

Chart your course

William J. Healey III, CPA

72100 Magnesia Falls, Suite 4 • Rancho Mirage, CA 92270

(760) 320.2107 • FAX (760) 320.6428

bh@healeycpas.com • www.healeycpas.com

► **Inside this issue**

Retirement plan options
for your business **2**

Be prepared for Employee
Retention Credit audit by IRS **3**

Cash Flow Corner **3**

Unlocking customer buying motivations
can lead to higher profits **4**

Tax & Business letter

FALL
2023

Building a fortress balance sheet

Ironically, the worst time to ask a bank for a loan is when you need it! Building a fortress balance sheet long before your loan request is often just what you need to entice a bank to support your efforts.

The fortress balance sheet concept

What this means for your business is using banking analytics to develop a balance sheet your banker and other financial experts will love. Here are three concepts to use when developing your fortress balance sheet:

1.) Liquidity is key. Everything starts and ends with cash. A balance sheet heavy in items like unused equipment is tough to convert to cash. A fortress balance sheet goal is to have enough in current assets to pay short-term liabilities.

2.) Debt-to-equity ratio. The calculation is total liabilities divided by total equity. A fortress balance sheet has much more equity than debt. Your goal is to get this ratio under 1.0. When that happens, you have more equity than debt.

3.) Debt service coverage. Fortress balance sheets have enough cash to pay debt obligations and then some. Look at your earnings, then add back interest expense and non-cash items like depreciation. Next, take this number and divide it by your debt service payments. If this ratio is under one, you're in trouble. If this ratio is over two, you're in the blue!

Building your fortress

Here are some suggestions to keep you on a path toward building your own fortress balance sheet:

■ **Control inventory and receivables.** If these are properly managed, you won't need to add debt to help pay for other items.

■ **Pretend you're a bank.** Are your debt service ratios and debt-to-equity ratios improving? If not, consider lowering shareholder distributions to maintain a high equity balance. Lower the use of your line of credit and cut costs wherever possible.

■ **Get rid of non-performing assets.** This may mean consolidating locations, selling obsolete inventory, or getting rid of old equipment. Continually look at ways to convert these assets back into cash.

You'll know when you have developed a fortress balance sheet, as banks will start selling to you versus you selling them on lending you money! ♦





IRSTAX NOTES

IRS cautions businesses about Employee Stock Ownership Plan compliance

The IRS is warning businesses to be alert to a range of compliance issues associated with Employee Stock Ownership Plans (ESOPs). Over the next year, the IRS says it will use multiple strategies, including education, outreach, and audits, to address these compliance issues.

Some of the issues with ESOPs identified by the IRS are valuation issues with employee stock, prohibited allocation of shares to disqualified persons, and failure to follow tax law requirements for ESOP loans causing the loan to be a prohibited transaction.

Any company that has stock can sponsor an ESOP for its employees, as long as the ESOP invests primarily in the securities of the employer. ESOPs can be complex arrangements since the ESOP can borrow funds from the employer or a third party to purchase shares of the employer.

In light of the complexity of ESOPs, the IRS has and will continue to undertake enforcement strategies to ensure compliance with tax law requirements by employers sponsoring an ESOP.

Interest rates remain the same for third quarter of 2023

Interest rates for the third quarter in 2023 will remain the same compared to last quarter. These rates include: 7% for overpayments (6% for corporations); 4.5% for the portion of a corporate overpayment over \$10,000; 7% for underpayments and 9% for large corporation underpayments. ♦

Retirement plan options for your business



Offering a retirement plan can be a powerful tool when you're competing to attract the best employees. If you want to offer a retirement plan without the administrative costs and hassles of a 401(k), your choices usually come down to either a SIMPLE IRA or a SEP IRA.

SIMPLE IRA

Employers (and the self-employed) with 100 or fewer employees can establish a SIMPLE (Savings Incentive Match Plan for Employees) plan. In 2023, employees can contribute up to \$15,500 of their own earnings, along with an extra \$3,500 if the employee is age 50 or older.

