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Tax & Business Alert

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WHEN IS EMPLOYER-PROVIDED LIFE INSURANCE TAXABLE?

If your company benefits include group term life insurance paid by your employer, a portion of the premiums paid for the coverage may be taxable. Depending on the amount of coverage you're provided, some of it may create undesirable income tax consequences for you.

The cost of the first $50,000 of group term life insurance coverage that your employer pays for is excluded from taxable income and doesn't add anything to your income tax bill. That's good news. But the employer-paid cost of group term coverage over $50,000 is taxable income to you. That means it will be included in the taxable wages reported on your Form W-2 — even if you never actually receive it. In other words, it's "phantom income."

HAVE YOU REVIEWED YOUR W-2?

What should you do if you think the tax cost of employer-provided group term life insurance is too high? First, you should establish if this is actually the case. If a specific dollar amount appears in Box 12 of your Form W-2 (with code "C"), that dollar amount represents your employer's cost to provide you with group-term life insurance coverage of more than $50,000, minus any amount you paid for the coverage. You're responsible for federal, state and local taxes on the amount that appears in Box 12 and for the associated Social Security and Medicare taxes as well.

But keep in mind that the amount in Box 12 is already included as part of your total "Wages, tips and other compensation" in Box 1 of the W-2. It's the amount in Box 1 that is reported on your tax return.

WHAT ARE YOUR OPTIONS?

If you decide that the tax cost is too high for the benefit you're getting in return, you should find out whether your employer has a "carve-out" plan. That's a plan that allows selected employees to carve out from the group term coverage. If your employer's plan doesn't offer a carve-out, ask if they'd be willing to create one.

HOW IS PHANTOM INCOME CALCULATED?

The cost of employer-provided group term life insurance that will be taxable income to you is determined using the IRS Premium Table based on preset factors such as age. Under these determinations, the amount of taxable phantom income attributed to an older employee is often higher than the premium the employee would pay for comparable coverage under an individual term policy. This tax trap gets worse as the employee gets older and as the amount of his or her compensation increases.

There are several different types of carve-out plans that employers can offer to their employees. For example, the employer can continue to provide $50,000 of group term insurance (since there's no tax cost for the first $50,000 of coverage). Then, the employer can either provide the employee with an individual policy for the balance of the coverage or give the employee the amount the employer would have spent for the excess coverage as a cash bonus that the employee can use to pay the premiums on an individual policy.

You may have questions about this important topic, such as how much your group term life insurance benefit is adding to your income. Contact us for help with this and other questions. ■

SHOULD YOU DIGITIZE YOUR TAX AND FINANCIAL RECORDS?

Traditionally, important tax and financial records have been stored as hard copies in desk drawers, filing cabinets and safe deposit boxes. These days, however, it's become increasingly popular and easy to digitize documents and store them electronically. Is this the right move for you?

THE CASE FOR GOING DIGITAL

One of the biggest advantages of digital documents is a drastic reduction in the amount of paper that you must sort, organize and store. Also, digital documents are generally more protected from damage than paper files — assuming they're stored properly. After all, paper records are subject to damage or loss by fire, theft, mold and sprinklers. These risks can be easily mitigated with good electronic storage practices.

Digitized records improve productivity. For example, documents can be efficiently searched for (and searched through) using keywords. But paper files that are misplaced or misfiled may require hours of rifling through file cabinets and paper folders.

Electronic documents can also be digitally date-stamped, which helps ensure that you're accessing the most recent versions. You can track edits to electronic files, monitor who's been viewing them and restrict access to sensitive documents, too.

OPTIONS FOR ELECTRONIC STORAGE AND SOME RISKS

To digitize paper documents, you need only a scanner. Scanners are widely available for purchase or rent. After digitization you can reduce your paper files by shredding many of them, though you may need to retain paper versions of some legal documents. (Consult an attorney about which ones.)

