangements	Estate Planning	
Furs	Major Assets	
Gifts - taxable	Tax Records	
Government employers - list of	Employment	
Health insurance	Insurance	
Home - contents of, photographic records	Insurance	
Home office	Tax Records	
Home improvements	Residences	
Inherited property - record of basis	Residences	
Insurance policies	Insurance	

Interest - record of	Residences and/or Tax Records	
IRA	Banking	
Jewelry	Major Assets	
K-1 Forms	Tax Records	
Safe deposit box keys	Banking	
Lawyers	Professionals and/or Estate Planning	
Lease - home	Residences	
License - driver's	Vehicles	
Life insurance policies	Insurance	
Limited partnership documents	Investments	
List of assets	Major Assets	
List of automobiles	Vehicles	
List of bank accounts	Banking	
List of brokerage accounts	Investments	
List of children's schools	Children	
List of credit cards	Credit and Loans	
List of debts	Credit and Loans	

List of employers - government and private	Employers	
List of home improvements	Residences	
List of life insurance policies	Insurance	
List of safe deposit boxes	Banking	
Living will	Important Personal	
Loans - list of	Credit and Loans	
Maintenance of appliances	Major Assets	
Marriage certificate	Important Personal	
Medical expenses	Tax Records	
Medical professionals	Professionals	
Mileage logs - expenses	Tax Records	
Military discharge	Important Personal	
Military employers	Employment	
Mortgage note	Residences	

Mortgage payments and yearly statement	Residence and/or Tax Records	
Moving expense	Tax Records	
Mutual funds	Investments	
Naturalization papers	Important Personal	
Owner's manuals	Vehicles and/or Major Assets	
Partnership statements	Tax Records	
Passports	Important Personal	
Paycheck stubs	Employment	
Pets	Important Personal	
Pension benefits - description	Employment	
Photos of family members	Important Personal	
Photos of home contents	Insurance	
Properties owned - list of	Residences	
Property damage - records	Insurance	

Prospectuses	Investments	
Real estate owned	Residences	
Real estate taxes	Residences and/or Tax Records	
Registration	Vehicles	
Rent - records of	Residences	
Residence closing - records of	Residences	
Retirement accounts	Investments	
Safe deposit boxes	Banking	
Savings accounts	Banking	
Schools - list of	Children	
Service - military	Employment and/or Important Personal	
Social Security numbers	Important Personal	
Stock certificates	Investments	
Survivors' benefits-descriptions	Employment	
Tax returns and forms	Tax Records	

Traffic tickets	Vehicles	
Titles to vehicles	Vehicles	
Travel expenses	Tax Records	
Trust documents	Estate Planning	
Unemployment compensation	Employment	
Vacation home	Residences	
W-2 forms	Tax Records	
Warranties	Major Assets	
Wills	Estate Planning	

The Home-Based Business: Some Basics You Should Consider

This Financial Guide reviews some of the special considerations of the home-based business.

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More than 52 percent of businesses today are home-based. Every day, people are striking out and achieving economic and creative independence by turning their skills into dollars. Garages, basements, and attics are being transformed into the corporate headquarters of the newest entrepreneurs - home-based businesspeople.

And, with technological advances in smartphones, tablets, and iPads as well as a rising demand for "service-oriented" businesses, the opportunities seem to be endless.

This Financial Guide discusses some of the **basics** you should consider in starting a home-based business. It does not attempt to cover all aspects of home-based businesses, but rather, addresses the general requirements of what's needed to start up a business in your home.

Is a Home-Based Business Right for You?

Choosing a home business is like choosing a spouse or partner: Think carefully before starting the business. Instead of plunging right in, take the time to learn as much about the market for any product or service as you can. Before you invest any time, effort, and money take a few moments to answer the following questions:

- Can you describe in detail the business you plan on establishing?
- What will be your product or service?
- Is there a demand for your product or service?
- Can you identify the target market for your product or service?
- Do you have the talent and expertise needed to compete successfully?

Before you dive head first into a home-based business, it's essential that you know why you are doing it and how you will do it. To succeed, your business must be based on something greater than a desire to be your own boss: an honest assessment of your own personality, and understanding of what's involved, and a lot of hard work. You have to be willing to plan ahead, and then make improvements and adjustments along the road. While there are no "best" or "right" reasons for starting a home-based business, it is vital to have a very clear idea of what you are getting into and why. Ask yourself these questions:

- Are you a self-starter?
- Can you stick to business if you're working at home?
- Do you have the necessary self-discipline to maintain schedules?
- Can you deal with the isolation of working from home?

