

The CFO Assistant

A Financial Newsletter • Small Business and Personal Finances

This newsletter is focused on business and personal financial matters and designed for small businesses, their owners and management. The goal is to increase the small business owners' awareness of financial issues, options and opportunities. The newsletter is prepared by Floyd Green CPA. Floyd Green provides Tax, Accounting and Retirement Planning Services. See Description on page 2.

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Be Aware - Tax Hit in Mutual Funds

As we are in the final quarter of the calendar year, it is the time when individuals think about making those final investments for the year. It is also the time of year when mutual funds pay out their net capital gains. Bottom line is that if you invest in a mutual fund and that mutual pays out a capital gain, you will be hit with capital gain tax. This is a tax that you definitely want to avoid. The reason is that you are simply getting back part of your own money as a capital gain dividend and having to pay taxes on it. Simple answer is to wait until the day after the capital gain is paid before investing in the fund.

Mutual funds are required to pay out net capital gains based on capital gains realized during the year. The capital gains are often paid during the end of the year. The capital gains are paid to anyone who is a shareholder at the time of the distribution. In reality, the ones who actually received the benefit of the capital gains are the shareholders who owned shares for the longer part of the year.

Capital gains distributions during this year are likely to be more than in previous years. This is according to mutual funds performance during 2006 and indications from some of the larger fund companies.

The best way to determine specific distribution information is to visit the website of the mutual fund company. You will often be able to find the following:

Record Date: The date the fund uses to determine the shareholders who will receive the dividend.

X-Date: The date the fund recognizes the drop in Net Asset Value according to the amount it intends to distribute.

Distribution Date: The date the fund actually pays out the dis-

tribution.

A Final Note. There is no need to manage the investment timing of tax deferred retirement accounts. These accounts do not incur income taxes and thus the capital gains distributions do not have a tax impact on the individual.

Health Insurance Plan - A Key Employee Benefit

Offering a health insurance plan will put your business in an advantageous position when talking with prospective employees. With medical and health insurance costs increasing at rates that significantly outpace inflation, everyone is looking for ways to bring overall health related costs down. Some of the benefits of offering a health insurance plan are listed below.

1. If the plan is set up properly and combined with a cafeteria plan, plan premiums can be paid for with pre-tax dollars and thus, employees save on their income taxes. The plan premiums will not be considered wages and thus, both the employee and employer will save on social security and medicare taxes.
2. Most small business insurance plans have explicit limits on annual out-of-pocket costs that the consumer can incur.
3. Benefits on most small group plans have no lifetime limits.

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4. Federal law requires small group health insurance to be offered on a guaranteed basis regardless of health status or illness of the employees and / or their dependents.

In early 2006, America's Health Insurance Plans (AHIP) conducted a nationwide survey of small business health insurance plans. The businesses included in the survey had 50 or fewer employees. We have pulled out some of the key statistics and findings of the survey and included them below.

- In 2006, the average cost for single coverage for an individual covered by a small group health insurance policy was \$311 / month. For family coverage, the average cost was \$814.
- Employees of smaller group plans tend to have a higher deductible than larger plans. The average small group plan deductible in 2006 was \$849. With this higher deductible, the employee is less likely to incur unnecessary medical costs. This will mean lower premiums for your group plan overall.
- More small businesses (57%) offer PPO coverage than any other coverage. HMO / POS make up 39% of coverage. HSA / HDHP make up 4% of coverage. Key characteristics of each plan type:

HMOs, PPOs, and POSs are all network based in-

surance plans that allow varying degrees of coverage for services received from non-network providers.

A HSA (health savings account) is a savings account to be used specifically for health related expenses. A *HDHP* is a health plan with a high deductible. A HSA is combined with a HDHP to offer a tax-advantageous benefit to employees.

- Most small businesses (87%) offer only one plan. Thus, choice is not frequently offered in terms of plans.
- Georgia's average monthly premium for small business employees is below the nation's average, at \$299 / month vs \$311 / month. The average family premium is \$783 / month for Georgia vs \$814 for the nation.
- The complete survey can be found on the website, www.ahip.org.

