THE Business Owner®

Expertise for the business owner since 1977

The Business owner®

Are a Few Money-Losing Products Stealing Your Profit?

Just a few money-losing products can wipe out a lot of bottom-line profit. Is it happening to you? The only way to know for sure is to do the analysis. This article will show you how.

First, here are the formulas that you'll need:

$$\text{Gross Profit(\$) Per Unit} = \text{Revenue Per Unit} - \text{Variable Cost Per Unit}$$

$$\text{Gross Margin(\%)} = \frac{\text{Gross Profit}}{\text{Total Revenue}}$$

$$\text{Breakeven(units)} = \frac{\text{Fixed Costs}}{\text{Gross Profit Margin Per Unit}}$$

$$\text{Profit(\$)} = \text{Revenue} - \left[\text{Fixed Costs} + \left(\text{Units Sold} \times \text{Variable Cost per Unit}\right)\right]$$

Now, it's just a matter of three easy steps.

Step 1: For each product or service, determine gross profit per unit and gross margin per unit.

Gross profit per unit is the incremental profit earned per unit sold, as described in the following formula:

$$\text{Gross Profit(\$) Per Unit} = \text{Revenue Per Unit} - \text{Variable Cost Per Unit}$$

The revenue per unit is the revenue earned from a single unit sold. The expense or cost considered is that expense or cost that is incurred directly and solely due to the additional unit sold — also referred to as both the direct cost, and as the cost of goods sold. Such costs may include the cost of materials (tangible or otherwise), labor, or both. Such cost ignores indirect costs (also referred to as fixed costs) such as facilities, non-direct labor (which is commonly referred to as sales, general and administrative expense), insurance, office supplies, etc.

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- Ask the Editor: Deductible Business vs. Personal Expenses
- Smart Owners Are Making These Year-End Tax Moves
- 2007 Tax Information

The Business Owner 1977–2007 Celebrates 30 Years

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From the Editor

David L. Perkins, Jr.

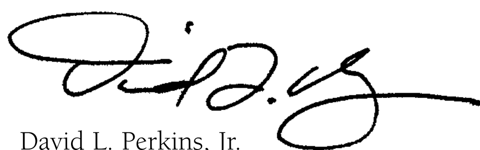
Simply amazing. 2007 is nearly in the history books. I can remember wondering if I'd live long enough to see the year 2000. Now we're close to rolling up the first decade of the 21st century. And I hope 2007 is shaping up to be a very good year for you.

Heck, the recession of 2002 is now five years behind us. We've enjoyed a full five years of broad economic expansion. Will it continue? Who knows? The problems in the credit and mortgage lending markets sent shock waves through the economy and seemed to be the beginning of the end, but now it appears that our momentum has carried us through.

Equally amazingly to me is that this publication has been supporting and empowering you, the business owner, for 30 years. Our first year was 1977. And because time flies, you and I both need to stay focused on moving our businesses and our personal lives in the directions we envision. It starts with a vision. If you don't have one, a bright one, get it now. Find one. You want tomorrow to be better than today. So do I. It will be so only if we constantly assess, learn, set new objectives and work hard to achieve them. Our January-February 2008 issue will address that topic.

But for now, here's to finishing the year strong, doing a little year-end tax planning, eliminating any money-losing products and then setting a firm plan that will make 2008 the best year ever.

Sincerely,



David L. Perkins, Jr.
Publisher and Editor

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Perils Abound in Requiring Employees to Pay for Damaged Property

The Department of Labor, the federal governing body on the issue of wage and hour laws in the United States, says that a salaried employee may not have his or her salary reduced to pay for an employer's lost or damaged property.

A recent DOL opinion letter states that a "salary" is not subject to reduction for lost, damaged or destroyed property of the employer, even if the employee authorizes it. In fact, a salary is a fixed, guaranteed amount paid free and clear of potential reductions. If a salary were subject to deduction for reimbursement of lost or damaged property, it would no longer be a salary.

A salaried employee may not have his or her salary reduced to pay for an employer's lost or damaged property.

That is significant because to be exempt from overtime provisions of the federal Fair Labor Standards Act, any managerial or administrative employee must be paid on a salary basis. So, if a company deducts for a lost phone, broken computer, etc., the company would make the otherwise exempt employee nonexempt, and owe the employee for any overtime worked that week. This may not sound onerous, but some employers have found themselves liable for many weeks (even years) of overtime pay when they deducted small portions of amounts owed by employees from multiple paychecks.

Furthermore, DOL says that requiring the employee to reimburse the company out of his or her own pocket won't work either. For an employee to be paid on a valid "salary" basis, that salary may not be subject to reduction for lost, damaged or destroyed property of the employer.

What about nonexempt (hourly) employees? Use caution here. A number of states have laws that forbid, or strictly limit, employer policies that require reimbursement for lost or damaged company tools or equipment. Other states require separate written agreements whereby the employee agrees to a deduction of any kind, and some states dictate certain parameters. ❑

Mike Lissau, employment law expert with Hall Estill, provided content for this article. Email him at mlissau@hallestill.com.

"We've talked them down from destruction of property to misdemeanor huffing and puffing."

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Your Biggest Customer Has Decided to Cancel

Now that we have your attention, this is a reminder to take good care of your largest customers. The first step in doing so is to know who they are. Rank them by gross profit — in dollars and percentage of total revenue. See the Delphi Corp. example to the right.

Delphi Corp.'s Largest Customers
By Gross Profit

(000's)	2004		2005		2006		Thru 11/30/07	
Abrams	$189	18%	$275	22%	$192	15%	$192	16%
Z-Tech	$21	2%	$75	6%	$102	8%	$120	10%
Davis Brothers	$105	10%	$88	7%	$26	2%	$48	4%
Precision Services	$42	4%	$63	5%	$51	4%	$60	5%
T. R. Blake	$32	3%	$13	1%	$51	4%	$72	6%
Duffy	$21	2%	$38	3%	$51	4%	$60	5%
All Others	$641	61%	$701	56%	$805	63%	$646	54%
Total Revenue	$1,051	100%	$1,252	100%	$1,277	100%	$1,197	100%
Total Operating Profit	$116		$100		$140		$132	

As you can see, Abrams has contributed $192,000 in gross profit so far this year. That's 16% of total gross profit earned by the company. And, for comparison purposes, the $192,000 earned from Abrams so far this year far exceeds the $132,000 in total year-to-date operating profit. So if Abrams were lost, Delphi would post a net loss.

Sobering? You bet.

Run your own numbers. Update them regularly and place them on the wall for everyone in your office to see. Review them at your regular staff meetings. When Abrams calls, the entire office should spring into action. Same for Z-Tech, Davis Brothers, et al.

Your relationships are either getting stronger or getting weaker. And if you are not sure which it is, they're getting weaker.

Now let's look at the brighter side. That someone is a repeat customer tells you three important things:

1. They know you, your products and your reputation. You don't have to spend time and money introducing your company to them.
2. They have a proven interest and need for your products or services. After all, they have ordered from you before.
3. You know something about them — their creditworthiness and their pattern of paying their bills.

To be sure, you have a bird in the hand. To grow your business, you want to find additional customers, but let's not neglect this bird in the hand. Maintaining a customer is much more profitable than searching out and winning new ones.

But let's go even further than that. You've heard of the pendulum theory. The pendulum always swings; never stands still. Similarly, in your business, relationships with your key customers never stand still. Your relationships are either getting stronger or weaker. And if you are not sure which it is, they're getting weaker. So the best way to keep a good customer is to work on strengthening and growing your business with that customer. Here are some suggestions.