Working under the same roof that your family lives under may not prove to be as easy as it seems. It is important that you work in a professional environment; if at all possible, you should set up a separate office in your home. You must consider whether your home has enough space for a business and whether you can successfully run the business from your home.

Compliance with Laws and Regulations

A home-based business is subject to many of the same laws and regulations affecting other businesses and you will be responsible for complying with them. There are some general areas to watch out for, but be sure to consult an attorney and your state department of labor to find out which laws and regulations will affect your business.

Zoning

Be aware of your city's zoning regulations. If your business operates in violation of them, you could be fined or closed down.

Restrictions on Certain Goods

Certain products may not be produced in the home. Most states outlaw home production of fireworks, drugs, poisons, sanitary or medical products, and toys. Some states also prohibit home-based businesses from making food, drink, or clothing.

Registration and Accounting Requirements

You may need the following:

- Work certificate or a license from the state (your business's name may also need to be registered with the state)
- Sales tax number
- Separate business telephone
- Separate business bank account

If your business has employees, you are responsible for withholding income, social security, and Medicare taxes, as well as complying with minimum wage and employee health and safety laws.

Planning Techniques

Money fuels all businesses. With a little planning, you'll find that you can avoid most financial difficulties. When drawing up a financial plan, don't worry about using estimates.

The process of thinking through these questions helps develop your business skills and leads to solid financial planning.

> **Related Guide:** For guidance on setting up a business plan, please see the Financial Guide BUSINESS PLANS: How To Prepare An Effective One.

Estimating Start-Up Costs

To estimate your start-up costs, include all initial expenses such as fees, licenses, permits, telephone deposit, tools, office equipment and promotional expenses.

Business experts say you should not expect a profit for the first eight to 10 months, so be sure to give yourself enough of a cushion if you need it.

Projecting Operating Expenses

Include salaries, utilities, office supplies, loan payments, taxes, legal services and insurance premiums, and don't forget to include your normal living expenses. Your business must not only meet its own needs but make sure it meets yours as well.

Projecting Income

It is essential that you know how to estimate your sales on a daily and monthly basis. From the sales estimates, you can develop projected income statements, break-even points, and cash-flow statements. Use your marketing research to estimate initial sales volume.

Determining Cash Flow

Working capital--not profits--pays your bills. Even though your assets may look great on the balance sheet, if your cash is tied up in receivables or equipment, your business is technically insolvent. In other words, you're broke.

Make a list of all anticipated expenses and projected income for each week and month. If you see a cash-flow crisis developing, cut back on everything but the necessities.

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Remember, preparation is the foundation of success. Learn how to strengthen your home-based business. Success doesn't just happen--you have to make it happen.

Financial Planning Tips For Business Owners

- 1. Employee Stock Plans
- 2. Succession Plan
- 3. LLC and LLP Ownerships
- 4. Avoid Nondeductible Compensation
- 5. Purchase Corporate Owned Life Insurance
- 6. SIMPLE Retirement Plan
- 7. Keogh Retirement Plan
- 8. Section 179 Expensing
- 9. Deduct Health Insurance Premiums
- 10. Review Compensations
- 11. Don't Overlook Minimum Retirement Distributions
- 12. Don't Double Up Retirement Distributions
- 13. Filing Requirements
- 14. Roth IRAs
- 15. Jointly or Separately?
- 16. Hobby Loss Rules
- 17. Post-Death Planning
- 18. Child Tax Credit

1. Consider establishing an employee stock ownership plan (ESOP).

If you own a business and need to diversify your investment portfolio, consider establishing an ESOP. ESOP's are the most common form of employee ownership in the U.S. and are used by companies for several purposes, among them motivating and rewarding employees and being able to borrow money to acquire new assets in pretax dollars. In addition, a properly funded ESOP provides you with a mechanism for selling your shares with no current tax liability. Consult a specialist in this area to learn about additional benefits.

2. Make sure there is a succession plan in place.

Have you provided for a succession plan for both management and ownership of your business in the event of your death or incapacity? Many business owners wait too long to recognize the benefits of making a succession plan. These benefits include ensuring an orderly transition at the lowest possible tax cost. Waiting too long can be expensive from a financial perspective (covering gift and income taxes, life insurance premiums, appraiser fees, and legal and accounting fees) and a nonfinancial perspective (intra-family and intra-company squabbles).