Employers are required to contribute to their employee's SIMPLE account using one of two formulas: 1) Matching the employee's contributions dollar-for-dollar, up to 3 percent of the employee's earnings, or 2) Contributing 2 percent of an employee's earnings up to the 2023 compensation limit of \$330,000.

New SIMPLE plans must be established between January 1st and October 1st.

SEP IRA

Any employer, including self-employed individuals, can establish a SEP (Simplified Employee Pension) plan.

Only the employer contributes to the SEP account. In 2023, the contribution limit is either 25 percent of the employee's salary or \$66,000, whichever is lower. Employers are not required to make annual contributions to a SEP IRA.

Unlike a SIMPLE plan, SEP IRAs can be established and funded at any time prior to the tax filing due date (plus extensions). Because of this, SEP IRAs are a popular tax planning tool for sole proprietors as a way to reduce taxable income.

BENEFITS

Here are some of the benefits of offering either a SEP or SIMPLE plan:

- **Compete for employees with affordable retirement plans.** The SEP IRA and SIMPLE IRA were created to help small business owners provide an easy and low-cost way to offer a retirement plan. You can differentiate your company by offering one of these plans and being transparent with how you calculate employer contributions.
- **The employer and employee can both reap tax savings.** Employees can reduce their taxable income with contributions to a SIMPLE IRA, while businesses can claim contributions to their employees' retirement plan as a deduction on its tax return for SEP IRAs.
- **Employees can still contribute to their own individual IRA.** Let your employees know that in addition to having either a SEP or SIMPLE account through your company, they may also qualify to contribute to their own traditional IRA or Roth IRA.

Please call if you have any questions about whether a SEP or SIMPLE retirement plan might be right for your business. ♦

Be prepared for Employee Retention Credit audit by IRS

The IRS is reviewing more than two million claims for the Employee Retention Credit (ERC), with special attention being given to new applications. Here is what you need to know.

Background

The ERC is a credit taken on employment tax returns for businesses (not individuals) impacted by the pandemic between March 12, 2020 and January 1, 2022. The credit, which has been modified three times since it was enacted, can still be taken by amending previously-filed payroll tax returns. For payroll tax returns filed in 2020, you have until April 15, 2024 to file an amended return to claim the credit. For 2021 returns, the deadline is April 15, 2025.

Current situation

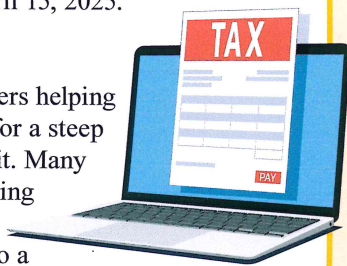
The IRS is wary of promoters helping businesses claim the ERC for a steep fee or a percent of the credit. Many of these promoters are making incorrect claims, either to make a quick buck or due to a lack of understanding of the rules.

In response, here is what the IRS is planning in order to audit and fix incorrect ERC credits that are attempting to be claimed:

- ▶ **The IRS is ready to fully review ERC claims (IR-2023-135).** You need to be prepared to defend your ERC claim and be ready for an immediate review of any amended payroll tax filing that includes a new ERC claim.
- ▶ **Legal clarity on the definition of shutdown.** A Generic Legal Advice Memorandum (GLAM) from the IRS Legal Counsel clarifies how they will look at supply chain disruptions as it relates to government shutdown claims (AM-2023-005).

What this means

- ▶ **If you took the ERC:** Review your claim and get your documentation in order, assuming your claim will be reviewed by the IRS.
- ▶ **If you are considering an ERC:** Be very careful who helps you file amended payroll tax filings to get the ERC. Credentials matter.
- ▶ **If you have not taken the credit:** Conduct a review and take the ERC if your business qualifies. Be sure to retain all documentation in the event of an IRS audit. ♦



CASHFLOW CORNER

Cash flow tune-up: More important than ever!



For years, Amazon lost money on their financial statements but appeared to be unfazed by the negative financial press. Why? Because their laser beam focus was on cash flow! Here are ideas to help define your business's success using cash flow techniques.

