FINANCE

Improving Cash Flow Through Proactive Tax Planning

BY JARED ASAY

High and low. Feast or famine. Up and down. This is the nature of the construction business. That's why forecasting, budgeting and managing cash can be a real challenge. A construction company's cash position impacts not just its ability to operate now, but also in the future. As such, the better the cash flow, the more successful the business.

> "Companies win when they think of taxes strategically all year long.

Owners of LLCs or S-corporations seldom think of taxes as a way to improve their businesses. They view taxes as an expense, but that's not entirely true. Taxes are the company's responsibility and, when managed properly, they can actually improve a firm's cash position.

A proactive tax plan is consistent with the company's budgets, complimentary to its bonding needs and sensitive to the owner's financial resources. Rather than thinking about taxes in December, or at the end of the fiscal year and again on April 15, companies win when they think of taxes strategically all year long.

Understand the Differences Between Book and Tax

Construction companies can use several different types of tax reporting methods depending on their size and services. The options include percentage of completion (also known as the book method), completed contract, cash and others. Working with a construction CPA can help companies make the reporting method choice that maximizes their cash position.

Money-saving differences within these tax reporting methods can be permanent or temporary. One example of a permanent difference is accounting for 50 percent of meals and entertainment and certain non-deductible penalties. Two common temporary differences focus on depreciation methods and deferred income. The tax savings can be significant, but they require the guidance of a construction CPA to plan one or more years into the future so there are no surprises in April for the prior year's activity.

Save Now for Future Cash Requirements

When times are good, people embrace their success and are tempted to spend. But construction company owners must recognize the cyclical nature of the industry. Good times don't necessarily justify increasing their own salaries, taking additional distributions of profits or purchasing business assets in excess of the company's current needs.

For example, what happens when a contractor purchases a new backhoe for $100,000? It's likely that the company will take an IRS Section 179 depreciation expense for the current year tax return. This accelerated tax deduction saved the company and the business owner approximately $35,000 in taxes. But, has the company set aside $35,000 for taxes that will come due when there is no more depreciation to take on that asset? Also, did the company pay cash or use debt to purchase the asset? If the company used debt, the cash required to pay the additional principal payments must come from future cash income.

Lacking this financial planning can hurt a business by setting up a cash flow pinch and by giving bonding agents and lenders a reason to pause. Why not consider creating a separate savings account or opening a certificate of deposit so that the bonding agents and lenders who read financial statements see funds set aside for future taxes on current earnings?

Business owners become better informed by identifying the company's current and future cash outlays (including the future tax effect of current earnings and activity). They'll make more informed decisions, and the company will become more self-sufficient. They'll also experience increased bonding capacity and enhanced ability to meet debt covenants.

Pay Taxes Strategically

Industry volatility makes planning and budgeting more complex. The IRS' system of tax brackets are calculated based on taxable income. Paying taxes generally indicates a

Don't miss ABC's upcoming events!

ABC INDUSTRIAL USERS SUMMIT
Oct. 16–17, 2014
San Antonio, Texas
www.abc.org/ius

2014 ABC LEADERSHIP CONFERENCE
Nov. 11–13, 2014
Miami, Fla.
leadership.abc.org

Attorneys 2014 Conference
Nov. 13–14, 2014
Miami, Fla.
attorneys.abc.org

Workforce Conference
March 3-6, 2015
Ft. Lauderdale, Fla.
wdc.abc.org

2015 ABC LEGISLATIVE CONFERENCE
June 25, 2015
Washington, D.C.
legcon.abc.org

abc.org/events

company had a successful year (i.e., the higher the tax bracket, the better the year).

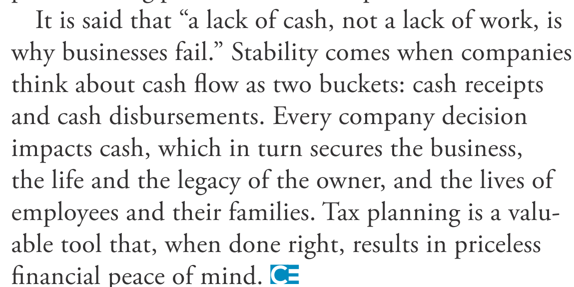
However, given the volatility of the construction industry, companies should do everything they legally can to avoid paying tax at the highest bracket one year, only to show break-even or loss the next year. A loss may sound good initially, but it can restrict the owners from using their much-needed itemized deductions.

Certain IRS provisions allow contractors to manage this volatility. Cash-basis companies can either accelerate payments to suppliers or defer receipts of payment from customers near year-end to stay at the lower tax brackets.

Employer contributions to pension plans also can shift a company to a lower tax bracket. By developing a target taxable income amount at year-end and building a proactive tax plan early on, companies can manage tax liabilities and avoid surprises.

Coordinate Tax Planning With Financial Planning

Smart companies recognize that tax planning cannot happen in isolation; it's an important piece of their overall organizational plan. Coordination among all facets of the business is critical to the company's long-term success and legacy. Companies that plan in isolation may decide to defer a small amount of money on taxes only to find that the decrease caused their bonding limits to fail their line of credit or debt covenants. Tax planning is part of the big picture, not its own picture.



It is said that "a lack of cash, not a lack of work, is why businesses fail." Stability comes when companies think about cash flow as two buckets: cash receipts and cash disbursements. Every company decision impacts cash, which in turn secures the business, the life and the legacy of the owner, and the lives of employees and their families. Tax planning is a valuable tool that, when done right, results in priceless financial peace of mind. CE

Jared Asay is senior audit manager for Morrison, Clark & Conover CPAs, Chandler, Ariz. For more information, call (480) 424-7855 or email jasay@morrisonclarkconover.com.