focus

june/july 2008

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How can you make the most of Social Security?

As life expectancies grow, planning for retirement is more important than ever. For some people, Social Security will be a significant source of income. For others, it will make up a relatively small portion of their retirement funds. Either way, it pays to maximize the benefits.

The most important decision regarding Social Security is when to start collecting benefits. You can start as early as age 62 or as late as age 70.

Estimating your benefits

Your benefits are derived from a formula based on your earnings record at the time you start collecting. You can estimate the amount by consulting your annual Social Security statement or using an online calculator at socialsecurity.gov/planners/calculators.htm.

The amount also depends on whether you start collecting before or after your "normal" retirement age. Historically, that meant 65, but today it's scheduled to go as high as 67, depending on your year of birth. If you were born between 1943 and 1954, for example, normal retirement age is 66. If you were born after 1954, it increases in two-month increments for each year until it reaches 67, which is the normal retirement age for anyone born in 1960 or later.

Timing is everything

The ideal time to begin collecting Social Security benefits varies depending on your circumstances. But here are some general guidelines to consider:

Life expectancy. Once you start collecting Social Security benefits, you'll receive monthly checks for the rest of your life. The system is designed to provide you with about the same total benefits over your life expectancy, regardless of when you start collecting. If you start early, you'll receive a smaller check over a longer period of time. If you start late, you'll receive a larger check over a shorter period of time.

This assumes, of course, that you live to your actuarially determined life expectancy. If you have reason to believe that you'll live longer — a history of centenarians in your family, for example — then you might be wise to delay benefits and take the higher monthly amount. If, on the other hand, health problems or family history indicate a shorter lifespan, you may be better off collecting benefits as early as possible.

Other sources of income. If, once you retire, your other sources of retirement income won't be sufficient to meet your living expenses, then maximizing lifetime benefits shouldn't be your highest priority. Under those circumstances, you'll need to start collecting Social Security benefits early.

If you have several sources of retirement income to choose from, including Social Security, the analysis gets a bit more complicated. You'll need to consider a number of factors, including expected returns on your investments, the amount of your Social Security benefit at different ages, the potential tax implications of various strategies and minimum distribution requirements for IRAs and qualified retirement plans.

Career plans. If you plan to work after you become eligible for Social Security, the decision gets a little more complicated. Generally, unless

your compensation isn't enough to cover your living expenses, or you have reason to believe that you won't reach your life expectancy, it's best to delay Social Security benefits at least until the normal retirement age.

If you start collecting before you reach normal retirement age, your benefits will be reduced by $1 for every $2 you earn above a specified threshold ($13,560 in 2008). In the year you reach normal retirement age, benefits are reduced by $1 for every $3 you earn above a different threshold ($36,120 in 2008).

This reduction applies, however, only if you elect to begin taking benefits before the month in which you reach normal retirement age. Starting with that month, you can continue working without reducing your Social Security benefits.

Have a plan

Keep in mind that, if your income from a job is high enough, a portion of your Social Security benefits may be taxed. So, as you approach retirement, work with your financial advisors to design a strategy that makes the most of Social Security and your other retirement savings. ◈

Let's be reasonable

Setting salaries for S corporation owners

If your business is an S corporation, the way you characterize payments to owners who work in the business can have a significant tax impact. Failure to pay reasonable salaries to these shareholder-employees raises a red flag for the IRS. And if the agency reclassifies distributions of corporate profits as wages, you may be hit with a hefty bill for back payroll taxes, penalties and interest.

The issue

As a "pass-through" entity, an S corporation generally isn't subject to corporate income tax, at least at the federal level. Instead, its net income is passed through to its shareholders, who are taxed at their ordinary income tax rates.

At first glance, you might think it makes no difference whether you pay corporate earnings to shareholder-employees as wages or distributions. After all, shareholders are taxed on the corporation's net income whether it's distributed or not. Shareholder-employees are also taxed on their compensation, but the corporation deducts those amounts in calculating its net income. So, the tax result is the same whether a shareholder receives the money as salary or as a distribution of corporate profits, right? Not quite.

Although the result is the same for *income* tax purposes, there's a big difference when it comes to Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) tax purposes. That's because wages are subject to FICA and FUTA taxes, but S corporation income or distributions are not. And, unlike partners and sole proprietors, S corporation shareholders aren't subject to self-employment tax, which is designed to cover FICA and FUTA contributions.

(See “Adding it all up” for an example of how minimizing or eliminating shareholder salaries can produce substantial tax savings.)

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The challenge

Given the potential tax savings, it’s no surprise that many S corporations are tempted to pay little or no salaries to their executives. It’s also no surprise that the IRS doesn’t like it. If the IRS feels that shareholder-employee salaries are unreasonably low, it may reclassify some or all of their distributions as wages in an effort to collect unpaid FICA and FUTA taxes, plus penalties and interest.

