Summer 1986

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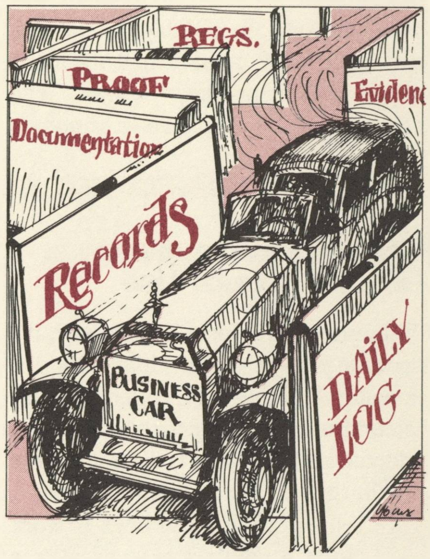
Company Cars: Are the Rules Driving You Crazy?

Beginning January 1, 1986, the rules for substantiating local business travel expenses changed once again, adding even more confusion to the business owner's life. You'll recall that in 1985 Congress attempted to require everyone to maintain a log to support deductions for business travel, but that rule was repealed midyear, and throughout the 1985 tax year the "old" rules prevailed. The law was again changed, however, to require, starting in 1986, a greater degree of substantiation.

In 1985 and earlier years it was possible to comply with the rules by proving deductions by oral statements corroborated by circumstantial evidence of travel. The credibility of such oral statements was obviously affected by such factors as the type of vehicle, the type of business conducted, whether the vehicle was used for commuting, the distance of the commute, and whether the employee's family members had access to the vehicle for personal use. The new rules for the tax years beginning in 1986, however, require that a taxpayer prove business auto use with either (1) adequate records, or (2) sufficient evidence, oral or written, which will corroborate the taxpayer's own statement. Adequate records include account books, diaries, trip sheets, or similar records.

Thus, according to the new rules, the business owner should have documentation of the date of usage, the business miles driven in relation to total miles driven, and the business purpose. The regulations are ambiguous regarding what constitutes "adequate" documentation, but it seems that the owner should maintain some sort of written record or computation of business mileage. The regulations do provide an example of appropriate documentation: maintaining a log for a portion of a year that is representative of the normal use of the vehicle. When a vehicle is driven repetitively on established routes, measurement of the distances may be documented and projected quite easily; however, when destinations are not repetitive, the necessary substantiation may be difficult and burdensome.



An employer may diminish his or her auto record-keeping burden if the business has a written policy prohibiting personal use of the company car; if the car is kept on the business premises; and if the employer knows that there is only *very* minor personal use of the vehicle. In these cases, there is no requirement to substantiate the business use of the auto. The owner must be prepared, however, to prove that the company policy is being enforced. In addition, there will be no need to substantiate the business use of the vehicle if an employer has a written policy prohibiting personal use of the company car except for commuting, provided there is a valid business purpose for an employee occasionally taking the vehicle home at night and the employee is not an officer or owner of more than 1 percent of the company.

You might ask, "What's so important about the new automobile substantiation rules?" Well, these records are the basis for determining what percentage of your automobile usage is properly deductible as a business expense. They will also show what amount of compensation, if any, needs to be included in an employee's earnings statement for personal use of the automobile.

It's never too late to begin maintaining adequate business records or to adopt company policies necessary to alleviate some documentation burdens. Be aware that the IRS is likely to scrutinize car expense deductions now more than ever. Therefore, the better the business's records, the more deductions the business will be allowed in the event of an audit. Remember, record keeping is essential, and your CPA can help you establish the procedures necessary for you to obtain the maximum benefit.

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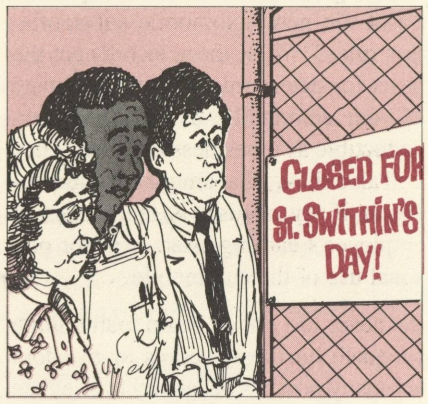
When the IRS Calls

Should the IRS ask for documents or information, find out exactly what it wants, assure the agent that the call will be returned, then call your CPA. You may not need a CPA in every instance, but at least a CPA can make sure deadlines for taking actions are not overlooked.

