

BY DOUG SCHNITZSPAHN

**As more fitness equipment is manufactured in China, what impact will it have on product quality? It all depends on what type of relationship your vendors have created with their Asian partners.**

**W**atch the nightly news and you may never buy a product made in China again. The pet food kills innocent kittens. The tires explode on the highway. The children's toys are illegally juiced with lead and other toxins. The toothpaste is spiked with antifreeze. Every night there is a new crisis, a new recall. The PR blow to Chinese manufacturing has been so bad that at the Asia-Pacific Economic Cooperation summit in Sydney in September, Chinese President Hu Jintao made a pledge to President Bush that Beijing would up its quality control efforts in monitoring Chinese manufacturing.

But how much does the specialty fitness retailer need to worry about product that is manufactured in Asia and, specifically, in China? Will exploding ellipticals be the next

Chinese horror to air on network news? Anything is possible. If retailers, though, do their homework and work with trusted manufacturers, our interviews and research have revealed that they should have no problem with the quality of products made in Asia, and retailers should not expect their reputation with customers to suffer.

#### THE CHINESE EXPLOSION

The inescapable reality is that it is nearly impossible to avoid products made in China. Low tariffs and cheap labor make manufacturing in the rapidly industrializing nation of 1.3 billion people the only way most North American businesses can remain competitive. According to the U.S. Department of Commerce, total trade between the United States and China ballooned from \$7.9 billion in 1989 to \$170 billion in 2003. U.S. dependence on Chinese imports continues to rise, with a \$232 billion trade imbalance between China and the United States in 2007. With the once hard-line Maoist communist country still in what *(continued on page 4)*



# » Let 'em Read News



In today's connected world, news and information can't hide for long—no matter how hard someone tries. There is little sense in trying to hide behind some electronic veil, and even less sense in trying to shield your staff from the opportunities to learn about their industry.

"I don't want my staff distracted," or "If I need them to know something, I'll share it with them" are but a few of the reasons that company executives and store owners tell us about why they are the only ones receiving SNEWS® while their staff members remain in the dark. Fair enough, we say, but is that realistic? There is little doubt that with the prevalence of text messaging, instant messaging, email and the web, rumors and buzz spread at a zillion miles an hour and take on a life of their own much more quickly than in the past. The more you try to hide something, the more likely it is your staff will end up only hearing half a story or one that isn't even close to the truth.

That's where SNEWS®, the parent of the FitBiz electronic publication you are reading, fits in. SNEWS® is all about the day-to-day micro-picture purveying of news and information that helps the fitness industry go

'round. We aren't about rumors (unless we are making the calls to bust them). We are about news that helps somebody in an industry see the bigger picture of what's going on, be it financial statements, company trends or personnel changes. We are about being a bit of an industry watchdog, as well as a source to help people connect with each other. We believe that every staff member of a store or company should be reading and debating the industry's news. If he or she reads about the goings-on in an industry, the person will more likely feel a part of it—meaning they may actually stick around longer and see the industry as more than a transient job. So ... let 'em read SNEWS®! It's free and it's good for your business.



Thanks for being a part,

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(continued from page 1)

many economists refer to as a "Wild West" phase of its conversion to a Western free-market system, government regulation lacks teeth. The black market often dictates supply, bribery is a built-in part of the system, and manufacturers will often ignore the specs mandated by North American partners. There is a definite risk in importing Chinese goods.