It’s important, therefore, for S corporations to pay reasonable salaries to their shareholder-employees. But what’s reasonable? Unfortunately, there’s no mathematical formula for answering that question. Some companies use rules of thumb, such as characterizing payments as 60% salary and 40% distribution, or setting salaries as a percentage of corporate earnings or revenues. Rules of thumb are of limited value, though.

Consider a formula that sets an owner-CEO’s salary as 10% of gross revenues. Now suppose that the CEOs of competing businesses have similar qualifications and experience and put in the same number of hours each year. One corporation has $1 million in revenues, while the other corporation’s revenues are $2 million. Is it reasonable for the second CEO to earn twice as much as the first?

A better approach is to analyze each position on a case-by-case basis. Each company is different, and an employee’s value depends on a variety of factors, some tangible and some intangible. Some factors to consider include:

- The shareholder-employee’s role in the company, including position, number of hours and duties,
- Comparable salaries, based on compensation surveys and other industry data, as well as salaries paid by similar companies for similar services,
- The company’s size, growth history and financial condition, and
- Consistency between salaries paid to shareholders and nonshareholders.

For each shareholder-employee, you should document your methodology and the factors you relied on to establish a reasonable salary.

No guarantees

Determining a reasonable salary for an S corporation shareholder-employee is a judgment call, so there’s no way to “audit-proof” your salary decisions. But if you carefully analyze the relevant factors (other than tax savings) and document your thought process, you can minimize the risks of an IRS challenge. ◈

Adding it all up

Lucy is the sole shareholder and an employee of an S corporation. In 2008, the corporation’s net income is $100,000, all of which is distributed to her. If Lucy receives no salary, she’ll avoid Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes. FICA, which is paid by both the employer and the employee, consists of a 6.2% Social Security tax on wages up to $102,000 (in 2008) and a 1.45% Medicare tax. FUTA, which is paid by the employer only, is a 6.2% tax on the first $7,000 in wages.

If the IRS reclassifies $60,000 of distributions as salary, Lucy and the company will owe the following taxes, not including interest and penalties:

Company’s share of FICA:	$60,000 x 7.65% =	$4,590
Company’s FUTA taxes:	$ 7,000 x 6.2% =	$ 434
Lucy’s share of FICA:	$60,000 x 7.65% =	$4,590
Total:		$9,614

Note that the corporation can deduct its share of payroll taxes ($5,024), which, assuming that Lucy is in the 28% tax bracket, reduces her income taxes by $5,024 x 28%, or $1,406.72. Still, the reclassification results in a net tax increase of $9,614 – $1,406.72, or $8,207.28.

Managing your credit history

Like most people, you're probably well aware of the importance of managing your credit history to protect your standing among current and future lenders. What you may not know, however, is how to go about doing it.

Obtain your reports

Managing your credit history begins with requesting copies of your credit report annually. To cover your bases, make sure you get a credit report from all three major credit-reporting agencies:

- TransUnion (transunion.com),
- Equifax (equifax.com), and
- Experian (experian.com).

The Fair and Accurate Credit Transactions Act allows you to obtain one copy free of charge from each credit-reporting agency each year. You can order them online through the authorized central Web site: annualcreditreport.com. Consider spacing out report requests every four months (rather than requesting them all at once), so you're aware of any changes to your credit history throughout the year.

Look for misinformation

When you receive a credit report, review it carefully. Start by verifying your personal identification information. Creditors may make errors when entering your information for a credit or loan application.

Next, look for any inaccuracies or information that could drag down your credit score. Your credit score represents your creditworthiness and risk as determined by the credit bureaus. A poor score is typically anything under 525; an excellent rating is a score of 750 or higher. A poor score can result in creditors charging higher interest rates, imposing greater restrictions on loan amounts or even denying you the opportunity for loans altogether. When calculating a credit score, the bureaus typically review information pertaining to opening and closing of credit card and loan accounts, payment history, legal judgments, bankruptcy filings and tax liens.

To correct discrepancies, provide supporting documentation and a letter of explanation to all three credit agencies. Additionally, if you're billed for credit card charges you didn't make, dispute the charge within 60 days. Because the credit card company can't report unpaid charges to the credit bureaus for the next two billing cycles, disputed charges won't carry over to your credit history.