3. Consider the limited liability company (LLC) and limited liability partnership (LLP) forms of ownership.

These entity forms should be considered for both tax and non-tax reasons.

4. Avoid nondeductible compensation.

Compensation can only be deducted if it is reasonable. Recent court decisions have allowed business owners to deduct compensation when (1) the corporation's success was due to the shareholder-employee, (2) the bonus policy was consistent, and (3) the corporation did not provide unusual corporate prerequisites and fringe benefits.

5. Purchase corporate owned life insurance (COLI).

COLI can be a tax-effective tool for funding deferred executive compensation, funding company redemption of stock as part of a succession plan and providing many employees with life insurance in a highly leveraged program. Consult your insurance and tax advisers when considering this technique.

6. Consider establishing a SIMPLE retirement plan.

If you have no more than 100 employees and no other qualified plan, in 2022, you may set up a Savings Incentive Match Plan for Employees (SIMPLE) into which an employee may contribute up to $14,000 per year if you're under 50 years old and $17,000 a year, if you're over 50. As an employer, you are required to make matching contributions. Talk with a benefits specialist to fully understand the rules and advantages and disadvantages of these accounts.

7. Establish a Simplified Employee Pension (SEP) IRA or Individual 401(k) Plan before December 31st.

If you are self-employed and want to deduct contributions to a new retirement plan for this tax year, you must establish the plan by December 31st. You don't actually have to put the money into your retirement account until the due date of your tax return (generally April 15). Consult with a specialist in this area to ensure that you establish a retirement plan that maximizes your flexibility and your annual contributions.

8. Section 179 expensing.

Businesses may be able to expense up to $1,080,000 in 2022 for equipment purchases of qualifying property placed in service during the filing year, instead of depreciating the expenditures over a longer time period. The limit is reduced by the amount by which the cost of Section 179 property placed in service during the tax year 2022 exceeds $2,700,000.

9. Don't forget deductions for health insurance premiums.

If you are self-employed or are a partner or a 2-percent S corporation shareholder-employee you may deduct 100 percent of your medical insurance premiums for yourself and your family as an adjustment to gross income. The adjustment does not reduce net earnings subject to self-employment taxes, and it cannot exceed the earned income from the business under which the plan was established. You may not deduct premiums paid during a calendar month in which you or your spouse is eligible for employer-paid health benefits.

10. Review whether compensation may be subject to self-employment taxes.

If you are a sole proprietor, an active partner in a partnership, or a manager in a limited liability company, the net earned income you receive from the entity may be subject to self-employment taxes.

11. Don't overlook minimum distributions at age 72 and rack up a 50 percent penalty.

The Further Consolidated Appropriations Act, 2020, which went into effect on January 1, 2020, included the SECURE (Setting Every Community Up for Retirement) Act and increased the age for required minimum distributions (RMDs) to the year a taxpayer turns age 72. In prior years, minimum distributions were generally required at age 70 1/2. Now, these minimum distributions from qualified retirement plans and IRAs must begin by April 1 of the year after the year in which you reach age 72. The amount of the minimum distribution is calculated based on your life expectancy or the joint and last survivor life expectancy of you and your designated beneficiary. If the amount distributed is less than the minimum required amount, an excise tax equal to 50 percent of the amount of the shortfall is imposed.

12. Don't double up your first minimum distributions and pay unnecessary income and excise taxes.

You are allowed to delay the first distribution until April 1 of the year following the year you reach age seventy-two. In subsequent years, the required distribution must be made by the end of the calendar year. This creates the potential to double up in distributions in the year after you reach age 72. This double-up may push you into higher tax rates than normal. In many cases, this pitfall can be avoided by simply taking the first distribution in the year in which you reach age 72.

13. Don't forget filing requirements for household employees.

Employers of household employees must withhold and pay social security taxes annually if they paid a domestic employee more than $2,400 a year in 2022. Federal employment taxes for household employees are reported on your individual income tax return (Schedule H, Form 1040). To avoid underpayment of estimated tax penalties, employers will be required to pay these taxes for domestic employees by increasing their own wage withholding or quarterly estimated tax payments. Although the federal filing is now required annually, many states still have quarterly filing requirements.

