Prepare Your Company for the End of the Year

by Leslie Shiner

The weather's getting colder — a sure sign that it's time to prepare your company for the close of the financial year. Ideally, you've been keeping up with at least some of the paperwork this involves all along — but if not, there's still time.

Too many contractors put off thinking about taxes until April, only to find they made an accounting mistake and don't have the funds they need to pay the government. You can avoid this situation by taking certain steps before the year is out.

Fix Your Financial Statements

If you're like most contractors, creating and reviewing financial statements is low on your list of priorities. But the IRS requires this information; you'll have to produce it sooner or later. If you prepare it soon enough, you can use it to manage your finances and, quite possibly, legally defer tax payments to a later year.

Haven't kept up with your paperwork? There's still time.

It all boils down to knowing whether or not you're making a profit, and if you are, how much. So you should begin by updating your financial statements and making sure that everything is correct.

Checking accounts. I had a client who accidentally entered the same $15,000 deposit twice in his check ledger. Since he reconciled his checking account only once or twice a year, it was some time before he caught the error. As a result, his income statement showed $15,000 too much income.

He was in a 35 percent tax bracket, so he ended up paying $5,250 in taxes on income that didn't exist. He eventually got this money back — but until then, the government had it, interest-free.

Accounts receivable. If you keep your books on an accrual basis, it's important to review your accounts receivable and make sure those amounts are actually collectible.

If you are not going to get paid for an invoice, write it off. That way, at least you won't have to pay taxes on money you'll never collect.

Accounts payable. I've seen many A/P lists with lots of old bills on them. Frequently the money is no longer due, because either the amount was accidentally entered twice or the bill was already paid (though not properly accounted for).

If you have old bills in A/P, clear them out so that you can correct your income statement. Just be aware that if you write off an old accounts-payable bill, you will have fewer expenses and more net profit — and therefore more taxes to pay.

Meet With Your CPA or Tax Preparer

Be sure to meet with your accountant or tax preparer no later than the middle of December. Together you should forecast your costs and income for the rest of the year and estimate your net income or taxable profit for the entire year. At that point you can ask your tax preparer what you can do to minimize your tax liability or defer all or part of it to a later year.

The taxes you defer will eventually have to be paid, but for most contractors it's better to have the money now to use in the business than it is to give it to the government any sooner than necessary.

Depreciation. Most contractors don't track depreciation throughout the year, even though the current year's depreciation can affect the amount of taxes they have to pay.

Ask your tax preparer to estimate how much depreciation you can write off this year, because it will be a factor in projecting your net taxable profit.

Time Your Purchases Correctly

You shouldn't buy things just to get deductions, but if there is something you really do need to buy, there may be some tax advantage in timing its purchase.

If your tax preparer knows what your income is likely to be, he or she will be able to tell you whether it makes more financial sense to make purchases before or after the end of the year.

This applies to all kinds of purchases. Perhaps you need to replace your truck or the office computers. Or maybe your trucks and equipment are due for an overhaul or major repairs. You might be running low on office supplies, or custom-printed forms and letterhead. Or, if you have the cash, you might want to prepay licenses, dues, or legal and accounting fees.

Keep in mind that the timing depends on whether you prepare your taxes on a cash or accrual basis.

For example, if you prepare them on a cash basis, you could reduce this year's taxes by paying January's rent in December. If you do them on an accrual basis, you could purchase something this year, pay for it next year, and still be able to deduct or depreciate it on this year's tax return.

Credit cards. Credit cards are a way for a cash-basis taxpayer to buy something and legally deduct it now, but pay for it next year. The IRS treats credit-card purchases as loans that can be deducted in the year they occur. (This applies only to third-party cards like Visa and MasterCard, not to the second-party store cards issued by individual vendors.)

As with any tax deduction, don't take it without first talking to your tax preparer and finding out what kind of documentation you're required to provide.