One Holiday Policy for Companies Is to Let Employees Pick Their Own

How does a small company observe Yom Kippur if it has no Jewish employees? Or St. Patrick's Day and Kosciuszko Day if it employs no Irish or Poles? The sticky question of which holidays to observe and which to ignore is increasingly being answered, where the nature of the business permits, by leaving the decision up to the employees.

Some businesses now close down for just a handful of standard, nationally observed holidays: 4th of July, Labor Day, New Year's, etc. They make the rest optional—floating—holidays



which employees can observe individually, in accordance with their respective religious or national antecedents or, simply, their preferences.

The creation of a new federal holiday, Martin Luther King Day, on the third Monday in January, beginning in 1986, brings the matter to the forefront. Does a company add a new holiday without dropping an old one? If an old one is dropped, which one should it be? More and more often the answer is: Let the employees decide for themselves.

A 1980 survey by the Bureau of National Affairs, a Washington research and publishing organization, found that two-thirds of responding companies gave a total of at least 10 paid holidays a year to their employees.

That selecting the holidays to observe can be a fairly complicated matter is shown by the holidays honored. The almanacs list more than a hundred.

Cash Flow Stimulants Require Regular Use

To improve a company's cash flow, it's necessary to reassess relentlessly the inventory, billing and collection policies. Businesslike procedures to be adopted and followed consistently, not just in fits and starts, might include

☐ Issuing progress billings if work under a contract extends over a considerable period.

☐ Making sure that billings promptly follow shipments—within 24 hours at the outside.

☐ Offering incentives to people in your sales and credit departments for collecting delinquent accounts.

☐ Supplementing perpetual inventory records with frequent physical counts; reviewing the results to identify slow-moving or obsolete items and taking steps to clear them out.

☐ Establishing and using automatic procedures to remind customers of past-due balances and following up with more sternly worded messages.

☐ Depositing all cash receipts daily.

Three Courses Open To Beat Competition

Planners might want to keep in mind the three ways suggested by A.D. Frazier, senior vice-president of the First National Bank of Chicago, for beating the competition:

☐ Through *differentiation*—by creating a product or service that is perceived as unique.

☐ With *overall cost leadership*—by lowering costs and underpricing rivals.

☐ By *focusing*—concentrating narrowly on a particular type of customer or product line.

When Borrowing from Own Company Make Sure It's Not a Dividend

Should you borrow funds, for whatever purpose, from your own company, there is always the danger that the IRS will treat the transaction as a corporate distribution—a dividend—and tax it as such. There are, however, certain actions that can be taken that might help convince the IRS—and the courts, if it came to that—of the validity of the loan. First and foremost, make sure the transaction is documented, just as any arm's-length loan arrangement would be. Spell out, in writing, interest rates, security, repayment schedules and other details.

Nine Tests of Loan

The Research Institute of America, in its January 17, 1986, *Research Institute Recommendations,* recently identified nine considerations that the authorities can be expected to use in deciding if a loan is indeed a loan:

☐ The extent to which the borrower, as a shareholder, controls the corporation.

☐ The size of the withdrawal.

☐ Whether there is a limit to permissible withdrawals.

☐ Whether security is given.

☐ Whether there is a maturity date by which repayment must be made.

☐ Whether the corporation makes an effort to enforce repayment.

☐ The company's earnings and dividend history. (A record of no dividends' ever having been paid could, in such a situation, be a red flag to the IRS.)

☐ Whether the borrower has a plan—and the means—for repayment.

☐ Whether there is evidence that the borrower did try to repay the money.

Big Plans Often Require Big Cash; A Few Suggestions for Raising It

Whatever plans you may work out for your company's future, they are likely to call for an infusion of cash. Where will it come from? Some possibilities include

☐ *Equity financing,* through the public sale of stock. Most small companies can exclude this as an option; it simply isn't likely to happen, unless the firm has reasonable expectations of doing 30 or 40 million dollars a year of business in the next few years, which is not what is generally thought of as a small business.

☐ *Venture capital.* This is also the sale of equity, but to one individual or small group rather than to the general public. Venture capitalists look for a product, a gimmick, a business idea that no one else has, with at least a year's head start on the competition and also a foreseeable potential for having 30 to 50 million dollars of annual gross income. The venture capitalist also can insist on taking managerial control.