14. Consider funding a nondeductible regular or Roth IRA.

Although nondeductible IRAs are not as advantageous as deductible IRAs, you still receive the benefits of tax-deferred income. One way to do this is to convert a traditional IRA to a ROTH IRA. You can withdraw all or part of the assets from a traditional IRA and reinvest them (within 60 days) in a Roth IRA. The amount that you withdraw and timely contribute (convert) to the Roth IRA is called a conversion contribution.

If properly (and timely) rolled over, the 10 percent additional tax on early distributions will not apply. However, a part or all of the distribution from your traditional IRA may be included in gross income and subjected to ordinary income tax. You can roll over all or part of the withdrawal into a Roth IRA; however, any amounts that you do not roll over will generally be taxable (except for the part that is a return of nondeductible contributions) income and may be subject to the 10 percent additional tax on early distributions.

15. Calculate your tax liability as if filing jointly and separately.

In certain situations, filing separately may save money for a married couple. If you or your spouse is in a lower tax bracket or if one of you has large itemized deductions, filing separately may lower your total taxes. Filing separately may also lower the phase-out of itemized deductions and personal exemptions, which are based on adjusted gross income. When choosing your filing status, you should also factor in the state tax implications.

16. Avoid the hobby loss rules.

If you choose self-employment over a second job to earn additional income, avoid the hobby loss rules if you incur a loss. The IRS looks at a number of tests, not just the elements of personal pleasure or recreation involved in the activity.

17. Review your will and plan ahead for postmortem tax strategies.

A number of tax planning strategies can be implemented soon after death. Some of these, such as disclaimers, must be implemented within a certain period of time after death. A number of special elections are also available on a decedent's final individual income tax return. Also, review your will as the estate tax laws are in flux and your will may have been written with differing limits in effect. In 2022, estates of $12,060,000 (up from $11,700,000 in 2021) are exempt from the estate tax with its 40 percent maximum tax rate (made permanent starting in tax year 2013).

18. Check to see if you qualify for the Child Tax Credit.

For tax years 2018 through 2025, the child tax credit increases to $2,000 per child, up from $1,000 in 2017, thanks to the passage of the TCJA. The enhanced child tax credit, which was made permanent by the Protecting Americans from Tax Hikes Act of 2017 (PATH), remains under TCJA. The refundable portion of the credit increases from $1,000 to $1,400 so that even if taxpayers do not owe any tax, they can still claim the credit. Under TCJA, a $500 nonrefundable credit is also available for dependents who do not qualify for the child tax credit (e.g., dependents age 17 and older).

The "SIMPLE" Plan: A Retirement Plan for the Really Small Business

Several different types of retirement plan - 401(k), defined benefit, and profit-sharing - can be made to suit a prosperous small business or professional practice. But if yours is a really small business such as a home-based, start-up, or sideline business, maybe you should consider adopting a SIMPLE IRA plan.

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A SIMPLE IRA plan is a type of retirement plan specifically designed for small business and is an acronym for "Savings Incentive Match Plans for Employees." SIMPLE IRA plans are intended to encourage small business employers to offer retirement coverage to their employees but work just as well for self-employed persons without employees.

SIMPLE IRA plans contemplate contributions in two steps: first by the employee out of salary, and then by the employer, as a "matching" contribution (which can be less than the employee contribution). Where SIMPLE IRA Plans are used by self-employed persons without employees - as IRS expressly allows - the self-employed person is contributing both as employee and employer, with both contributions made from self-employment earnings.

One form of SIMPLE IRA plan allows employer contributions without employee contributions. The ceiling on contributions, in this case, makes this SIMPLE IRA Plan option unattractive for self-employed individuals without employees.

To establish a SIMPLE IRA Plan you:

- Must have 100 or fewer employees.
- Cannot have any other retirement plans.
- Employees must earn $5,000 a year.

And, here is a quick list of pros and cons:

- Plan is not subject to the discrimination rules that everyday 401(k) plans are.
- Employees are fully vested in all contributions.
- Straightforward benefit formula allows for easy administration.
- Optional participant loans and hardship withdrawals add flexibility for employees.
- No other retirement plans can be maintained.
- Withdrawal and loan flexibility adds administrative burden for the employer.

How Much You Can Put in and Deduct

Those with relatively modest earnings will find that a SIMPLE IRA Plan lets them contribute (invest) and deduct more than other plans. With a SIMPLE IRA Plan, you can put in and deduct some or all of your self-employed business earnings. The limit on this "elective deferral" is $14,000 in 2022 ($13,500 in 2021).