Establish and Maintain Multiple Points of Communication: With important customers, you want strong connections with multiple people in their organization: owners, managers, accountants, buyers, salespeople. You want people who will be champions for your firm and also provide feedback/intelligence.

Make it easy for them to order. Simplify your order forms and establish a toll-free number. Practice your team's skill in handling order intake with speed, effectiveness, flair — and up-sell whenever possible.

Serve and Sell: Repeat customers are special. You have a relationship of trust. Serve them actively in various ways, including with your products. Again, they trust you. They depend on you — largely for products and services you provide. So be confident. Offer them more products. Review ideas with them for new products and services. Inform them of specials and discounts. Your existing customers are a known commodity. Go after them for more business.

Respond immediately to problems and complaints: Complaints are wonderful things. They provide business intelligence. The alternative is customers who are so frustrated or irritated that they simply cancel without telling you why. So when you get a complaint, thank them and ask them how you can correct the problem and make them happy again.

The bottom line? Be proactive. Don't be the person who gets the cancellation call and is shocked. If you stay in touch with your customers and clients, then you should anticipate and deal with problems before they come home to roost. This way, you can react and protect your interests — and those of your customers and clients. ❑

> **"Imagination is more important than knowledge."**
> *Albert Einstein*

Smile, Laugh and Connect to Reduce Stress and Improve Health

Often we speak about the "good chemistry" of a relationship, the "good chemistry" of a place or the "good chemistry" of an event.

Many physicians recognize that "good chemistry" means positive feelings and good health, and "bad chemistry" indicates negative feelings and poor health. The growing field of Psychoneuroimmunology (PNI) is discovering that the physiology of feelings and health can be altered by many controllable factors that positively or negatively impact individuals and society. Physicians also recognize those who positively act happy impact their health and well-being.

Harness the "pharmacy within"

Endorphins, with a chemical structure similar to morphine, are one group of neuropeptides often referred to as the "inner uppers," which get us "high" on life. As a group, they are most often identified as "the happy chemistries," which enhance health and success. Evidence shows they can be acted on.

Endorphin levels are raised through a range of activities. Besides laughing, these include smiling, eating, exercising, cheering, singing, listening to music, creative visualizing, camaraderie and romance.

This sheds new light on ancient questions. Are we happy because we're healthy, or are we healthy because we're happy? Do we laugh because we're happy, or are we happy because we laugh? Yes, happy people are apt to laugh often. At the same time, feelings of pleasure and happiness can result from the physical act of laughter, because laughter is a potent way to raise endorphin levels.

Those who know how to experience the joy of raising endorphin levels hold the keys to a wide range of possible benefits. Physical benefits include lessening of tissue inflammation, reduction of pain, relaxation of muscles, suppression of the appetite and enhancement of the immune system. Psychological benefits include a sense of euphoria that can counter fear, anger and depression. People with "good chemistry" know how to "live it up" and tend to be friendlier, optimistic, humorous, creative, confident, perceptive, productive, popular, and yes, more successful and wealthier.

What you can do

The social benefits of raised endorphins are of critical importance for our society. The good news is people can direct dramatic changes by learning and teaching a few actions and thought-techniques.

Endorphin levels are raised through a range of activities. Besides laughing, these include smiling, eating, exercising, cheering, singing, listening to music, creative visualizing, camaraderie and romance. Obviously not all of these are appropriate for every occasion! Yet some are, and it pays to capitalize on them. As an example, actors use many actions and thoughts in the green room to get into the "chemistry" of a happy part. Here are three simple strategies you can start using immediately:

Smile!

Smiling can produce an immediate change of physical, mental and emotional state. Test this idea for yourself. Force a smile the next time you're feeling pensive or worried. Do this no matter how silly it seems at the moment, and then carefully observe the resulting changes in your attitude. Notice any subtle feelings of relaxation, relief or renewed perspective on life.

When we smile, we become our own physicians, filling an endorphin prescription from our pharmacy within. If we want to alter our brain chemistry, we don't have to take expensive drugs, we can just smile.

Smiling at yourself is something you can do often. Think of those times you've stood in front of the mirror with a smile — before the big date, the big interview or the big meeting. Or consider searching for your face in a group picture; chances are, you look to see what you're "wearing" on your face. If the picture shows your smile, you'll probably feel good about what you see.

So, the first and easiest way to start changing the chemistry is to "costume" your face and smile. Ask friends and family to become aware of how much they smile at each other. Remind them of a phenomenon so commonplace that we constantly forget it: when people smile at us, we usually respond with a smile. Conversely, when we smile at others, they usually smile back, and that's an "upper."

Laugh!

See if you can upgrade smiles into outbursts of laughter. Many memorable events and outstanding personal encounters are those that kindled laughter. Recalling those memories can trigger the physiological experiences we had during the actual event.

Those who know how to experience the joy of raising endorphin levels hold the keys to a wide range of possible benefits.

As an example, here's a prescription for you. Fill it for yourself and then offer it to friends. It's called "Laughter Rx." Stand in front of a mirror and belly-laugh three times each day for at least 15 seconds at a time. It's important to approach this task with gusto, not a mere snicker or lackluster chuckle. Whenever possible, do this in the company of others because laughter is contagious. At first your family and friends will laugh at you, but soon they will laugh with you. This is an easy way to start a "happy-demic."

While you may feel silly doing this, you will get a good laugh out of the experience. Lead with the body and the mind will follow. In other words, let an action generate the physiology of your emotions. Don't wait to laugh until you feel happy; laugh to boost your endorphins, and then feel happy. Physiology can be staged and scripted to produce the healthy pleasure that adds life to any occasion. Learn to laugh for the "health of it."

There are several ways to use the laughter prescription. The enthusiasm and goodwill generated are a wonder of nature — living proof that "laughter is the best medicine."

Connect!

It's impossible for human beings to enjoy optimum health unless they experience

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Public Speaking: Your New Marketing Platform?

Public speaking is like a sharp knife. It can be an extremely useful tool but dangerous, too.

Speaking well in front of a group can do wonders for your name recognition and credibility — and that of your business. Speaking poorly can undermine decades of effort to get others to take you seriously. It can brand you and your business as "not very sharp," and cause employees and customers to lose confidence in you.

Speaking well in front of a group can do wonders for your name recognition and credibility — and that of your business.

So why risk it?

This is a very important question. Sometimes the smart answer may be "don't." But before you dismiss it, give it some consideration — if only for the reason that it's so darn tough and expensive to get your company recognized. How hard it is to create awareness — and get people to respect, trust and want to associate with you and your company.

Public speaking offers a powerful way to accomplish these things, and because so many of your peers can't or won't do it, you'll likely have the platform all to yourself.