Selling Receivables

☐ *Factoring.* This, in effect, is selling your accounts receivable at a discount, with the factoring firm then assuming the risks and handling the collections. Such an arrangement is ongoing; your current invoices are turned over to the factor as invoices are sent out. The invoices instruct debtors to remit payments to the factor. As the factor receives these remittances, it takes its cut and deposits the balance to your account. The cut typically includes a fee of 1 percent of your total credit sales plus interest, at 2 or 3 points above the prime rate, on invoice amounts that are paid before the original due dates.

Factor and Bank Join

☐ *Borrowing against receivables,* instead of factoring them. Some banks will make such arrangements, or a factoring firm and a bank sometimes will agree to a combination of borrowing and factoring.

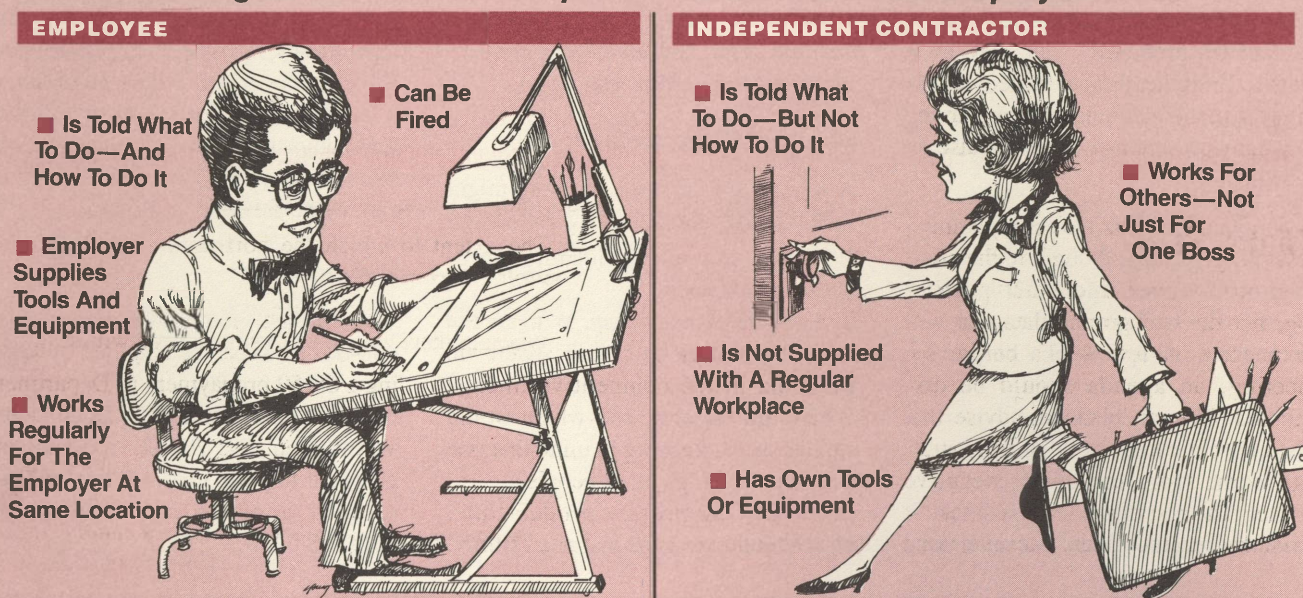
Have You Wondered Where $$ Are Hiding?

If you have ever sensed that your money was getting away from you without your knowing what happened to it, you can sympathize with Uncle Sam. He has about $154 billion worth of coins and bills in circulation but can't account for more than about 12 percent of it.

Much of It Abroad

A lot of it is thought to be in the underground economy—never banked, never recorded. More is tucked away under the mattresses of people who don't believe in banks or investments. The biggest hunk, though, is said to be abroad, especially in countries where the dollar is trusted far more than the local currency. In many of those places our money is a hedge against the inflation that besets the domestic currency.

How IRS Distinguishes Between Independent Contractors and Employees



Employers are ever alert for the possibility of cutting costs by reclassifying employees as independent contractors, thereby saving on Social Security taxes, fringe benefits and other employment expenses. The IRS also is ever alert... to the fact that employers do this. It has set down criteria that distinguish independent contractors from employees. The criteria do not eliminate questions about borderline cases that fall between the opposing categories, but the guidelines are useful in that an employer wishing to change a worker's classification can have some idea of what specific requirements must be met.