Cash flow. In some cases, cash flow will be the deciding factor in your year-end planning. One client of mine used to have a hard time pursuing year-end tax-saving strategies because he was always scrambling to come up with enough cash to make a down payment on his liability insurance. Finally, to avoid this problem, he purchased a six-month policy on January 1 and then switched back to a full-year policy on July 1.

Prepare Those 1099s Now

If you paid more than $600 to a subcontractor this year, you are required by law to send him a 1099 form by January 31st of next year.

Too many contractors wait until the last minute and then find that they neglected to get the sub's tax ID number. You are supposed to get this number in advance (before you pay the sub), but that doesn't always happen.

If you can't track down the sub and have to file 1099s without tax ID numbers, you could be subjected to substantial fines.

Consider Taking Money Out of the Business

Bonuses, dividends, profit-sharing plans, and 401(k)s are all ways to take money out of the company in such a way as to reduce or defer taxes. The amounts and methods of distribution depend on the type of company you are: sole proprietorship, partnership, subchapter S-corp, C-corp, or LLC.

However, you should never take money out of your company until you've laid the proper groundwork.

First, your income statement and balance sheet must be accurate and up-to-date; otherwise, you won't even know if you made a profit.

Second, you should be able to accurately project your cash flow, because you don't want to disburse money if it's going to put your company in a bind later on.

And finally, since the tax laws are very specific about how and when you can take money out, you should talk to your tax preparer before cutting yourself or anyone else a check.

I've seen contractors set up and fund profit-sharing plans only to discover that they'd done it all incorrectly. With better planning, the resulting paperwork and penalties could have been avoided.

Make Sure You're Getting Good Advice

If your CPA or tax preparer talks to you only once a year, waits for you to send in your financial statements in February or March, or does your taxes without asking any questions, then you may not be dealing with the right person.

A good CPA or tax preparer should be helping you all year long, should want to see your financial statements in the middle of the year, and should be interested in helping you plan for the end of the year.

Leslie Shiner *has worked as a financial and management consultant for more than 25 years. Her office is in Mill Valley, Calif.*

Get Paid Faster With Credit Cards

by Norm St. Onge

As a small-job contractor, I do everything from home repairs and seasonal maintenance to larger projects like decks and kitchen updates. A fair number of my customers are vacation-home owners whose primary residence is several hours away.

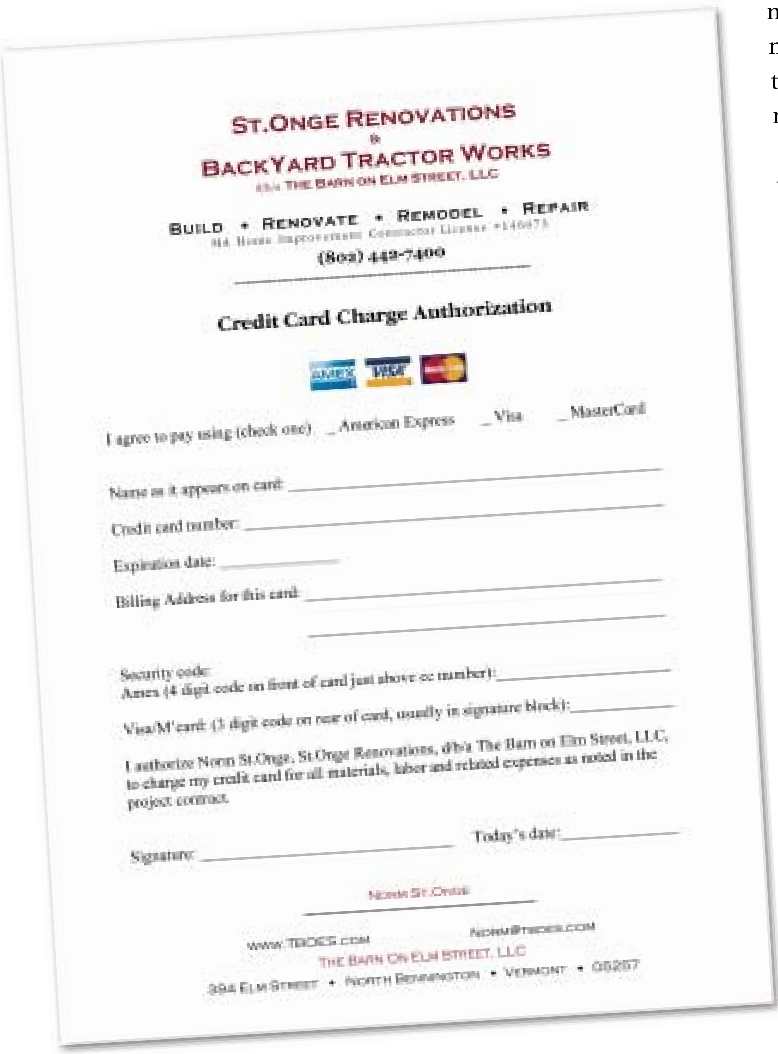
The traditional challenges of working with nonresident customers — material choices, status reports, and documentation — have largely been overcome with e-mail, faxes, and digital photos.