So if you think you might want to take advantage of this unique opportunity to create awareness and build your brand — in ways your competitors don't use — here are some tips:

1. **You Are Your Company:** As a business owner, you are your company's brand. Your image is synonymous with that of your company. Keep this in mind when you make public presentations. If your company brand is "tough," be tough. If it's innovation, show innovation. But above all, show quality. Do you see CEOs of high-growth, highly successful companies make poor presentations? Heck no. Don't do it yourself. The impressions you make will be lasting ones.
2. **Audiences Are Consumers — They Know What Quality Looks Like:** Just as customers are experts in customer service because they receive it every day, audiences are experts in presentations. They see and hear them every day on TV, radio and in person. This means that the bar for quality is pretty darn high. To be sure, audiences will know right up front you're not paid to speak, but you still need to meet a basic standard of competence, quality and preparation.
3. **Know Your Audience:** Audiences want respect. The most basic ways to show respect are to arrive early, look great, stick to your time allotment, be prepared and — know something about the audience. So before speaking to a group, find out something about them. Talk to members in advance and, of course, search the web. Then, when you speak, look for ways to demonstrate that you did your homework.
4. **Know Your Message:** In developing your speech, the first question to ask is why you are speaking. If you were invited, ask the event coordinator why. Your message should fully address the reason you are there. Next, what do you want to say? That is, what is your message? Make sure it is meaningful and relevant to the audience, then work on your delivery. Make it clear, bold and compelling.
5. **Get a "Study Buddy":** You can't do it alone. You're just not objective enough by yourself. Find someone who can help you write the speech, work on the message and means for delivery, get you to practice even when you don't want to, and give you feedback until you've "got it right." Who can play that role for you? To be sure, it must be someone you trust and whose judgment you value. It also must be someone who will give honest feedback and who has time to work with you — many hours if needed. This could be an employee or a good friend. It also could be a speech coach.
6. **Be Yourself:** Audiences want to hear a little about you, your business, and what or who contributed to who you are and how you see the world. You should make a special effort to find compelling ways to tell your stories. Stories are also a great way to drive home the points of your speech. Audiences remember stories and examples, but speakers often miss the mark when they make up stories rather than find real ones they actually experienced. Real stories are more easily told with excitement and feeling. In addition, using firsthand stories ensures that the material is original and accurate.
7. **Minimize Use of Visuals:** When a business owner speaks, audiences are looking for vision and inspiring ideas, not a lot of detail. You want high contact, not high content. Visuals are best at providing content details. So while PowerPoint may have a place in meetings and presentations, use of visuals in a public speech should be kept to a minimum — if not eliminated altogether. If you do use visuals, search for one visual way of presenting a concept and use it over and over again.
8. **Get Close, Build Rapport:** Boring speakers keep their distance and read from their notes in a monotone voice with no visual aids or personal stories. You're not going to be boring. Go with few notes — just an outline. Show up early and greet and visit with the attendees as they arrive. Start on time and don't hide behind a podium. Roam around and talk to people individually, making eye contact. Recognize people by name whenever possible. Ask questions and take questions, listening closely and responding. Tell personal stories and drive points home, closing strong and then making yourself available afterward.
9. **Videotape Your Rehearsals:** Simply use your home camcorder and a simple, inexpensive tripod. But be forewarned — it will be painful. But better you see (and correct) the nervous movements and shockingly frequent "ums and ahs" in private rather than drop them on an unsuspecting audience.
10. **Time Your Rehearsals:** Nobody likes a speaker who "runs over." Say your piece, make your points, and do it on time and under budget. Do that and you'll be halfway home. The only way to make sure you can do that is through timed practice.

Because so many of your peers can't or won't do it, you'll likely have the platform all to yourself.

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***Are a Few Money-Losing Products Stealing Your Profit?* continued from cover**

The gross margin is simply an expression of the relationship between direct revenue and direct cost, expressed as a percentage and calculated using the following simple formula:

$$\text{Gross Profit Margin(\%)} = \frac{\text{Gross Profit Per Unit}}{\text{Total Revenue Per Unit}}$$

To illustrate, consider XYZ Company, a reseller of industrial filtration units. They calculate their direct cost per unit at $500. The $500 is the sum total of all direct costs that are incurred to deliver a single sold unit, such as the filtration unit itself, which is purchased from an outside vendor, and the cost of the labor paid to XYZ employees that perform very light machining and assembly on each unit. They sell each unit for $1,000. XYZ calculates their gross profit and gross profit margin on this product line as follows:

Revenue	$1,000	*100%*
Variable Cost [1]	$500	*50%*
Gross Profit	$500 [2]	*50%* [3]

[1] Also commonly referred to as Cost of Goods Sold and Direct Cost
[2] Referred to as gross profit (expressed in dollars)
[3] Referred to as the gross profit margin. Calculated by dividing the gross profit by total revenue.

Again, XYZ incurs the $500 direct cost only when a unit is sold. In practice, XYZ anticipates orders and builds units in advance, but the costing and calculation of gross profit remain unchanged.

Step 2: Determine the Fixed Costs Associated with the Product Line.

Fixed costs are incurred by simply maintaining the capability to produce the product and product line and to market and sell the products in the marketplace. Such costs do not increase with each additional unit produced or sold, and they typically include indirect labor and overhead costs such as rent, utilities, machinery, equipment, bookkeeping, licenses, permits and taxes.

XYZ Company calculates its annual fixed costs associated with its industrial filtration product line as follows:

Facilities Rental	$15,000
Utilities	$2,500
Facilities Maintenance	$2,500
Overhead Labor	$15,000
Office Supplies and Misc.	$5,000
Total	$40,000

Step 3: Calculate the Profitability of the Product Line.

With Step 1 and Step 2 completed above, Step 3 is simple. Here is the formula:

$$\text{Profitability of Product Line} = \left(\text{\#Units Sold per Year} \times \text{Gross Profit Per Unit}\right) - \text{Fixed Costs}$$

If your company has only one product or service, then the profitability of your product line should be identical to the profitability of your business, as in the pretax profit on your company's annual income statement. If this is the case, then organizing your income statement in a way that will clearly break out variable and fixed costs is recommended. But if you have multiple products, this analysis is useful to determine what products are contributing to your bottom line.

XYZ Company sells 150 units of the subject product line per year. As calculated above, its gross profit per unit is $500. Therefore, the total annual gross profit from the product line is $75,000. By subtracting the $40,000 of fixed costs required to be incurred annually to maintain the product line, we find that the industrial filter line adds $35,000 to the bottom line each year. The calculation is as follows.

$$\begin{aligned}\text{Profitability of Product Line} &= \left(\text{\#Units Sold per Year} \times \text{Gross Profit Per Unit}\right) - \text{Fixed Costs}\\ &= (150 \times \$500) - \$40,000\\ &= \$75,000 - \$40,000\\ &= \$35,000\end{aligned}$$

To illustrate the impact that money-losing products and services can have on a company's overall profitability, let's look at a consulting firm that has 20 types of consulting projects. Quantum Consulting spent a year tracking the labor hours and direct costs required to deliver each of its project types. Quantum also knows the income that each type of job brings. Here are the simplified 2006 data:

- Total annual revenue was $1,000,000
- Each of the 20 project types generated $50,000 in revenue
- Fixed overhead costs were, and will continue to be, $205,000 per year
- Operating profit was a negative $5,000

When each project type was analyzed for 2006, it revealed that two of the 20 project types lost money. In fact, the money-losing two together cost $50,000 more than the $50,000 in income they generated (i.e., together the two products brought in $100,000, cost $150,000 and therefore lost $50,000). If Quantum were to eliminate these offerings altogether and the labor associated with the delivery of such projects, revenues would decline to $900,000, but operating profit would increase $50,000 to $45,000. Here is the comparison.

INCOME STATEMENT – QUANTUM CONSULTING

	2006 Actual		Pro Forma	
Revenue	$1,000,000	*100%*	$900,000	*100%*
Costs of Goods Sold	$800,000	*80%*	$650,000	*72%*
Gross Profit	$200,000	*20%*	$250,000	*28%*
Fixed Expense	$205,000	*21%*	$205,000	*23%*
Operating Profit	($5,000)	*(5%)*	$45,000	*5%*

By simply eliminating 10% (two of the 20) of the project types and 10% of overall revenue, Quantum becomes a profitable company at a respectable operating profit margin of 5%. If fixed expenses could also be reduced, then the bottom line would rise dollar-for-dollar and the operating profit margin would increase sharply.

