



Newsletter

OCTOBER 2004

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Our office will be closed for the following holidays:

November 22nd through the 26th - Thanksgiving

December 24th – Christmas

January 31st – New Year's Eve

Our next newsletter will be mailed out the beginning of January 2005.

Remember if you have an article that you would like to contribute to our newsletter just fax it to us for our review. We must receive the article no later than December 15th for our January newsletter.

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IRS Warns of "Corporation Sole" Tax Scam

On March 29, 2004, the Internal Revenue Service issued a consumer alert advising taxpayers to be wary of promoters offering a tax evasion scheme that misuses "Corporation Sole" laws. Promoters of the scheme misrepresent state and federal laws intended only for bona-fide churches, religious institutions and church leaders.

This scheme shamelessly tries to take advantage of special tax benefits available to legitimate religious groups and church leaders. Unscrupulous tax promoters always look for ways to game the system and prey on unsuspecting victims.



Scheme promoters typically exploit legitimate laws to establish sham one-person, nonprofit religious corporations. Participants in the scam apply for incorporation under the pretext of being a "bishop" or "overseer" of the phony religious organization or society. The idea promoted is that the arrangement entitles the individual to exemption from federal income taxes as an organization described in Section 501(c)(3) laws.

This scheme is currently being marketed through seminars with fees up to \$1,000 or more per person. Would-be participants purportedly are told that

Corporation Sole laws provide a “legal” way to escape paying federal income taxes, child support and other personal debts by hiding assets in a tax exempt entity.

While fraudulent Corporation Sole filings have happened sporadically for many years, the IRS has recently seen signs the scam could be starting to spread with multiple cases seen recently in states such as Utah and Washington. The IRS is concerned about this increase and is taking steps to pursue Corporation Sole promoters and participants.

Used as intended, Corporation Sole statutes enable religious leaders – typically bishops or persons – to be incorporated for the purpose of insuring the continuation of ownership of property dedicated to the benefit of a legitimate religious organization. Generally, creditors of a Corporation Sole may not look to the assets of the individual holding the office nor may the creditors of the individual look to the assets held by the Corporation Sole. Currently, 16 states permit Corporation Sole incorporations. The IRS suggest that individuals considering becoming involved in any kind of tax avoidance arrangement obtain expert advice from a competent tax advisor not involved in selling the arrangement. Do not rely on legal opinions obtained or provided by the arrangement’s promoter. Start by asking the following questions:

- Is the arrangement designed to hide income or assets?
- Is the arrangement designed to evade income taxes?

Answering “yes”, or even “maybe”, to either of these questions should raise red fags for taxpayers.

Why Small Businesses Need a Bookkeeper

One of the most common problems plaguing small business owners is their inability to manage and understand their finances.

Many individuals start their own small business because they have talents and skills they can provide profitably to others. However, many do not have the time to, or any idea of how to, perform

the accounting and bookkeeping required to operate and manage a successful small business.

There are three primary reasons why accounting and bookkeeping are critical to the success of every business:

- Tax Planning
- Cash Flow Management
- Management Information

Tax Planning –

Many small business owners do not deal with financial information until their CPA requests it from them at the end of the year in order to prepare their taxes. The CPA then has the daunting task of sorting through the disorganized materials as quickly as possible to ready them for the IRS. Though this practice may seem “good enough” to some, business owners who operate this way are missing out on a golden opportunity to improve profitability.

Waiting till the last minute at year end prevents a business owner from doing proper tax planning year-round. By utilizing a bookkeeper to provide the CPA with information throughout the year, you can take advantage of tax deductions and tax planning concepts that will reduce your tax liabilities. The amount saved on taxes alone can save your business more than the cost of a bookkeeper!

Cash Flow –

Cash flow is the pulse of your business. Lack of it causes your business to suffer, and could eventually cause a business to close its doors. However, with proper cash flow management, a business owner can anticipate cash needs in time to arrange for financing, if needed, during difficult times.

The goal of cash flow management is to go beyond the bank balance and project farther out. What cash needs will your business have 3 months from now? 6 months? 12 months? The bookkeeper can assist you in collecting accounts receivable, reducing your tax burden, and acquiring financing by preparing all the necessary documentation for the financial institution or investor.

Management Information –

Information is power. The more information a business owner has, the more capable he or she will be at operating their business effectively. It is critical

what sales are, and how much money was spent.

Payroll is another critical area for a business owner to have good information about. Whether you outsource your payroll function to an outside provider or calculate payroll in-house, it is important to have it done properly by someone who can understand how it all works. In addition to handling the tax payments & form filings, a bookkeeper can perform payroll analysis that will help you determine how to maximize the effectiveness of your business's personnel.

Bookkeepers can also provide resources to a business owner that allow him or her to see the "score" of the business. The income statement allows the owner to compare the current period to prior periods and determine if the business is improving or not, and why profits were up or down. The balance sheet helps determine the strength and solvency of the business by providing information on financial obligations and resources.