If your earnings exceed that limit, you could make a modest further deductible contribution - specifically, your matching contribution as an employer. Your employer contribution would be three percent of your self-employment earnings, up to a maximum of the elective deferral limit for the year. So employee and employer contributions for 2022 can't total more than $28,000 ($14,000 maximum employee elective deferral, plus a maximum $14,000 for the employer contribution.)

Catch up contributions. Owner-employees age 50 or over can make a further deductible "catch up" contribution as employee of $3,000 in 2022 (same as 2021).

> An owner-employee age 50 or over in 2022 with self-employment earnings of $40,000 could contribute and deduct $14,000 as employee plus an additional $3,000 employee catch up contribution, plus a $1,200 (3 percent of $40,000) employer match, for a total of $18,200.

Low-income owner-employees in SIMPLE IRA Plans may also be allowed a tax credit up to $2,000 in 2022 for single filers ($4,000 married filing jointly). This is known as the "Saver's Credit" and income in 2022 must not be more than $68,000 for married filing jointly, $34,000 for singles and $51,000 for heads of household.

SIMPLE IRA plans are an excellent choice for home-based businesses and ideal for full-time employees or homemakers who make a modest income from a sideline business.

If living expenses are covered by your day job (or your spouse's job), then you would be free to put all of your sideline earnings, up to the ceiling, into SIMPLE IRA plan retirement investments.

An individual 401(k) plan, however, could allow you to contribute more, often much more, than SIMPLE IRA Plan. For example, if you are less than 50 years old with $50,000 of self-employment earnings in 2022, you could contribute $14,000 to your SIMPLE IRA PLAN plus an additional 3 percent of $50,000 as an employer contribution, for a total of $15,000. A 401(k) plan would allow a $33,000 contribution.

With $100,000 of earnings, the total for a SIMPLE IRA Plan would be $17,000 and $45,500 for a 401(k).

Withdrawal: Easy, but Taxable

There's no legal barrier to withdrawing amounts from your SIMPLE IRA Plan, whenever you please. There can be a tax cost, though: Besides regular income tax, the 10 percent penalty tax on early withdrawal (generally, withdrawal before age 59 1/2) rises to 25 percent on withdrawals in the first two years the SIMPLE IRA Plan is in existence.

A SIMPLE IRA Plan

A SIMPLE IRA Plan really is a "simple" plan to set up and operate than most other plans. Contributions go into an IRA that you set up. Those already familiar with IRA rules investment options, spousal rights, and creditors' rights don't have a lot new to learn.

Requirements for reporting to the IRS and other agencies are negligible, at least for you, the self-employed person. Your SIMPLE IRA Plan's trustee or custodian, typically an investment institution, has reporting duties and the process for figuring the deductible contribution is a bit simpler than with other plans.

What's Not So Good about SIMPLE IRA Plans

Other types of retirement plans are often better than the SIMPLE IRA Plan once self-employment earnings become significant. Other not-so-good features include the following:

Because investments are through an IRA, you're not in direct control. You must work through a financial or other institution acting as trustee or custodian, and will in practice have fewer investment options than if you were your own trustee, as you could be in a Keogh. For many self-employed individuals, however, this won't be an issue. In this respect, a SIMPLE IRA Plan is like the SEP-IRA.

Other plans for self-employed persons allow a deduction for one year (say 2022) if the contribution is made the following year (2023) before the prior year's (2022) return is due (April 2023 or later with extensions). This rule applies to SIMPLE IRA Plans, for the matching (3 percent of earnings) contribution you make as an employer. But there's no IRS pronouncement on when the employee's portion of the SIMPLE IRA Plan is due where the only employee is the self-employed person. Those who want to delay contribution would argue that they have as long as it takes to compute self-employment earnings for 2022 (though not beyond the 2022 return due date, with extensions).

> The sooner your money goes in the plan, the longer it's working for you tax-free. So delaying your contribution isn't the wisest financial move.

You can't set up the SIMPLE IRA Plan after the year ends and still get a deduction for that year, as is allowed with SEPs. Generally, to make a SIMPLE IRA Plan effective for the year it must be set up by October 1 of that same year. A later date is allowed where the business is started after October 1. In this instance, the SIMPLE IRA Plan must be set up as soon thereafter as administratively feasible.