When it comes to storage, you essentially have two options:

1. A self-hosted system. Here, you buy a dedicated hard drive (or several high-quality thumb drives) on which to store your digital records. It's best not to keep these files on your home computer because, if it crashes or gets hacked, your sensitive data will be exposed. Hackers can't get to self-hosted files because they're not on the internet, and you can limit your drive's exposure to natural disasters or accidental damage by keeping it in a fire-proof safe.

2. The cloud. You've likely heard of, and may even use, internet-based storage for photos or other items. You can do this for tax and financial records as well, but you've got to be careful. Choose a reputable and stable provider that encrypts everything. The upside is you'll have instant access to your files anywhere in the world — as long as you have a secure internet connection. The downside: You'll lose access during internet outages and no cloud system is 100% guaranteed secure.

DOCUMENT SECURITY IS PEACE OF MIND

For many people, the right approach to secure document storage might be using both paper and electronic to some extent. Retain paper files of certain documents for a recommended period and digitize everything else. We can help you find the best way to keep your tax and financial records organized and safe. ■

TOO MUCH INVENTORY AT YOUR BUSINESS? TRIM THE FAT!

Businesses need to have inventory on hand. But having excess inventory is expensive, so it's important to keep it as lean as possible. Here are some ways to trim the fat from your inventory without compromising revenue and customer service.

ACCURACY FIRST

Effective inventory management requires starting with an accurate physical inventory count. That allows you to determine your true cost of goods sold — and to identify and remedy discrepancies between your physical count and perpetual inventory records. A CPA can introduce an element of objectivity to the counting process and help minimize errors.

Next, compare your inventory costs to those of other companies in your industry. Trade associations often publish benchmarks for:

- Gross margin ([revenue – cost of sales] / revenue),
- Net profit margin (net income / revenue), and
- Days in inventory (annual revenue / average inventory × 365 days).

Your company should strive to meet — or beat — industry standards. For a retailer or wholesaler, inventory is simply purchased from the manufacturer. But the inventory account is more complicated for manufacturers and construction firms. It's a function of raw materials, labor and overhead costs.

The composition of your company's cost of goods will guide you on where to cut. In a tight labor market, it's hard to reduce labor costs. But it may be possible to renegotiate prices with suppliers.

Don't forget the carrying costs of inventory, such as storage, insurance, obsolescence and pilferage. You can also improve margins by negotiating a net lease for your warehouse, installing antitheft devices or opting for less expensive insurance coverage.

PRODUCT MIX

Cutting your days-in-inventory ratio should be done based on individual product margins. Stock more products with high margins and high demand — and less of everything else. Whenever possible, return excessive supplies of slow-moving materials or products to your suppliers.

Product mix should be sufficiently broad and in tune with consumer needs. Before cutting back on inventory, you might need to negotiate speedier delivery from suppliers or give suppliers access to your perpetual inventory system. These precautionary measures can help prevent lost sales due to lean inventory.

REALITY CHECK

Often, managers are so focused on sales, HR issues and product innovation that they lose control over inventory. Contact us for a reality check. ■

A FAMILY BUDGET FOR YOUR NEEDS — TODAY AND TOMORROW

A wise person — who may or may not have been an accountant — once said, "Simplicity is the key to a family budget." However, the budget should also be comprehensive enough to cover all necessities. To find the right balance, a budget should cover two distinct facets of family members' lives: the near term and the long term.

Your near-term budget should encompass the day-to-day items that affect your family. First, the home: This is often the most expensive item in a personal budget, and includes mortgage payments or rent, utilities, maintenance, and supplies.

Other items related to daily life that need to be accounted for include groceries, fuel, clothing, child care, insurance and out-of-pocket medical expenses. Also, families need to draw clear distinctions between fixed and discretionary spending.

Along with being a practical guide to near-term family spending, a budget should address long-term goals, some of which are further out than others. For example, virtually everyone's longest-term objective should be to have a comfortable retirement. So, a budget needs to incorporate retirement plan contributions and other ways to meet this goal.

A relatively less long-term goal might be funding college for each child. And, as a long-term but "as soon as possible" objective, a budget needs to be structured to pay off debts and maintain a strong credit rating. Our firm can help you craft a sensible budget that reflects your family's distinctive needs. ■