6 Tips for Managing Law Firm Taxes

There are some important tax to-dos you'll need to complete before filing your law firm taxes. Are you ready? It's a good idea to approach your taxes proactively. These 6 tips should help you get started:

- **#1: Gather all pertinent tax information for your law firm as you go.**
- **#2: Closeout outstanding receivables and payables.**
- **#3: Prepare for an audit.**
- **#4: Strategize with your accountant.**
- **#5: Streamline financial management.**
- **#6: Pull your credit reports + scores.**

Let's explore each a bit more in depth, going over (a) the tasks you'll need to account for and (b) the best way to go about handling them.

Tip #1: Gather all pertinent tax information for your law firm as you go.

You’re going to need to gather documentation covering the full gamut of activity in your firm, and it’s best to collect these documents throughout the year to make it easier when tax season rolls around. This isn’t limited to financial data either. Tax information can include important business data, such as:

- Expenses and deductions (e.g., bills, receipts, canceled checks, etc.)
- Inventory and equipment data
- Depreciation data
- Personal and business deductions
- Vendor bills
- Loan agreements
- Legal paperwork (e.g., parties in lawsuits, purchases, settlements, acquisitions, civil defense, etc.)
- Medical, insurance, payroll and employee records
- Your income and financial statements
- Theft or loss documents
- Corporate payroll data
- Employee documents (e.g., policies, dress codes, CLE requirements, W-2 reimbursement policies, etc.)
- A copy of your schedule K-1, (if applicable) which outlines shareholder income, losses, deductions and credits

As far as lists go, this isn’t comprehensive. It’s just a helpful place to start.

Tip #2: Closeout outstanding receivables and payables.

Do some of your clients owe you money?

Do your best to close out any outstanding accounts receivables before the end of each year. Chase down clients responsible for unpaid invoices, resolve any disputes and do your best to collect. Certain law firm software will even send automated payment reminders to your clients to ensure they pay in a timely manner.

Then there are payables.

Most law firms are organized as flow-through entities. A large amount of receivables means you won't fare as well come tax time. Use accounts payables to offset receivables that put you in a less than favorable situation.

It's a bit of a balancing act.

Tip #3: Prepare for an audit.

Conducting an internal audit means you have an updated copy of your balance sheet and profit and loss statements. Additionally, you'll want an up-to-date copy of your income statement to analyze firm expenditure and savings.

Why go to all this trouble?

Remember all of the details to gather suggested in task one? These are the same details the IRS will ask for if you're audited.

A tax audit is not a comforting thought at all. But it's an important step savvy law firms plan for.

Why?

The IRS released its guide to auditing lawyers. It's a 54-page document showing examiners how to pursue attorneys and law firms aggressively. Essentially, it's a step-by-step, how-to guide on auditing you, and, therefore, could serve as a valuable resource to your firm.

If you're well prepared, with the necessary data in-hand, your audit will likely go more smoothly. It's a helpful first step if your firm receives the dreaded IRS notification letter.

Tip #4: Strategize with your accountant.

Ideally, this is an ongoing process.

Most firms don’t spend a whole lot of time with their accountants, which is an unfortunate mistake. If you haven’t taken the time to reach out to your accountant, now’s the time. Don’t wait until the 11th hour when your accountant is inundated by the tax rush.

Provide them with your documentation they need. Give them with the appropriate access, statements and reports they need. If they need you to provide them with an unexpected piece of data, help them with what they need. The easier you make things for *them*, the better *your* circumstances will be.

Tip #5: Streamline your financial management.

Does your firm have good financial habits?

Implement disciplined financial controls over your cash. Some action steps to take can include:

- Tracking your time appropriately and invoicing sooner rather than later.
- Requiring an upfront retainer for all new clients.
- Checking references if you’re working with business-to-business clients. It’s a well-known fact that large corporate clients are often slow to pay.
- Setting retainer/project minimums and sticking to them.

- Creating, outlining, and enforcing your late payment penalties with customers.
- Rejecting clients who consistently inflict financial harm on your firm.
- Rewarding customers who autopay.
- Factoring payment processing fees into your invoices.
- Negotiating payment processing fees at the bank, card, or processor level.
- Negotiating for extended payment terms for your bills upfront.
- Endorsing checks immediately “for deposit only.”
- Minimizing overhead.
- Investing your cash on hand.
- Building business credit/funding via traditional (e.g., loans, line of credit) and untraditional (e.g., crowdfunding, alternative loans, investors).

These details are important because they give you the ability to scale your business up or down *rapidly*. Train employees to manage your cash flow safely and protect your practice from fraud and embezzlement. These headaches are completely avoidable if you have the proper foundation in place. What’s more, these good financial habits are reflected in a variety of places: credit reports, bank account data, and more.

Tip #6: Pull your credit reports + scores.

Do you have credit available?

You’ll want to pull credit reports for yourself and any notable partners in your firm. You’ll also want to pull your business credit reports. Here’s why this is important for your firm.

Your personal credit reports + scores give you a heads up on any judgments or derogatory marks that may create problems with ethics regulators. It's common practice for lenders to pull all three of your credit scores (your tri-merge or VantageScore), using the middle number in their creditworthiness and financial assessments.

This is crucial.

Pulling your credit report ahead of time means your creditworthiness ahead of time. You can address any serious problems *before* regulators come knocking. It also ensures you have suitable access to credit so you're able to make the financial moves you need to make. You can refer to sites like Credit Karma or Free Annual Report for a free copy of your credit report.

What about business credit report?

Your business credit report (and score) is more important if you're the owner or shareholder at your firm. A strong business credit rating means your firm is better able to:

- **Get financing** from both conventional and unconventional lenders at more favorable terms (i.e., no personal guarantees) when you need it.
- **Minimize insurance costs:** A strong business credit score means it will cost less to insure and protect your firm from any unexpected disasters.
- **Proper financial separation:** Specifically of personal and business finances. This separation makes tracking expenses and filing taxes much easier for businesses.
- **Increased borrowing power:** You're able to borrow larger amounts of money, in less time and with more favorable terms than those without a strong business credit score.

Credit reports and scores come from Equifax, Experian, and Dun and Bradstreet. Your business credit reports contain more data but are typically more concise. Here are samples for each:

- Equifax sample business credit report
- Dun and Bradstreet sample business credit report
- Experian sample business credit report

See what I mean? Short, concise, and to the point.

We’re just scratching the surface here. But whatever methods you choose, it’s a good idea to approach them proactively. Gathering all of your data/documentation ahead of time and staying audit-ready make a significant difference.

But this isn’t everything. You’ll want to bring in the professionals. Make a list of the documentation you’ll need to provide — schedule meetings with your accountants and financial professionals ahead of time. If you’ve kept decent records and you’re reasonably prepared, you won’t be caught off guard.