Develop a culture of improving your cash position. Get in the habit of monitoring your bank account activity daily to watch for mistakes or unforeseen charges. Then look at each business process that involves cash — pay special attention to purchasing, inventory, collections and payroll. Consider extending terms for paying vendors, establishing shorter terms for customers to pay and implementing a review process to double check payroll calculations. Also assign someone to constantly monitor opportunities to turn your inventory back into cash more quickly.

Create a cash flow forecast. With your knowledge of cash, create a forward-looking statement of monthly cash flow. The most common practice is a rolling 12-month forecast. This projects cash out twelve months. Then for each new month, drop the most current month and add another month one year out. This will reflect the ebbs and flows of cash throughout the year and identify times of cash crunch.

Create and monitor relevant ratios. There are many helpful cash flow ratios. Identify ratios that are especially helpful to your business. Have debt? Consider the cash flow coverage ratio (operating cash flow ÷ by debt) to help

plan for scheduled debt payments. Are you making a lot of capital purchases? Use the free cash flow calculation (operating cash flow – capital expenditures) to determine how much cash is left after purchasing your assets.

Build in some contingencies. Understanding your business cycles can help you strategically manage cash in high cash months in order to cover shortfalls that come in low cash months. Set up a line of credit so it's available in case of an emergency, or as a bridge during short-term liquidity needs. A line of credit charges interest only when used, so it's a perfect tool to have at your disposal.

Put monitoring in place. Assign someone to monitor cash flow, then assign someone else the task of reviewing their findings. Key areas of focus are:

- **Large cash expenditures.** These can be hidden on your income statement or balance sheet. A few examples are payments on capital purchases, debt obligations, dividends, guaranteed payments to partners and taxes.
- **Taxes.** When not accounted for correctly, income taxes can cause a two-fold problem — a large lump sum that is due in a short amount of time, plus a larger obligation to account for going forward. Don't wait until the end of the year to project your tax provision.
- **Cash accounts.** Assign yourself or someone you trust to review cash accounts, remembering to properly separate duties to provide proper controls. ♦

HEALEY & ASSOCIATES

Certified Public Accountants and Consultants

William J. Healey III, CPA

72100 Magnesia Falls, Suite 4

Rancho Mirage, CA 92270

Unlocking customer buying motivations can lead to higher profits

Without taking the time to understand the beginning of a customer's buying process, businesses can find themselves outflanked by competitors who conduct in-depth research into their customers' motivations for making a purchase.

Here are some suggestions for gaining a better understanding of why your current customers buy from you, which can lead to more loyal customers and higher profits:

► **Identify the specific problem your customers are trying to solve.** Every purchase your customer makes is done to solve a problem. Sometimes identifying the problem is very straight forward, such as saving time. Other problems may be more difficult to recognize, like satisfying a desire to spend time outdoors by purchasing camping equipment.

► **Find ancillary reasons that customers buy from you.** While most customers buy from you in order to solve a specific problem, sometimes there are secondary reasons why a customer chooses to do business with you. Maybe you support a specific charitable organization, are located within a reasonable distance from a customer's residence or are affiliated with a particular group. Consider engaging in small talk with your customers to find out possible ancillary reasons why they choose to do business with you.

► **Uncover your customers' price sensitivity.** Some customers don't care how much they pay for something, as long as it addresses the problem they're trying to solve. Other customers only care about low prices, regardless of product or service quality.

Knowing your customers' price sensitivity can help you build more profit into your products and services.

Discovering your customers' buying motivations can help lock them in as repeat buyers for a long time and provide information for attracting new customers. ♦



October 16

- ☐ Filing deadline for 2022 individual and calendar-year C corporation tax returns on extension.

During November 2023

- ☐ Estimate your 2022 income tax liability and review options for minimizing your 2023 taxes. Call to schedule a tax planning review.

NOTE: This newsletter is issued quarterly to provide you with an informative summary of current business, financial and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.

©2023

We appreciate your business. Please call any time we can be of assistance to you in your tax, financial, or business affairs.

HEALEY & ASSOCIATES CPAS • (760) 320.2107