Key recommendation on setting up your company small business health insurance plan. Consider adding a HSA / HDHP as one of the insurance plan options. When such a plan is offered, it is chosen approximately 50% of the time. The problem is that such plans are usually not offered.

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Tax Corner

If you cannot rely on the IRS for good advice, who can you rely on? If you get casual tax advice from an IRS operator or worker, you may not rely on this advice if the issue is questioned by the IRS. To be able to rely on specific IRS direction, you will have to have a formal private ruling. Other tax notes below:

- If you own a corporation that is engaged primarily in the fields of accounting, engineering, law, health, consulting, actuarial science and architecture, be aware that your corporation is a personal service corporation. The tax rates for a personal service corporation are different from those of other corporations.
- If you mistakenly misclassify an employee as a contractor, the IRS may offer some tax relief on back social security taxes. Relief will be minimized if 1099s were not filed.
- The IRS is taking a look at online sellers and suspects that many of these businesses are not reporting all of their income. The IRS is considering having companies such as eBay give 1099 forms to sellers. The 1099s would have the annual amount of sales proceeds. The IRS would then be able to match these 1099s up to the tax returns.
- In 2008, the IRS will start random audits of individual tax returns again. The IRS typically uses certain formulas to determine who to audit. From time to time, the IRS brings these formulas up to date. Keeping the formulas up to date is expected to cut the number of exams that have no changes. Thus, the random audits to be performed are expected to be a basis for determining the formulas used for selecting returns for audits.
- It is expected that Congress will extend certain tax breaks that expired after 2005. However, if these are not extended by November 2006, the IRS forms will be printed without the extended tax breaks. This could mean quite a bit of confusion if the tax breaks are extended subsequent to the form being printed.
- If a personal residence loses value over a period of time, you are not allowed a tax loss deduction. If you convert it to a rental property, you are not allowed a deduction for the loss incurred prior to the conversion. The loss in value after being converted to a rental property is deductible.
- If you default on a personal residence mortgage and the lender ends up forgiving part of the balance of the mortgage, the forgiven amount is considered as income by the IRS.

Good Time To Purchase a House !

The housing market is relatively soft. And though it is yet to be seen whether we are in a significant downturn, the market does appear to be as weak as we have seen over the last few years. Thus, it is a good time to move into that first home or upgrade to a different home.

Though it is not the best time to be selling, it is a good time to be purchasing. With all else being equal if you are selling a \$150,000 home and purchasing a \$250,000 home, you are a net buyer (by \$100,000) and this is a buyer's market. My recommendation is to buy that first home now or if you want to purchase a higher price home, do it in the soft market.

How About Waiting To Purchase?

You probably have some time if you prefer to wait. We would not expect the market to start a steep upward trend overnight. Also, there are still quite a few things that may serve to keep the market soft for a while.

1. There are still lots of "for-sale" signs in yards today. Drive around almost any subdivision and you see the "for-sale" signs.
2. There are still plenty of residential real estate investors in the market who would like to reduce their number of properties. There are all types of investors holding rental homes in Atlanta. These homes have a wide range of values and rental incomes. Many of these homes do not have renters and some of the owners are struggling to make monthly payments.
3. It is questionable whether rates will decrease in the near term. Though the fed left rates unchanged on Oct. 24th and the previous week, they did still hint at the possibility of inflation. This could mean rate increases in the future.
4. As more time goes by, more of those interest-only and teaser-rate mortgage loans start to adjust to higher interest rates and higher monthly payments. For those who bought more house than they could afford, some will be looking to down-size, meaning more houses on the market.

Holding and Renting Residential Properties Long-Term.

This is probably not a bad idea. On a month to month basis, do not expect much net cash flow if you have a mortgage on the property. There are several financial and market positives that would be in your favor though.

1. The interest on the mortgage is tax deductible.
2. The depreciation of the property provides another tax-break, but has no impact on cash flow.
3. Metro Atlanta is experiencing one of the highest population growth rates in the country. These people need places to stay.
4. The diverse economy means one that is more capable of handling economic downturns.

The CFO Assistant

3300 Buckeye Road, Suite 401
Atlanta, GA 30341

Phone 770-457-2550
Fax 770-457-2677
Website: www.cfoassistant.com
Email: info@cfoassistant.com

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