Working as a team by maintaining tax planning, administering cash flow, & the management of information, the bookkeeper and the business owner can identify potential problems before they become insurmountable. For all these reasons, a small businesses that employs a bookkeeper is a smart businesses, and more likely to succeed!

For more information contact *Rhenee Foster* at Red Carpet Accounting and Tax Services 310-578-1087; fax 310-306-7245 Rhenee@rcatspro.com <http://www.rcatspro.com>

How to Legally Recoup Your Investment From Your Failing Business

When your business turns bad your thoughts naturally turn to recouping your investment in your business. Skimming receipts "off the books" avoids easy detection but it's not your best method. Conversely, to dutifully record all withdrawals may invite claims for repayment from a bankruptcy trustee. So how can you both safely and legally take money out of your failing company?

* If you repay yourself for an earlier loan to the company, then fight to keep the business out of bankruptcy court for at least one year after you're repaid. Since you are an insider, creditors can recover preferential payments made to yourself (or any relative, or officer,

director or stockholder of your corporation) within the year preceding the bankruptcy.

* Stagger your repayments as much as possible. Instead of large, easily detected payments to one or two individuals, make many smaller payments to a larger number of individuals. It's considerably safer. These withdrawals are not easily detected and a bankruptcy trustee will be less inclined to start many lawsuits against numerous individuals. This is particularly true when the funds repaid a variety of obligations – from reimbursed expenses to wages to consulting fees.

* Try to earmark withdrawn funds as wages. Grossly excessive wages may be considered a fraudulent transfer and a misappropriation of funds, as may obviously excessive compensation paid to relatives or friends whose services to the troubled company are of questionable value. Still, wage payments are less easily challenged than are withdrawals for other purposes- such as loan repayments.

Caution: Does your company carry loans to you on its books? You can easily forget an old \$20,000 loan from your business, but once documented on your books the bankruptcy trustee has little choice but to pursue collection. Can you debit the loan against other obligations the business may now owe you? Did you transfer some personal assets to the business in repayment? You see the point. Have the loan cancelled by your accountant before you turn your books and records over to the bankruptcy trustee. Another strategy: If you personally guaranteed business debts, then transform the loan into payment for serving as a guarantor of the business. It will create taxable income to you, but this tactic can help you avoid a lawsuit to repay the funds to your business creditors.

Information You Must Safeguard from Creditors

If you are in financial trouble, don't inadvertently give creditors information that improves their chances for collection at the expense of your business. What *can* you safely let creditors know and what *must* you conceal when the road is bumpy?

* Admit to creditors your temporary financial difficulties, but *never* openly admit insolvency, and certainly not in writing. Creditors can use your admission of insolvency to petition your business into bankruptcy.

* Never reveal to a creditor the names of your other creditors, or give a creditor your supplier list. Without this information a creditor cannot easily find two other creditors to join in a bankruptcy petition.

* Never disclose to creditors payment arrangements you negotiated with other creditors. If creditors discover other creditors obtained preferential treatment, they will have more cause to force you into bankruptcy.

* Never confide in a creditor your plans for your business. Creditors who do not see your plan as in their own best interest will sabotage those plans.

Conversely, there are a number of steps you can take to encourage creditor support when your business is in trouble.

* **Communicate.** Creditors become most anxious when debtors don't communicate with them. Accept your creditor phone calls. Better: Take the initiative and notify your creditors if you can't meet your obligations and need a moratorium to work things out. Good communication greatly increased your credibility and reduces creditor anxiety.

* **Anticipate concerns.** Assure creditors they are being treated equally. Creditors rightfully become most impatient when they believe other creditors are gaining an advantage.

* **Be Honest.** Creditors rightfully turn against customers who play games. Guaranteed to make creditors angry: Bad checks on COD purchases lead the list. Finding you violated your word and preferred other creditors with payment is another. Suspicions you diverted assets or embezzled funds is the most serious. Creditors usually cooperate with honest debtors and creditor cooperation is essential if your troubled business is to survive.

Who Should and Shouldn't Have Computer Servers

Many small business owners without a good computer consultant may be unaware of the benefits of having a computer *server* for their network. This is not a web server for web pages, it's a central computer in your network that manages and controls all the other computers in your office.

Having a network server installed in your office offers a wide array of benefits to the business owner. Here are just a few examples:

* A central location for files, spreadsheets, business application data (for example, accounting software data, customer files, etc.)

* The ability to *share* data and files with other members in your organization (for example, your salespeople can enter estimates or sales orders while accounting processes A/R for the same customer – at the same time)

But even more important than shared data, is the fact that when a server is properly configured, all the data on each desktop computer in your business is saved on the server. This means that, in the event of a hard disk failure on an employee's computer, no data is lost, because it's on the server. Servers usually have redundant hard disks, so, if one of them crashes, it's no big deal as the other disk keeps going. Servers also get backed up to tape regularly. This means that only one backup needs to be managed: the server's, instead of hoping (*praying?*) that everyone in your office is backing up their own data. Small business servers are very affordable, starting at about \$1,500.00 for a basic model.

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