Now, another alternative would be for Quantum to find a way to keep the two money-losing offerings but make them profitable. The average gross profit of the 18 profitable offerings is 28%. If we assume that the two losers could also earn 28% or $14,000

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gross profit each, then Quantum's Proforma Income Statement would look like this:

$1,000,000	*100%*
$720,000	*72%*
$280,000	*28%*
$205,000	*21%*
$75,000	*7.5%*

Now, by simply analyzing the profitability of each product and turning around the two money-losers, Quantum's bottom line has increased to a respectable 7.5% profit margin. And that, compared to a net loss, is all the difference in the world.

A small number of money-losing products or services can have a devastating impact on the overall profitability of a company. Quantum lost money in 2006 though 90% of its products were profitable!

The lesson: Analyze your per-product profitability. Have these reports produced regularly, and then use the information to create profitability across your entire product line. The impact of losers is too great to ignore.

Setting Hurdle Rates for Profitability

As the saying goes, "There is no such thing as a free lunch." Similarly, companies do not become highly profitable without significant effort to make it so. Coupled with the fact that profitable delivery of products or services is the only way an owner can further his or her other company-supported goals or objectives, every business owner should make profitability the first and highest objective. As such, every business owner should set hurdle rates for the minimum profitability allowable for any product or service offering.

For example, well-managed retailers assign a value to each inch of shelf space, then they measure the gross profit produced by each item. Items that do not meet the required gross profit contribution are dumped for ones that will.

The Power of the Gross Profit Margin

The profitability of a business is very sensitive to its gross profit margin, because the gross profit must cover all of the fixed operating costs of the business. As such, it is important to recognize the effect that changes in gross profit margins can have on operating profit when purchasing and pricing decisions are being made.

To illustrate, if a company has a 40% gross profit margin (i.e., cost of sales takes 60% of revenue) and a 10% operating profit margin (also referred to as pretax profit), a 10% increase in the cost of goods sold will reduce operating profit by 60%. Here's the math with percentages:

	Pre($)	Post($)	% Change
Sales	$100	$100	–
Cost of Goods	$(60)	(66)	*10%*
Gross Profit	$40	34	*(15%)*
SG&A	$(30)	(30)	–
Operating Profit	$10	4	*(60%)*

The lesson: Gross profit and gross profit margins must be protected. Keep this in mind every day. Fight to obtain ever lower pricing from your vendors and find ways to win sales without reducing prices.

Checking Contribution to Fixed Overhead Expenses

Before an unprofitable product line is eliminated, be sure that you have accurately estimated indirect expenses that can be eliminated if the line is killed. If fixed-expense savings are overestimated, the result could be lower overall company profitability.

To illustrate, let's look at Rader Corp. Rader has five product lines. In 2005, four products produced $200,000 each in annual gross profit and one produced just $50,000 in annual gross profit. As such, gross profit was $850,000 in 2005. Rader's operating costs were $750,000 in 2005 and its net income was $100,000. At year-end, Rader's CFO made a pitch to Sam Rader, the owner, making a case for eliminating the fifth product line. The CFO estimated that $100,000 of fixed overhead costs could be eliminated along with the weak line. Here is the 2005 performance, the CFO's pro forma for 2006, and the actual 2006 performance:

	Actual 2005	CFO's 2006 Pro Forma	Actual 2006
Gross Profit	$850	$800	$800
Operating Costs	$750	$650	$750
Operating Profit	$100	$150	$50

On paper, the CFO's idea looked great. But the staffing cuts were delayed and then never made, and the extra facility space was not leased to a third party as projected. The result was that the fixed costs remained unchanged from 2005, but the marginal product, the one that contributed only $50,000 in gross profit in 2005, was not available to help cover overhead costs. Unfortunately, most of the year went by without Rader management realizing its mistake. But in the fall, it had to decide whether to: (1) reduce fixed operating expenses as planned, or (2) attempt to replace the lost gross profit by selling more of the remaining four product lines, or (3) add a new product that might be able to contribute more gross profit, or (4) reintroduce the eliminated product.

Sam Rader decided to reintroduce the eliminated product in a "platinum package" that was expected to perform up to par with its peers. If it does, the 2007 income statement will look as follows:

	2007 Pro Forma
Gross Profit	$1,000
Operating Costs	$750
Operating Profit	$250

Assessing Return on Marketing Expenditures

For most businesses, marketing and advertising expenditures are incurred to increase sales of already-established products. As such, the expenditure of a particular advertising or marketing program is justified by the additional sales and resulting gross profit that it generates. To assess the return on an expenditure of this type, simply calculate the number of sales that result, or are expected to result, multiply this number by the gross profit per unit, then subtract the cost of the investment made or required. Finally, divide the result by the investment made or required.

continued on next page

***Are a Few Money-Losing Products Stealing Your Profit?* continued from previous page**

For example, Vintage Wineries spent $100,000 on a series of ads in the northeastern United States that management estimated would generate 40,000 additional bottles of wine sold at an average gross profit of $3 per bottle. To assess the profitability of the expenditure, the following formula is applied:

$$\text{ROI} = \frac{[(\text{Gross Profit Per Unit} \times \text{\# of Units Sold}) - \text{Ad Cost}]}{\text{Ad Cost}}$$

= [($3 x 40,000) - $100,000] / $100,000

= ($120,000 - $100,000) / $100,000

= $20,000 / $100,000

= .20 or 20%

In this example, Vintage obtained a nice return on its investment of 20%.

Every business owner should consider the return on investment of expenditures, using an analysis similar to the above. Certainly, Vintage might also consider the present value of future purchases by customers that try their product during the analyzed period. Regardless, a process of expenditure justification should be applied to investments made in an effort to either project returns or assess actual returns.

Assessing the Attractiveness of Proposed Products or Services

You are considering adding a new product. To run the numbers, you need the following:

Annual fixed costs – Costs that do not change with volume changes such as rent, utilities, insurance, or the annual cost of furniture, fixtures and equipment.

Variable Cost Per Unit – The direct cost of producing a single unit.

Net Sale Price Per Unit – The income per unit after any sales commission.

 # Of Units Estimated to Be Sold – The number of products or services expected to be sold during the analyzed period.

The process for assessing the potential profitability of a new product or service is virtually identical to the process for assessing a marketing expenditure – both are investments. To further illustrate this type of analysis, let's consider an auto detail business that is considering adding window tinting.