The only other major obstacle is getting deposits and payments in a timely fashion.

Typically, my vacation-home clients are around only on the weekends, so I'll generally stop by on a Saturday morning to discuss their project. Then I'll put together a tight proposal during my office time the following week and send a contract via e-mail or fax.

Unless there's some sort of crisis, I might not see the homeowners again for several months, so in addition to getting a signature on the contract, I get their credit-card number.

My contract has an addendum page where the customers provide the pertinent credit-card info; the page also contains a signature line authorizing me to charge their credit card for the work specified (see example, left).



St.Onge Renovations
&
BackYard Tractor Works
d/b/a The Barn on Elm Street, LLC

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(802) 442-7400

Credit Card Charge Authorization

I agree to pay using (check one) _ American Express _ Visa _ MasterCard

Name as it appears on card: __________

Credit card number: __________

Expiration date: __________

Billing Address for this card: __________

Security code:
Amex (4 digit code on front of card just above cc number): __________

Visa/M'card: (3 digit code on rear of card, usually in signature block): __________

I authorize Norm St.Onge, St.Onge Renovations, d/b/a The Barn on Elm Street, LLC, to charge my credit card for all materials, labor and related expenses as noted in the project contract.

Signature: __________ Today's date: __________

Norm St.Onge

www.TBOES.com Norm@TBOES.com
The Barn On Elm Street, LLC
394 Elm Street • North Bennington • Vermont • 05257

Big Benefits

I decided early on to accept credit cards simply because I wanted to make it as easy as possible for my customers to pay me.

Mail is slow — and seems that much slower if you're waiting for a check to arrive — and cash is impractical for large jobs. Depending on my schedule and where I'm working, I might have checks and cash in my briefcase for days before getting to the bank.

Once deposited, checks that don't bounce take several business days to clear. Before I started accepting credit cards, I generally had to wait 10 to 14 days after receiving a check for the money to be available in my account — longer if there was a problem with the check.

Floating several jobs with this scenario was nerve-racking, to say the least. That's why I now prefer credit-card transactions (though I still accept checks and cash). It's the fastest way to get paid — especially when the homeowner lives somewhere else.

While the ease of payment is certainly a big benefit for me, that's not necessarily what I emphasize when I discuss credit-card payments with the customers. Often, I describe using credit cards as a form of protection.

These people live hours away. They've just met me for the first time, and 15 minutes into the conversation I'm informing them that I need a sizable deposit to purchase materials and reserve time in my schedule. I can see the hesitation on their faces: They know that they're unlikely to have any recourse if I disappear once the check is cashed.

But if they pay by credit card, all it takes is one call to Visa or MasterCard to put the brakes on.

