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Management Fees

Not ordinary and necessary business expenses

By Erin Koplitz, CPA

Daniel Fuhrman owned a trucking business. For liability purposes he organized his business into five wholly owned corporations including Top Line Express, Inc. and Top Leasing, Inc. In addition to his corporations, he was the sole member in a limited liability company called Grasshopper Leasing, LLC.

Grasshopper owned about 30 trucks. Its sole business was leasing the trucks to affiliated entities, mainly Top Line. Top Line would use the trucks in its business of hauling goods that consisted primarily of auto parts. Top Line employed all the business office personnel for Daniel's trucking business, while Top Leasing employed all the truck drivers.

Grasshopper did not have any employees. Top Line's employees performed management and administrative services for Grasshopper. However, there wasn't a written contract between Grasshopper and Top Line. Furthermore, Top Line did not maintain any contemporaneous time records for the services its employees provided to Grasshopper. During 2004 and 2005, Top Line invoiced Grasshopper for management services that it allegedly performed for Grasshopper. In 2004 and 2005, Grasshopper paid Top Line $101,382 and $108,000, respectively.

In reporting the income from Grasshopper, Daniel claimed "Other expenses" of $103,645 and $115,168 on his 2004 and 2005 Schedule C, *Profit or Loss From Business (Sole Proprietorship)*. The majority of the amounts claimed as "Other expenses" reflected the management fees that Grasshopper paid to Top Line.

The IRS issued deficiency notices and determined deficiencies of $27,917 and $25,534, and §6662(a) accuracy-related penalties of $5,583 and $5,107 for 2004 and 2005, respectively. The deficiencies were a result of the IRS disallowing $57,052 for 2004 and $63,660 for 2005 of Schedule C "Other expenses." The notice explained that these amounts were disallowed because Daniel had not established that the "Other expenses" were ordinary and necessary business expenses.

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LIFE LESSONS

how to be successful personally, professionally, and financially

By Michele Knight, CPA

I was recently given the opportunity to speak to a group of talented young students at the Daniel's College School of Business. I presented the students with some life lessons about how to be successful personally, professionally, and financially. Many of those lessons can serve as a reminder to us grown-ups as well, so I'll share some of them with you!

The first lesson is simple common sense: to get rich, spend less than you make. I've worked with clients ranging from school teachers to CEO's, and there isn't necessarily a correlation between annual salary and net worth. The simple secret to amassing wealth is to live below your means. And, while I don't believe that money can buy you happiness, I do believe that money buys security, and that's something we all desire.

Another important life lesson is always to be charitable. My personal passion is with Rotary; yours might be a church, an animal shelter, or your child's school. Whatever it is you feel strongly about, make sure that you are giving back whenever you can. At times, this may be as simple as writing a check. At other times, when cash is tight, you can volunteer your time. Don't be pressured into giving away money and jeopardizing your family's financial stability. All that matters is that you give what you can. The

Take a **fresh look** at the **American** dream.

rewards you receive will outweigh your investment every time.

It's important that people understand why they should start saving money as soon as they can. Did you know that if you saved $5 per day for one year—the cost of one cup of coffee or a pack of cigarettes—and invested that money with an 8 percent return, you would have $3,800 in ten years, $8,100 in twenty years, and $17,600 in thirty years? If you saved that same $5 per day for thirty years—not just for one year—you would have contributed $54,750 to savings, but it would be worth $215,000! If you're not familiar with the "time value of money," check it out online. It's a very powerful concept!

The students also wanted advice on how they should save their money. As always, I advised them to seek out a qualified financial planner, but the current popular theory is to start by putting money into a 401(k), up to the amount your company will match, then invest the next $5,000 into a Roth IRA, and then max out your 401(k). After that, if you have more money to invest, the options are plentiful.

If your children are able to work, or if you are self-employed and could hire them once they reach an appropriate age, consider matching their income with an additional deposit into a Roth IRA for them. Imagine the long-term benefits that a teenager could reap if they can let that investment grow for twenty to thirty years and then withdraw it tax free.

And, the last bit of advice I offered them was to take a fresh look at the American Dream. In this new economy, home ownership may not be the best goal for everyone. There is a sense of security in being able to pay your bills each month without fear or stress. Renting a place until you save up enough money to cover the down payment—several months of mortgage payments—and enough for repairs and maintenance on a house may be the best option for your family.

In pursuit of finding the secret to success, I reached out to a few people who have retired early, with enough resources to enjoy every moment of it. Their advice was so similar in nature that I think it would be unfair to keep it to myself. Their secret is this: make what you need and then don't lose it. We all know people who are able to save a great deal of money, but then they loan it to a friend, invest it in a new business, or watch it go down the drain in the stock market. In these days of get-rich-quick schemes and high expectations for 10 percent returns, many people have lost sight of the "slow and steady wins the race" approach.

Other tips they shared are equally as valuable. If you are aiming for financial success in your life, consider the following:

- Live below your means.
- Drive cars until they fall apart.
- Don't invest in things you don't understand.
- Give what you can of your time and money to charity; it will all come back to you.
- Marry someone with similar work ethics and financial priorities as yours.
- Don't be afraid to put your goals in writing.
- Recheck your financial plan every year.
- Save for your retirement first, then your children's educations.
- And, of course, buy low, sell high!

Naturally, this advice doesn't apply to everyone in every situation, but please consider sharing bits and pieces with your kids, your clients, your parents, and your friends. We're never too young—or too old—to improve our financial picture.

Michele Knight is a CPA and QuickBooks ProAdvisor who has been fascinated with saving money since her father taught her about the time value of money at the age of nine. Both are proud NATP members today. For more info and insights, please visit www.cpamichele.com.