Otto's Auto Detail has the space available in its existing facility. The estimate of fixed and variable expenses is as follows:

	Fixed Annual Expenses
Tools and Equipment:	$1,000 ($4,000 total / 4 yr. payback)
Advertising:	$7,000
Utility Bill Increases:	$800
Total:	$8,800
	Variable Expenses Per Tint Job
Labor:	$30 per car, incurred only as needed
Materials:	$30 per car, on average
Total:	$60

Now, Otto plans to sell each window tint job for $150 — the market rate in his area. In addition, he estimates that he can sell and deliver one a day, on average. He calculates his estimated profit as follows:

$$\text{Profit} = \left[\begin{matrix}\text{Units Sold}\\ \text{Per Year}\end{matrix} \times \left(\begin{matrix}\text{Income}\\ \text{Per Unit}\end{matrix} \times \begin{matrix}\text{Variable Cost}\\ \text{Per Unit}\end{matrix}\right)\right] - \begin{matrix}\text{Annual}\\ \text{Fixed Costs}\end{matrix}$$

= [360 x ($150 - $60)] - $8,800

= (360 x $90) - $8,800

= $32,400 - $8,800

= $23,600

To better understand his downside, Otto calculated his breakeven as follows:

Breakeven (units) = Fixed Costs / Gross Profit Per Unit

= $8,800 / $90

= 98 units (cars)

He went further and calculated the return on investment (ROI) that he would receive if he hits his sales and cost estimates. To do so, he had to adjust his numbers a bit. The total amount that he will invest at the beginning of year one is $11,800 ($4,000 in fixed assets, $7,000 in advertising and $800 in utility expenses). His annual profit is estimated to be $24,600 – $1,000 higher than the profit estimate used above because, in the ROI analysis, we subtracted from expense the $1,000 amortization of the original $4,000 investment in fixed equipment and tools. His calculations are as follows.

ROI = Annual Profit / Invested Amount

= $24,600 / $11,800

= 209%

Otto has a very nice investment at hand with a 209% annual Return on Investment.

What to Do About the One-Time Costs Incurred When a New Product Line Is Added

As we have discussed, to "run the numbers" one must calculate the annual fixed expense and the variable revenue, expense and resulting gross profit for each unit sold. But what about one-time costs that may have to be incurred when the decision is made to begin providing a new product or service, such as the purchase of real property, machinery or equipment?

The answer is that the cost of these items will be a fixed cost, as the cost of these items is not affected by unit volume — at least not within certain capacity ranges. In addition, these up-front costs must be turned into an annual cost. This can be accomplished easily by leasing the equipment rather than buying it, or by using the annual debt service requirement of the capital equipment. If the expenditure is made out of internal funds, simply divide the total amount by either the life of the capital items or the desired payback period in years. If the equipment is financed and a down payment is made, the down payment amount should be treated similarly.

For example, if the equipment is expected to last 10 years, but the owner wants a five-year payback, the down payment would be amortized over five years. As such, one-fifth of the down payment amount would be added to the annual fixed costs to arrive at the total.

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Smile, Laugh and Connect to Reduce Stress and Improve Health, **continued from page 5**

genuine connection. The word “connection” in its broadest sense means bonding with friends, family, lovers, nature and community.

At its most basic definition, connection means touch. Research with both animals and humans shows debilitating effects occur when touching ceases to be part of our lives. We fail to thrive physically and emotionally, and we become more insecure and prone to illness.

We can overcome this problem in small yet significant ways. A simple handshake, like a smile or laugh, has the power to bond people in non-threatening ways. When appropriate, timely and tasteful, and mutually acceptable, give the pat on the shoulder and other everyday gestures of friendliness and support. Of course, there are ways to foster connection other than physical touch. People appreciate being asked about their homes, families, hobbies, travel plans and social interests. This can create connections, satisfaction and relationships.

Memorable encounters with family, friends or strangers are those where participants feel a strong and lasting sense of being included and involved. These events evoke physiological feelings of belonging and camaraderie. There are no better ways to foster the healthy chemistry of happiness than smiling, laughter and connection.

So put on a smile, laugh for the “health of it” and stay in touch! ❑

Dr. Dale Anderson is an author and speaker who practiced medicine for nearly 50 years as a family doctor, board-certified surgeon and board-certified emergency physician. As a speaker, Dale travels the country prescribing method acting techniques and happiness as good medicine. He also coordinates the ACT NOW project, a coalition of dramatic artists who think medically. Dale’s most recent book, “Never Act Your Age,” was awarded a National Senior Media Award, a National Health Information Award and a Foreword Magazine Award. Contact Dale at www.acthappy.com.

Public Speaking: Your New Marketing Platform? **continued from page 6**

11. **Strong Opening, Strong Close:** The most memorable parts of your speech are the opening and the close. The opening 30 seconds are probably the most important part of your speech. After all, first impressions are immensely powerful. Then a strong close can erase a lot of mistakes and, of course, it’s your chance to leave a positive, lasting impression. So try to memorize the opening and closing word for word. Don’t use notes. Personal stories that drive your points home might do well here.

Speaking well takes a lot of time and effort. Unfortunately, time is probably one of your scarcest commodities. And therein lies another reason why few business owners use public speaking as a competitive weapon. ❑

Sally Williamson contributed her experience and expertise to this article. Ms. Williamson is CEO of Sally Williamson & Associates, an executive coaching firm that helps small businesses and large businesses develop effective communication strategies and business presentations. You can reach her at info@sallywilliamson.com.

PROFIT MAXIMIZATION

Are a Few Money-Losing Products Stealing Your Profit? **continued from page 9**

The Make-or-Buy Decision

Considering making a part internally that you currently outsource? You are facing what is referred to as a “make or buy” decision. To run the numbers you simply need to estimate annual fixed cost that will be incurred by making the product internally, and the per-unit cost. With these data, you can calculate your breakeven point and the profits to be earned at your current or projected sales levels. This will require a slight adaptation of the typical breakeven equation. In the make-or-buy decision, the “breakeven” point is the point at which the cost of making the parts internally equals the cost of buying them outside. Therefore, the equation is as follows:

$$\text{Breakeven} = \frac{\text{Fixed Costs}}{(\text{Internal Cost Per Unit} - \text{External Cost Per Unit})}$$

To illustrate, let’s assume that your company, ABC, now purchases 225,000 units annually from an outside source at an average cost of $0.25 per unit. Your calculations say that your per-unit variable cost will be $0.20 per unit at the same annual volume, and that an annual cost of $10,000 will have to be incurred to rent the required machine and staff it part-time.

The breakeven point for the proposed project is as follows:

$$\begin{aligned}\text{Breakeven} &= \$10{,}000 / (\$0.25 - \$0.20)\\ &= \$10{,}000 / \$0.05\\ &= 200{,}000 \text{ units}\end{aligned}$$

Therefore, we see that we cover our fixed costs and “break even” at 200,000 units. If our projected usage requirement is greater than 200,000 units, money will be saved by making the component in-house. If our usage requirement is less than 200,000 units per year, it will be cheaper for us to continue buying the parts from the vendor. At 225,000 units, our annual saving is calculated as follows:

$$\begin{aligned}\text{Savings} &= (\text{Unit Volume x Per Unit Savings}) - \text{Fixed Costs}\\ &= (225{,}000 \text{ x } .05) - \$10{,}000\\ &= \$11{,}150 - \$10{,}000\\ &= \$1{,}150\end{aligned}$$

ABC Company would save $1,150 by making the part internally as opposed to buying the parts from its vendor at the 225,000-unit level. ❑

Home Recordkeeping: Maintain Your Cost Basis to Reduce Tax

To minimize taxes on the eventual sale of your home, keep good records of expenditures on your home. The tax you eventually have to pay when you sell your home will be calculated from your cost basis ("basis"). It's your job to keep track of your basis, and maintain documents that support your basis calculations. A higher basis means lower taxes, so you want to build up your basis, but in doing so you must conform to rules set by the IRS. The rules are not too complex.

To start, your cost basis begins with what you paid for the home. Add to that the costs you incurred in purchasing the home, including costs associated with financing your home. The accompanying table lists home purchase costs that may be added to the basis, and those that may not.

The tax you eventually have to pay when you sell your home will be calculated from your cost basis. It's your job to keep track of your basis.

