



## **YOUR FINANCES: Smart Cash Flow Management Can Make You Rich**

December 2006, By Guy McPhail

As a small business owner, you know that the most precious commodity you can get your hands on is Free Cash Flow. That's the money a company has left over after it has paid all of its operating costs and other expenses. Smart business owners reinvest some or all of this money to generate long-term growth for their companies.

What too few business owners do, however, is think about their personal cash flow in the same terms. But they should. Just as investing free cash flow in new machinery or an extra salesman will help your company grow and create greater long-term value in the business, you can build your own personal wealth by investing your own free cash flow.

There are three primary ways to maximize personal cash flow:

1. Pay no more taxes than you need to, and invest the money you saved from the taxman.
2. Use debt smarter to preserve current cash flow and invest the difference.
3. Refine your lifestyle spending without depriving yourself, and add the money saved to your investment portfolio.

We will discuss tactics for maximizing cash flow in subsequent articles. But before we do, I want to illustrate another critical point, which my financial planning firm calls *integrated* cash flow management. Typically, people try to separate personal and business finances. Yet, for the business owner, investing for retirement, tax planning and business budgeting are related. And which sources of cash you use for which expenses can make a difference. Consider these examples:

### **Paying For Your Personal Financial Plan**

As you'll recall, I advised in a [previous column](#) that you should create a personal financial plan that will help you expand your business and build your personal wealth. You should start with a personal plan, then create or refine your business plan to support it. For this, you should seek a financial planner who is also a CPA and can handle both plans.

So, when it comes time to pay the planner, which checkbook should you use your personal checkbook or your company's? Most small business owners assume that because a personal financial plan is personal they must pay the financial planner with a personal check. Not so!

Because it is imperative that any small business owners business plan be aligned with his or her personal financial plan, the planners fee is a legitimate, deductible business expense.

What's more, it can cost you dearly to pay from your personal account. Say you hire a financial planner and his fee for meeting with you, putting together your personal financial plan and helping you implement the plan is \$7,500. If you are in the 40% tax bracket, and your business writes the check for your financial plan (assuming you have an S-Corp or an LLC business), your net cost would be just \$4,500 (the \$7,500 less 40% in tax savings), because the plan is a business expense. (And what do I recommend you do with that newfound \$3,000 in free cash flow? Right! Add that money to your investment portfolio and speed up reaching your wealth goal.)

On the other hand, were you to pay with a personal check it would cost you \$12,500 (That's the amount of earned income you would need to generate \$7,500 after taxes.) As you can see, smart cash-flow management can make a significant difference in helping you hold on to more of your money.

### **Paying For Your Disability Income Insurance**

Let's now consider how you should pay for your disability income (DI) insurance. It's another example of where the right choice is not obvious, but the wrong choice is rather costly.

First let me emphasize what I tell all my small business owner clients: Unless you have already achieved financial independence, DI insurance is a must. Without it, you may have nothing to fall back on if you're sidelined by injury or disease.

So what's the smarter way to pay your annual premiums: with a company check or a personal check? Like your financial plan, a DI policy counts as a legitimate business expense. So, the business should pay, right? Wrong. And, again, the reason is taxes. Lets say you determine that if you were to become disabled you would need \$60,000 a year to cover your basic living expenses. So, you have your company buy a DI policy that would pay out \$5,000 a month while you were disabled. Again, let's assume you are in the 40% personal tax bracket. In the eyes of the IRS, if your company foots the bill for your policy, the \$60,000 a year would be considered taxable income, like wages: Uncle Sam would take \$24,000 ( $\$60,000 \times 40\%$ ), leaving you with only \$36,000 to cover your \$60,000 worth of annual living expenses. Ouch.

If, instead, you should pay the DI policy's annual premium with a personal check, then every penny the insurance company pays out would be tax-free.

As these two examples demonstrate, an integrated approach to cash flow management can help you build wealth in your business and in your personal portfolio.

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