Planning for the Small Business Often Just A Matter of Asking, Answering Questions

Business planning has been described as simply the process of asking a lot of questions about a company, and then finding the answers. For example:

☐ What business are we really in? Is it the business we want to be in? Of all our products or services, which are the most profitable—potentially as well as in fact? Has our chief product peaked, or is it about to peak? If so, how do we replace it?

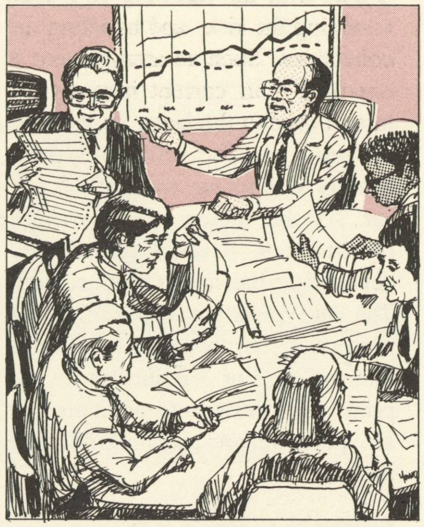
☐ How do we compare with other companies in our industry, in research and development, pricing, production? What are we doing to bring down costs, and what more can be done?

☐ Where do we want to be a year from now? Two years? Five years? What expansion of facilities, personnel and markets will be required to achieve our goals? How might such expansion be financed?

Advance Agenda

Any entrepreneur could go on all day adding to that list. One question leads to another. The trick is to focus the line of questioning, directing it along a predetermined path—toward the solution of specific problems. You may even want to limit the number of people taking part in the planning session; having too many present can cause the discussion to stray.

A couple of months before a planning session, give some thought to the areas it should cover and start pulling together the background data that will be needed. A few weeks before the meeting, an agenda should be distributed. Veteran planners advise that the preliminary draft of company strategy come from the chief executive officer. The rest of the team will take it from there, they say, but everyone should understand from the outset who is behind the whole exercise. Except for that, though, the advice is that all participants should be, at least for the occasion, on an equal level, with everyone free to speak up, knowing that his or her ideas will be given the same consideration as those of anyone else.



An important side benefit of the planning process is that it builds leadership among younger managers, giving them the broad view and developing concern for long-term objectives.

Possible Steps to Take

A typical agenda for a meeting might look into matters such as the following:

1. *Analyze the market.* Identify potential new customers.

2. *Assess the competition:* Who are the trend-setters among them? Where do we stand in the competitive lineup? Where are we now, and where would we like to be, keeping in mind that one can't be all things to all people?

3. *Review the present product line,* with attention to gaps that need filling, either right away or before long. How can we make sure we'll be able to deliver on planned additions to the line? How much must our capacity be expanded to achieve this?

4. *Look at our marketing skills;* get a line on what changes may be needed. Is a merger indicated? Subcontracting? A joint venture? Or can we handle it internally?

5. *Set specific objectives*—no mere generalizations or philosophical theorizing. Put our plans in writing, so that everybody doesn't come away with a different idea of what was decided upon. Set a timetable. Assign responsibilities for fulfilling the various parts of the plan.

Schedule follow-up planning sessions at fairly regular intervals, to check on progress and to update the plan. Planning is an endless process. You look back, you look ahead; you take advantage of opportunities that may arise and move promptly to meet unforeseen problems as they come along.

Directory for Dealing With U.S. Government

Small business owners interested in selling to (or buying from) Uncle Sam should look into the *U.S. Government Purchasing and Sales Directory,* revised in 1984. It tells how the government buys the myriad products and services it uses, and how a small business can locate sales opportunities.

How to Order

The 199-page guide (stock number 045-000-00226-8) can be obtained by sending a $5.50 prepayment to Department 36-PD, Superintendent of Documents, Washington, DC 20402. You can also charge it to your Visa, Choice or Mastercard account by telephoning 202/783-3238.

The MBE is adapted from the CPA Client Bulletin and is prepared quarterly by the AICPA for minority business enterprises. The MBE does not have any official authority and the information contained therein should not be acted upon without professional advice. 1211 Avenue of the Americas, New York, N.Y. 10036—8775. For information contact Mary Feinstein at above address. Tel.: (212) 575-7062.