Next, because you own your home and make improvements to it, you'll want to add some of those costs to the basis. In particular, you'll add the costs that can be deemed capital improvements ("improvements"). An improvement "materially adds to the value of your home, considerably prolongs the useful life, or adapts it to new uses." Examples are adding a room, finishing out a basement, installing a fence, putting in new plumbing or wiring, paving a driveway, replacing a heating or air-conditioning unit, or putting on a new roof.

Repairs are not considered improvements. Repairs keep your home in ordinary, efficient operating condition. Repairs also can be considered maintenance, as are keeping your house clean, in good working order, and acceptable in appearance, including painting, appliance repairs and yard work. These costs cannot be added to the basis of your home.

Today, so long as you live in your home for more than two years, you will enjoy a $250,000 tax deduction on any gain you receive on the sale of your new home if you are single, and a $500,000 deduction if you are married and file jointly. So, for example, if you are married and bought your home for $300,000, added $100,000 to your basis while you owned it (by improvements, so that the basis at the time of sale was $400,000), and then sold it for $700,000 (for a gain of $300,000), you would owe no tax because the entire $300,000 gain would be sheltered by the $500,000 deduction allowed by current IRS rules. In other words, your basis-substantiating recordkeeping would go unrewarded. That's because your $500,000 home sale deduction would completely shelter even the $400,000 gain that you received from the original purchase price of your home. You did not even need to use any of your $100,000 in basis-increasing improvements to shelter you from having to pay capital gains tax.

So if you don't think that you will be so fortunate as to be able to eventually sell your home for a gain that exceeds $500,000 of the original purchase price (or, if you are single, $250,000), you are free to choose not to maintain your increasing basis and the records that support them. But if you take this route, you run the risk that either the tax law will change or your home will appreciate more rapidly than you currently anticipate. Neither is unlikely. So our recommendation is that you maintain your basis and records to support it. It's not very difficult and could save you big dollars. ❑

Home Purchase Expenses That May Be Added to the Basis of Your Home:

- Abstract fees (abstract of title fees)
- Charges for installing utility services
- Legal fees (including fees for the title search and preparing the sales contract and deed)
- Recording fees
- Survey fees
- Transfer or stamp taxes
- Owner's title insurance
- Any amounts the seller owes that you agree to pay, such as:
  - ➢ Real estate taxes (some conditions apply)
  - ➢ Back interest
  - ➢ Recording or mortgage fees
  - ➢ Charges for improvements or repairs
  - ➢ Sales commissions

Home Purchase Expenses That May NOT Be Added to the Basis of Your Home:

- Fire insurance premiums
- Rent for occupancy of the house before closing
- Charges for utilities or other services related to occupancy of the house before closing
- Any fee or cost that you deducted as a moving expense
- Charges connected with getting a mortgage loan, such as mortgage insurance premiums (including funding fees connected with loans guaranteed by the Department of Veterans Affairs), loan assumption fees, cost of a credit report, fee for an appraisal required by a lender, and fees for refinancing a mortgage

Home Sale Taxes: Four Case Scenarios

The Base Facts Used in Each Case:

Original Purchase Price of the Home[1]	$100,000
Less: Capital Gain Rolled Over from Prior Home Sale	(80,000)
Add: Capital Improvements Made	$50,000
Basis in New Home	$70,000
Offer on the Home	$350,000
Taxable Gain	$280,000

[1] Purchased in 1992

IRC "Section 121" Home Sale Capital Gain Exclusion Amount	
> Single Taxpayers	$250,000
> Married Filing Jointly	$500,000

For each of the following cases, let's assume that you purchased your home in 1992 for $100,000. In that sale you "rolled over" an $80,000 capital gain (as per prior tax laws) from your prior home, so the beginning basis in your current home was $20,000. Since the purchase, you have spent $50,000 for capital improvements to the home, increasing the basis to $70,000. Now, you have an offer to sell the house for $350,000. Let's figure the sale taxes under several different scenarios.

Case 1: Single Taxpayer, No Business Use of Home

Your total capital gain is $280,000 ($350,000 minus your basis in the home of $70,000). As a single taxpayer who has lived in the home for more than two years, you qualify for the $250,000 Section 121 capital gain exemption. Therefore, your **taxable** gain is $30,000 ($280,000 minus $250,000), and so your home sale taxes total $4,500 (15% federal long-term capital gain rate times the $30,000 capital gain).

Note: If you live in a state that has a capital gains tax, you will also owe a state capital gains tax.

After two years, you can qualify for the exclusion again and exclude up to $250,000 of the gain on the sale of another residence.

Case 2A: Single Taxpayer with Business Use of Home

Let's assume that 20% of your home is used for business purposes, and that over the past 15 years you have deducted $18,000 in expenses (20% of the total cost to heat, cool, power, clean, and insure your home) and depreciation totaling $15,000.

Calculating the home sale tax is a little more complicated in this case because any depreciation taken must first be "repaid" before the calculation of any gain and/or use of any capital gain exclusion. So, to illustrate, the first $15,000 of your $280,000 gain is "used" to repay prior depreciation. That "depreciation recapture" amount is taxed at your ordinary income rate.
If we assume that your ordinary income bracket is 25%, you'll owe $3,750 for recapture of prior depreciation taken. Now, let's deal with the $265,000 of capital gain that remains ($280,000 total capital gain less the $15,000 of depreciation recaptured). Applying the $250,000 exclusion for single taxpayers, you will have a taxable capital gain of $15,000, which will be taxed at the long-term capital gain rate of 15% and tax of $2,250. So your total tax bill in this case is $6,000 ($3,750 +$2,250).

Thus, by using your home for business purposes you increased your home sale-related tax bill by $1,500 ($6,000 minus $4,500), because the $15,000 depreciation recapture amount is taxed at 25% instead of 15%. But don't forget that by using part of your home for business purposes you were able to deduct $18,000 in expenses over the past 15 years (and no recapture required on those).

Case 2B: Single Taxpayer with Business Use of a Detached Part of Home

In this case, let's say your "home" has a separate structure — an old servants' quarters, detached garage area or barn — separate from the main structure that you live in. Let's assume that you use that space for a business purpose. In this case, the tax rules are much different.

First, you can't use any of your $250,000 exemption to shelter the business use portion of your property. So let's assume that the separate structure used for business purposes accounts for 20% of the total square footage of improvements on your property (for example, your home is 3,500 square feet and your converted, detached garage is 875 square feet [875/(3,500 + 875) = 20%]).

The 20% business portion of your gain is $56,000, while the 80% personal portion of your gain is $224,000. First, the $15,000 depreciation that you took on the business use of your home on prior business tax returns is recaptured and taxed at your ordinary income tax rate (25%). This results in a tax of $3,750. Next, the remainder of the $56,000 business gain — $41,000 — is taxed at the long-term capital gain rate of 15%, which results in additional taxes of $6,150. Finally, the $250,000 exclusion for single taxpayers is applied to the personal capital gain of $224,000 and you will have no additional tax due.
So your total tax bill in this case is $9,900.

Thus, by using a separate portion of your property for business purposes, you increased your tax bill by $5,400 ($9,900 minus $4,500).

Note: If you had not used the separate portion of your property for business purposes for at least two of the five years preceding the sale, or if the portion of your property used for business would have been a part of your dwelling unit (as in Case 2A), as opposed to a separate portion of your property, you would have been able to use the full exclusion. In either case, you still would have had to pay the $3,750 "recapture" tax on the $15,000 you took as depreciation on prior tax returns, but the net savings would have been $3,900 — the amount of the exclusion you were not allowed to use ($26,000 times the 15% long-term capital gains rate).