Then there's a problem if the SIMPLE IRA Plan is intended for a sideline business and you're already in a 401(k) plan in another business or as an employee. In this scenario, the total amount you can put into the SIMPLE IRA Plan and the 401(k) plan combined can't be more than $20,500 in 2022 or 6,500 if catch-up contributions are made to the 401(k) by one age 50 or over.

Here's an example: If someone who is less than age 50 puts $10,500 in her 401(k), they can't put more than $10,000 in her SIMPLE IRA Plan in 2022. The same limit applies if you have a SIMPLE IRA Plan while also contributing as an employee to a "403(b) annuity" (typically for government employees and teachers in public and private schools).

How to Get Started in a SIMPLE IRA Plan

You can set up a SIMPLE IRA Plan on your own by using IRS Form 5304-SIMPLE, *Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) - Not for Use With a*

Designated Financial Institution, or Form 5305-SIMPLE, *Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) - for Use With a Designated Financial Institution*, but most people turn to financial institutions to take care of the paperwork for them. SIMPLE IRA Plans are offered by the same financial institutions that offer IRAs and 401(k) plans.

You can expect the institution to give you a plan document (approved by IRS or with approval pending) and an adoption agreement. In the adoption agreement, you will choose an "effective date," which is the beginning date for payments out of salary or business earnings. Remember, that date can't be later than October 1 of the year you adopt the plan, except when a business is formed after October 1.

Another key document is the Salary Reduction Agreement, which briefly describes how money goes into your SIMPLE IRA Plan. You need such an agreement even if you pay yourself business profits rather than salary.

Printed guidance on operating the SIMPLE IRA Plan may also be provided. You will also be establishing a SIMPLE IRA Plan account for yourself as a participant.

Keoghs, SEPs and SIMPLE IRA Plans Compared For 2022

Keogh	**SEP**	**SIMPLE IRA PLAN**
Plan type: Can be defined benefit or defined contribution (profit-sharing or money purchase)	Defined contribution only	Defined contribution only

Owner may have two or more plans of different types, including a SEP, currently or in the past	Owner may have SEP and Keoghs	Generally, SIMPLE IRA PLAN is the only current plan
Plan must be in existence by the end of the year for which contributions are made	Plan can be set up later - if by the due date (with extensions) of the return for the year contributions are made	Plan generally must be in existence by October 1st of the year for which contributions are made
Dollar contribution ceiling (for 2022): $61,000 for defined contribution plan; no specific ceiling for defined benefit plan	$61,000	$27,000
Percentage limit on contributions: 50% of earnings, for defined contribution plans (100% of earnings after contribution). Elective deferrals in 401(k) not subject to this limit. No	50% of earnings (100% of earnings after contribution). Elective deferrals in SEPs formed before 1997 not subject to this limit.	100% of earnings, up to $14,000 for 2022 for contributions as employee; 3% of earnings, up to $14,000 for

percentage limit for defined benefit plan.		contributions as employer
Deduction ceiling: For defined contribution, lesser of $61,000 or 20% of earnings (25% of earnings after contribution). 401(k) elective deferrals not subject to this limit. For defined benefit, net earnings.	Lesser of $61,000 or 20% of earnings (25% of earnings after contribution). Elective deferrals in SEPs formed before 1997 not subject to this limit.	Maximum contribution $14,000 (in 2022)
Catch up contribution 50 or over: Up to $6,500 in 2022 for 401(k)s	Same for SEPs formed before 1997	Half the limit for Keoghs, SEPs (up to $3,000 in 2022)
Prior years' service can count in computing contribution	No	No
Investments: Wide investment opportunities. Owner may directly control investments.	Somewhat narrower range of investments. Less direct control of investments.	Same as SEP
Withdrawals: Some limits on withdrawal before retirement age	No withdrawal limits	No withdrawal limits

Permitted withdrawals before age 59 1/2 may still face 10% penalty	Same as Keogh rule	Same as Keogh rule except penalty is 25% in SIMPLE IRA PLAN Plan's first two years
Spouse's rights: Federal law grants spouse certain rights in owner's plan	No federal spousal rights	No federal spousal rights
Rollover allowed to another plan (Keogh or corporate), SEP or IRA, but not a SIMPLE IRA PLAN.	Same as Keogh rule	Rollover after 2 years to another SIMPLE IRA PLAN and to plans allowed under Keogh rule
Some reporting duties are imposed, depending on plan type and amount of plan assets	Few reporting duties	Negligible reporting duties