Repeat customers are more willing to give me a check, but I still encourage credit cards. I explain to them that for a small one-man shop like mine, cash flow is paramount; prompt payment keeps me in business.

How It Works

My credit-card process is fairly low-tech, but for the few transactions I do per month, it works perfectly — without running up the extra fees associated with card-swipe terminals, cellphone readers, and custom-printed signature slips.

If necessary, instead of the contract addendum I can use the old-school carbonless form; the customers' credit-card info can be written in by hand or I can make an imprint of the card using the trusty "knuckle-buster."

Both the card imprinter and the forms are provided to me free of charge by my service provider.

To process a charge, I call an 800 number and an automated voice guides me through the sequence, which involves entering the credit-card number, expiration date, and charge amount via the phone keypad. Within seconds I have an approval number — or, on the rare occasion, a "decline."

The beauty of this process is that it can be done from the customers' driveway via cellphone, if needed.

Payment is generally credited to my bank account within 24 to 48 business hours.

Fees

So all this must be expensive, right? Wrong. There are many payment processing firms and their fee structures vary greatly.

The basic service fee that I pay to accept both MasterCard and Visa is $10 per month (regardless of the number of transactions) plus a discount rate of approximately 2 percent (that is, $2 on a $100 charge is retained by the service provider).

Discount rates can also be called transaction fees or interchange rates, depending on the service provider.

I also accept American Express, which charges $15 per month and a 3 percent transaction fee.

Transaction fees change periodically; typically, the more transactions you process, the lower the fee.

Other variables that may affect your transaction fee are your type of business or industry and how a cardholder's information is taken. An Internet-based mail-order business often pays a higher rate than someone conducting face-to-face transactions.

Altogether, I process six or fewer transactions per month, and all of these fees are factored into my overhead — so I'm certainly not losing money in order to accept credit cards.

Safeguards

I keep copies of work-in-process contracts in my briefcase so that specific information about jobs is at my fingertips. However, I keep the contract addendum with the credit-card number and signature locked in my office file. The last thing I want to do is explain to my customers how their credit-card info was stolen from my truck.

Also, I don't treat the customers' credit card as a blank check.

If additional materials are required or a payment draw is scheduled, I always call or e-mail the homeowners before I make charges on their card. This provides them with a measure of control and gives those who use their credit cards extensively an opportunity to switch credit cards to avoid overcharges or to accumulate airline miles.

For a small one-man shop like mine, cash flow is paramount; prompt payment keeps me in business.

While I believe it's always wise to have the customer sign off on the original scope of work, change orders, and so on, this precaution takes on added importance when dealing with credit-card customers.

As mentioned earlier, one "dispute call" to Visa or MasterCard and the disputed charge is frozen. It's imperative that the lines of communication between me and the customers stay open and clear, and that my work is fully documented in case there is a dispute — I'll need all of the information at hand to present my case to the credit-card company.

I have never had a disputed charge, but I always have sufficient documentation just in case.

Getting Started

If you find yourself intrigued by the benefits of accepting credit-card payments, but you're unable to decide whether it's right for your company, look at your business and ask yourself the following questions:

- Do you spend more time than you would like chasing customers for payment?
- Do you have a higher-than-usual rate of bounced checks?
- Do you think you can tap into a new market or an enhanced demographic by accepting credit cards?
- Or do you just think that since even the fast-food joints are taking credit cards now, maybe you should, too?

If you answered "yes" to any of the first three questions, perhaps you should consider pursuing a low-tech, low-fee approach to accepting credit cards — as I have — just to see how the process works for you.

Your first step should be to talk to your bank. Chances are it's already working with a number of credit-card–processing companies and can point you in the right direction.

One word of caution: The number of optional services these companies offer can be dizzying. Just remember that optional services come at a price and can quickly add up to $100 a month if you're not careful.

***Norm St. Onge** owns St. Onge Renovations and BackYard Tractor Works in North Bennington, Vt.*