What to do: Carefully analyze with your accountant the current and future tax effects of writing off part of your property for a business purpose. The trade-off is simply the value of today's tax deductions from the business portion of your property versus the additional future taxes to be paid if and when you sell your home. You and your accountant can work through the math for

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About the Publisher

David L. Perkins, Jr. owns, writes, edits and publishes *The Business Owner*, the newsletter of choice for more than 35,000 business owners who are serious about building wealth through successful private business ownership.

Perkins draws editorial ideas and inspiration from his own life as a business owner and investor, and his daily work as a merger and acquisitions consultant, where he has advised on more than 100 purchase/sale transactions involving both private and public companies. His M&A consulting firm is Acquisition Advisors, which he founded in 1997 and specializes in transactions valued between $5 million and $75 million. Visit AcquisitionAdvisors.com to learn more.

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***Home Sale Taxes: Four Case Scenarios*, continued from previous page**

both scenarios. You may find that your business-use deductions are not worth the potential capital gain and depreciation recapture taxes you will be paying when you sell your home.

Case 3: Married Couple Filing Jointly with No Business Use of Home

Current federal tax law allows married couples to exclude $500,000 of capital gain on the sale of their home, so the entire capital gain of $280,000 is "sheltered" by the $500,000 exclusion. But if this married couple had used the home for business use — as in the facts in Case 2A above — the couple still would be subject to the depreciation recapture of $3,750, but no capital gains tax would be due. Finally, just as a side note, if you used this home for business use as in the facts in Case 2B above, the taxes would be the same as Case 2B — $9,900. ❑

Armand Paliotta and Kendra Robben provided their expertise for this article. Mr. Paliotta and Ms. Robben are attorneys with Hartzog, Conger, Cason & Neville in Oklahoma City, Oklahoma.

Ask the Editor: Deductible Business vs. Personal Expenses

Ask the Editor: What prevents me from having my company pay for my personal expenses? I see other business owners doing it.

Answer: The Internal Revenue Service of the United States requires that you keep track of your revenue, expense and income in a certain manner. That manner does not allow you to deduct just anything as an expense. In fact, the IRS says that you can deduct only expenses that are "ordinary and necessary" for the operation of the business.

In addition to the ordinary and necessary tests, the IRS applies a "reasonable" test. They ask, "Is the expenditure a reasonable expense for the business?"

For further guidance, the IRS defines "ordinary" as common and accepted in a field of business (i.e., the field of business you are in), and defines "necessary" as helpful and appropriate to your business.

Ordinary would include expenses that are frequent and ongoing, such as amounts spent on telephone service or business meals, but it also can apply to something that you pay only once, such as the purchase of a trade booth.

An expense does not have to be indispensable to be a considered "necessary." The IRS will give you the benefit of the doubt on such things. For example, the cost of a client outing or a new piece of art for your reception area is deductible as a necessary business expense, assuming that the former is meant to build a relationship with a client, and the latter is necessary to provide comfort and an "established" feel for employees and customers.

But the cost of a new set of golf clubs purchased by a business owner would not be deductible. Of course, the business owner might claim that he or she needs them to play golf with clients, but the expenditure is largely considered to be for personal use and the IRS would in all likelihood deem them unnecessary. It would be considered a nondeductible personal expense.

In addition to the ordinary and necessary tests, the IRS applies a "reasonable" test. It asks, "Is the expenditure a reasonable expense for the business?" The answer may depend on the particular business at hand. For example, a helicopter might be deemed a necessary expenditure for a private ambulance service or an offshore drilling company or a large forestry company, but not for the owner of three Subway units in a single midsize city. Similarly, a lavish party with caviar and expensive champagne might be deemed necessary for a firm that does business with foreign dignitaries, but not for a local landscape architectural firm. ❑

Smart Owners Are Making These Year-End Tax Moves

It's been a pretty good year. The economy is strong and profits are healthy. Now it's time to work on reducing the tax bite. Here's how smart business owners whittle it down. They're making these moves before Dick Clark counts it down.

Set Up a Tax-Favored Retirement Plan

The most effective way to shelter income from taxes is by funding retirement accounts, and business owners now have better retirement plan options than ever before. The key is to get started. To reduce 2007 taxes, set up your new plan before year-end. Here are some popular options:

SEP: The Simplified Employee Pension (SEP) plan will allow you to contribute and deduct up to $45,000 this year.

Solo 401 (k): May allow you to contribute and deduct up to $45,000 this year.

Defined Benefit Pension Plan: This plan gives you the potential to contribute and deduct more than any other, up to $180,000 in 2007. The exact amount depends on factors such as your age and income.

Note that although these plans offer powerful tax-reducing and wealth-building benefits, they do contain rules and complexities. For example, some require that you open the plan to employees. Talk to your financial advisor.

Delay Revenue and Maximize Expense

By doing either one, you'll reduce current-year book profit and thereby lower your 2007 tax bill. Here's how:

- Delay shipments until January 1. You'll reduce current-year profit (assuming the jobs are profitable).
- Delay invoicing. Many companies simply recognize revenue when the invoice is cut. Delay invoicing and reduce current-year profit.
- Record all payables before the new year. Don't allow payables to sit in the inbox unrecorded.
- Arrange for vendors to deliver any invoices "in their system" before year-end, especially large invoices.
- Accrue (record) all unrecognized obligations such as earned-but-unpaid wages and bonuses.

Purchase Equipment and Software

Most small businesses are eligible for the "Section 179" deduction. For tax years beginning in 2007, you can immediately deduct up to $125,000 worth of business equipment — as long as it's up and running by year-end. That equipment can be new or used. Software costs qualify. Business-use vehicles also may qualify, but there are special rules for vehicles. See below for treatment of "heavy" vehicles deemed to be SUVs. Heavy vehicles NOT deemed to be SUVs are treated like other types of equipment for section 179 purposes (and that's a good thing).

Buy a Qualifying "Heavy Vehicle" SUV

To the extent that you don't use all of your $125K section 179 allowance on equipment and software, consider buying a new SUV before year-end to take up the slack. Be sure it's rated 6,000 pounds or more.

The Section 179 amount you can take from the purchase of an SUV to $25,000, but you can take that PLUS regular first-year depreciation on the cost left after the first deduction.

Also, be aware that you can claim depreciation deductions only for the business-use percentage of an assets cost. For example, if you use a vehicle 80% for business and 20% for personal purposes, you can depreciate only 80% of the cost.

The Section 179 deduction cannot exceed your business taxable income (calculated before the Section 179 write-off). For 2007, the deduction is phased out if your business acquires more than $500,000 worth of assets that would otherwise qualify for the Section 179 write-off.

When a heavy SUV, pickup or van is owned by your corporation, it must be used more than 50% for actual corporate business activities (based on mileage) to qualify for the Section 179 write-off. When the over-50% business-use test is failed, your corporation must depreciate the vehicle using the straight-line method (in which case it will take six years to write off the cost completely).

Offset Investment Gains and Losses

Investment losses are not tax-deductible but can be used to offset taxable gains. If you have sold investments in 2007 at a loss and have other investments — such as stocks — with paper gains, consider selling and taking a gain equal to the loss. The gain thus will be shielded from taxes. The reverse also holds true. If you have realized gains during 2006, consider selling some losers to offset the gain. Be alert to short- and long-term issues. Short-term gains are taxes at ordinary income rates. You'll need short-term losses to offset short-term gains, but short-term losses can also be applied to long-term gains.