Defend your position

Habitually reviewing your monthly credit card statements can help you catch fraudulent activity, including identity theft. If you find your identity has been compromised, promptly:

Close the unauthorized account. Call the creditor and explain the situation. Then submit required forms — available through the Federal Trade Commission (ftc.gov) — via certified mail to report the theft and close the unauthorized account. Request a return receipt and letter from the creditor acknowledging the fraudulent claim and stating that the company has closed the account and relinquished you from the fraudulent debt. Keep the letter as proof of the creditor's action. Also report the theft to local law enforcement and obtain a copy of the police report.

Contact one of the three major credit bureaus. Request that the agency put a fraud alert on your credit file to require creditors to contact you before opening any new accounts in your name or making changes to your existing accounts. The agency you contact will then notify the other two agencies to place fraud alerts on your credit file.

Keep score

When it comes to protecting your credit standing, you need to actively get in the game and become your own scorekeeper. Reviewing your credit history regularly can help you catch errors and detect unauthorized activity that could impair your ability to obtain credit cards, loans and better interest rates in the future. ◈

Be the top dog: Use search engine optimization

In today's plugged-in business world, your customers have a plethora of Internet-based information search tools — commonly known as search engines — at their fingertips to quickly locate products and services.

In effect, the return on investment in your company's Web site depends largely on how quickly prospects can locate it when using these tools. In fact, according to the 2006 "iProspect Search Engine User Behavior Study" conducted by Jupiter Research, companies whose Web sites were returned among the top search results were perceived as top brands by 36% of search engine users. Knowing that, how can you get your business listed at the top of the search listings?

Topping the list

Search engine optimization is all about improving your business's Web site rankings among the different Internet search engines, such as Ask, Yahoo!, Google and MSN.

When prospects type keywords related to your business into a search engine, you want your Web site to appear among the top of the search results. Common goals, for instance, are to appear on the first page or in the first 10 results returned. But, to accomplish this, you need to know how search engines index the content on Web sites and the different ranking criteria they may use.

Common goals, for instance, are to appear on the first page or in the first 10 results returned.

Using a software program called a "spider," search engines "crawl" around the Web looking to index Web sites for ranking. When ranking sites, most search engines use basic criteria such as:

- Short, simple URLs (Web site addresses),
- An intuitive site map and easy site navigation,
- Relevant keywords in titles, text and underlying coding,
- Useful, quality content,
- A substantial number of links to the site from other relevant sites, and
- Clean, easy-to-interpret coding.

Note that search engines may vary in the weight or emphasis they place on the different ranking criteria. You can learn a lot about how each search engine ranks Web sites by checking their "Help" sections on their sites.

Turbocharging your strategy

If this sounds like a lot of work, it is. But luckily you can buy search optimization software to help you analyze the effectiveness of your site

against the commonly used site-ranking criteria and create more search-friendly Web pages.

Beware, though, that overloading your Web pages with, for example, irrelevant links to other sites or keyword references can have an adverse effect. A search engine may interpret this as "spamming" and penalize your site with a lower ranking — or even ban your site.

Another important function of search engine optimization software is that it can help you proactively submit your company's Web site to the various search engines rather than waiting for them to come to your site.

Paying attention

Maintaining top rankings for your company's Web site is an ongoing effort that requires regular attention. If you don't have a skilled

Webmaster or IT professional on staff, consider leveraging the help of an outside consultant with expertise in search engine optimization. ◈

3 ways to keep inventory under control

Inventory is expensive. In addition to the cost of purchasing or manufacturing it, there's a significant cost just to keep it on your shelves. The more inventory you have, the greater your expenses for transportation, storage, handling, insurance and financing. In some states, inventory is even subject to personal property tax.

Given these costs, excessive or obsolete inventory can be a big drain on your cash flow. Here are three ways to keep inventory (and your costs) under control:

1. Manage it. Techniques such as cycle counting and just-in-time inventory management can help ensure you maintain accurate counts — and retain only the inventory you need when you need it — while keeping excess inventory off the shelves. Use a good software application to help with your sales forecasting and inventory management needs.

2. Sell it. If you find yourself with too much inventory, consider selling the excess at a discount to a liquidator or scrap dealer. If you have sold at a loss, you can deduct the excess of your cost basis over the sales price on your income tax return. To qualify for the deduction, the sale must be "bona fide." That is, you can't hedge your bets by retaining the right to buy the inventory back at a discount. If you can't find a buyer, you can destroy the inventory and immediately deduct your cost.

3. Give it away. Another option is to donate inventory to charity. Ordinarily, your charitable deduction is limited to your cost basis in the property (or, if less, the property's market value). C corporations, however, are entitled to an enhanced deduction for donations that can be used to care for the ill, the needy or children. The deduction is limited to the inventory's cost basis plus 50% of any appreciation in value (but no more than 200% of cost). It's also subject to general limits on charitable deductions (10% of a C corporation's taxable income, for example).

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