Spend Unused FSA/HSA Dollars

If there is any money left in your flexible spending account, spend it by year-end or lose it. So go get that checkup, procedure, prescription refill, new set of eyeglasses, etc.

Manage the AMT

If your income is above $75,000 and you have significant write-offs for personal exemptions and took (or are considering taking) some sizeable capital gains, talk to your financial advisor. You could be facing a big Alternative Minimum Tax (AMT) hit. ❑

> **"At every level, relationships are built on listening, connections, common interests, and experiences."**
>
> *Donald J. Trump*

2007 Tax Information

PERSONAL EXEMPTION	$3,400 per person (none if filing as a dependent)
EXEMPTION PHASEOUT	Starts at $234,600 (MFJ), $195,500 (H of H), $156,400 (single), $117,300 (MFS)
MAXIMUM SALARY DEFERRALS	$15,500 for 401(k), 501(c), 457 and 403(b) plans. ($25,000 if over 50) $10,500 the Simple, $13,000 if 50 or older.
MAX. RETIREMENT PLAN CONTRIBUTIONS	IRA (Regular and Roth*): $4,000; $5,000 if 50 or older Defined Contribution Plans: $45,000 Defined Benefit Plans: $180,000 * Roth phaseout begins @ $99K AGI for Single; $156K for MFJ; $0 for MFS
STANDARD MILEAGE RATES	Business: 48.5 cents; Charity 14 cents; Medical/Moving 20 cents
ITEMIZED DEDUCTION PHASEOUT	Starts at AGI over $156,400 (MFJ, H of H, S), $78,200 (MFS)
SOCIAL SECURITY	7.65% (6.2 % SS +1.45 % Medicare) SS levied on first $97,500 in wages only ($6,045 max. SS paid by any individual). Household help: SS tax levied only after $1,500 paid.
KIDDIE TAX (Children under 18)	First $850 not taxed; $850 to $1,700 at child's rate; over $1,700 at parents' rate.
FOREIGN INCOME EXCLUSION	$85,700
SECTION 179 LIMIT	$125,000 max. aggregate, less phaseout as total 179 property placed in '07 exceeds $500,000.
CAPITAL GAINS RATES* *Non-collectables ("collectables" are taxed at 28%)	Assets held 1 year or less: taxed at ordinary income rates Assets held more than 1 year: • 15% for taxpayers in brackets higher than 15%, • 5% for taxpayers in 15% or lower tax bracket
CHILD TAX CREDIT	$1,000 for each child under age 17. Phaseout begins at $75K AGI for Single; $110K for MFJ and $55K for MFS.
AMT RATES	26% of income up to $175,000 ($87,500 (MFS)); 28% thereafter
AMT EXEMPTION	$33,750 (S, H of H); $45,000 (MFJ); $22,500 (MFS). Phaseout begins at $150K; $112.5K and $75K, respectively.
DIVIDEND INCOME	5% for 10% and 15% income tax rate payers; 15% for taxpayers in brackets higher than 15%
ANNUAL GIFT EXCLUSION	$12,000
ESTATE TAX EXCLUSION	$2,000,000
RETIREMENT PLAN WITHDRAWALS MANDATORY	Age 70 1/2
HOME SALE EXCLUSION	$250,000(S), $ 500,000 (MFJ)

ESTATES AND TRUSTS

If Taxable Income Is:	The Tax Is:
Not over $2,150	15% of taxable income
Over $2,150 but not over $5,000	$323 plus 25% of the amount over $2,150
Over $5,000 but not over $7,650	$1,035 plus 28% of the amount over $5,000
Over $7,650 but not over $10,450	$1,777 plus 33% of the amount over $7,650
Over $10,450	$2,701 plus 35% of the amount over $10,450

MARRIED FILING JOINT/SURVIVING SPOUSE

If Taxable Income Is:	The Tax Is:
Not over $15,650	10% of taxable income
Over $15,650 but not over $63,700	$1,565 plus 15% of the amount over $15,650
Over $63,700 but not over $128,500	$8,773 plus 25% of the amount over $63,700
Over $128,500 but not over $195,850	$24,973 plus 28% of the amount over $128,500
Over $195,800 but not over $349,700	$43,831 plus 33% of the amount over $195,850
Over $349,700	$94,601 plus 35% of the amount over $349,700

* Standard deduction $ 10,700 (+$1,050 for each spouse age 65+or blind, $2,100 for each spouse age 65+and blind.)
* Standard deduction (SD) for the dependents is the greater of $850 or earned income plus $300 (not to exceed the SD for dependent's filing status).

HEAD OF HOUSEHOLD

If Taxable Income Is:	The Tax Is:
Not over $11,200	10% of taxable income
Over $11,200 but not over $42,650	$1,120 plus 15% of the amount over $11,200
Over $42,650 but not over $110,100	$5,838 plus 25% of the amount over $42,650
Over $110,100 but not over $178,350	$22,700 plus 28% of the amount over $110,100
Over $178,350 but not over $349,700	$41,810 plus 33% of the amount over $178,350
Over $349,700	$98,356 plus 35% of the amount over $349,700

* Standard deduction $ 7,850 (+$1,300 for each spouse age 65+or blind, $2,600 for each spouse age 65+ and blind.)
* Standard deduction (SD) for the dependents is the greater of $850 or earned income plus $300 (not to exceed the SD for dependent's filing status).

SINGLE

If Taxable Income Is:	The Tax Is:
Not over $7,825	10% of taxable income
Over $7,825 but not over $31,850	$783 plus 15% of the amount over $7,825
Over $31,850 but not over $77,100	$4,386 plus 25% of the amount over $31,850
Over $77,100 but not over $160,850	$15,699 plus 28% of the amount over $77,100
Over $160,850 but not over $349,700	$39,149 plus 33% of the amount over $160,850
Over $349,700	$101,469 plus 35% of the amount over $349,700

* Standard deduction $ 5,350 (+$1,300 for each spouse age 65+or blind, $2,600 for each spouse age 65+ and blind.)
* Standard deduction (SD) for the dependents is the greater of $850 or earned income plus $300 (not to exceed the SD for dependent's filing status).

MARRIED FILING SEPARATE RETURNS

If Taxable Income Is:	The Tax Is:
Not over $7,825	10% of taxable income
Over $7,825 but not over $31,850	$783 plus 15% of the amount over $7,825
Over $31,850 but not over $64,250	$4,386 plus 25% of the amount over $31,850
Over $64,250 but not over $97,925	$12,486 plus 28% of the amount over $64,250
Over $97,925 but not over $174,850	$21,915 plus 33% of the amount over $97,925
Over $174,850	$47,301 plus 35% of the amount over $174,850

* Standard deduction $ 5,350 (+ $1,050 for each spouse age 65+or blind, $2,100 for each spouse age 65+ and blind.)
* Standard deduction (SD) for the dependents is the greater of $850 or earned income plus $300 (not to exceed the SD for dependent's filing status).

CORPORATE TAX RATES

If Taxable Income Is:	The Tax Is:
$0 to $50,000	15%
Over $50,000 but not over $75,000	$7,500 plus 25% of excess over $50,000
Over 75,000 but not over $100,000	$13,750 plus 34% of amount over $75,000
Over $100,000 but not over $335,000	$22,250 plus 39% of the amount over $100,000
Over $335,000 but not over $10,000,000	$113,900 plus 34% of the amount over $335,000

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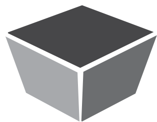

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