But how wary does today's fitness retailer need to be? The volatile environment of Chinese business does not mean that all Chinese products are fatally flawed or that North American companies cannot play a role in the Chinese manufacturing process. Done right, Chinese manufacturing fuels even the most trusted, visible and successful U.S. brands. "You go in the Apple store and the computers are made in China, the iPods are made in China," Robert Kapp, former president of the U.S.-China Business Council, and the owner of Robert A. Kapp and Associates, a consulting firm for companies pursuing business development with and in China, told FitBiz by SNEWS®. "When you look at companies as demanding as Apple, you know they did

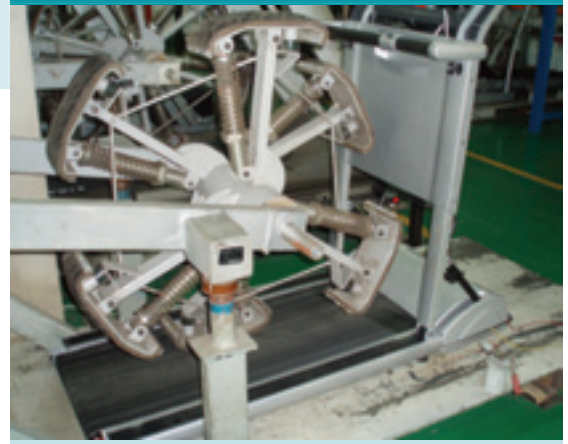
it right. They are producing just as well in China as they are anywhere else in the world—but it takes diligence."

Getting a clear picture of just how diligent your vendors are in their Asian operations is the key for specialty fitness retailers. That can lower the risk of carrying possibly low-quality Asian products that could result in returns, grumpy customers and undesirable word-of-mouth.

EYES ON THE PROCESS

"Nobody comes to China to manufacture high-quality goods," Kapp said. "They come because of cost and logistics. The trick is intense due diligence from the foreign company that is producing in China for export."

A large share of fitness manufacturers operate out of Taiwan, which has built a reputation as a quality partner and, interestingly enough, many Taiwanese manufacturers are opening factories in China for the same reasons as U.S. manufacturers—



Johnson Health Tech performs a durability test on a treadmill at one of its facilities outside of Shanghai, China.

it saves money. But Taiwan once suffered from the same cheap reputation that has cast a shadow over Chinese goods and, we were told, can serve as a model of how China can develop.

"There's always a learning curve," said Ed Banasky, national sales manager for Fitness Master, which runs a design center and manufacturing facility in Taiwan, as well as some manufacturing in China. "I mean, back in the late '80s, early '90s, everything from Taiwan stunk."

One important point that retailers who want to understand (continued on page 5)

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the process should realize is that many fitness equipment suppliers are not necessarily manufacturers—for the most part, they are simply importers who contract the work out to foreign manufacturers. So the long-term relationships the supplier creates with trusted contractors are key when it comes to ensuring quality production. It is far easier for companies that already have a foothold in Asia to pursue the type of due diligence necessary to ensure quality production.

Banasky reinforced the importance of being involved in the entire process. “We go back on a bi-monthly basis and look at samples of new products,” he said. “We set the standards here, set the specs. We get a prototype and send it over there with the spec parameters and develop as we go along. It takes constant visits, constant communication. Any type of change has to be approved, and we always get a final sample that has to get approved.”

“It’s a long process,” he said, “but it’s just something you have to keep on top of—you don’t want them to slip in changes that you don’t know about.”

For Diamondback Fitness, which has

operated in Asia since 1991, communication and a good liaison make the difference.

“Not everything coming out of China is poor quality,” said Steve Lindenau, president of Diamondback. “It’s how you deal with the factories that makes the difference. We have had great success with the quality ratios—but we have lots of experience in how to play the game in Asia.”

One important step Diamondback has made is to hire multi-lingual Taiwanese and Chinese employees who can break through the language and cultural barriers and give insight into Asian business. Diamondback’s Anita Liu-Miller is a native Taiwanese, fluent in English and Mandarin.

“American companies always have this barrier,” Liu-Miller told FitBiz by SNEWS®. “The Taiwanese don’t speak English, so you always communicate through a salesperson, but I can talk to the owner in Taiwanese and the relationship just gets closer. I hear stories. I can get better pricing. You have to really know your suppliers and know their abilities. We don’t just deal with the manufacturers, we deal with suppliers and you have to know who you can trust and build a lot of relationships.”

The parent of Johnson Health Tech (with

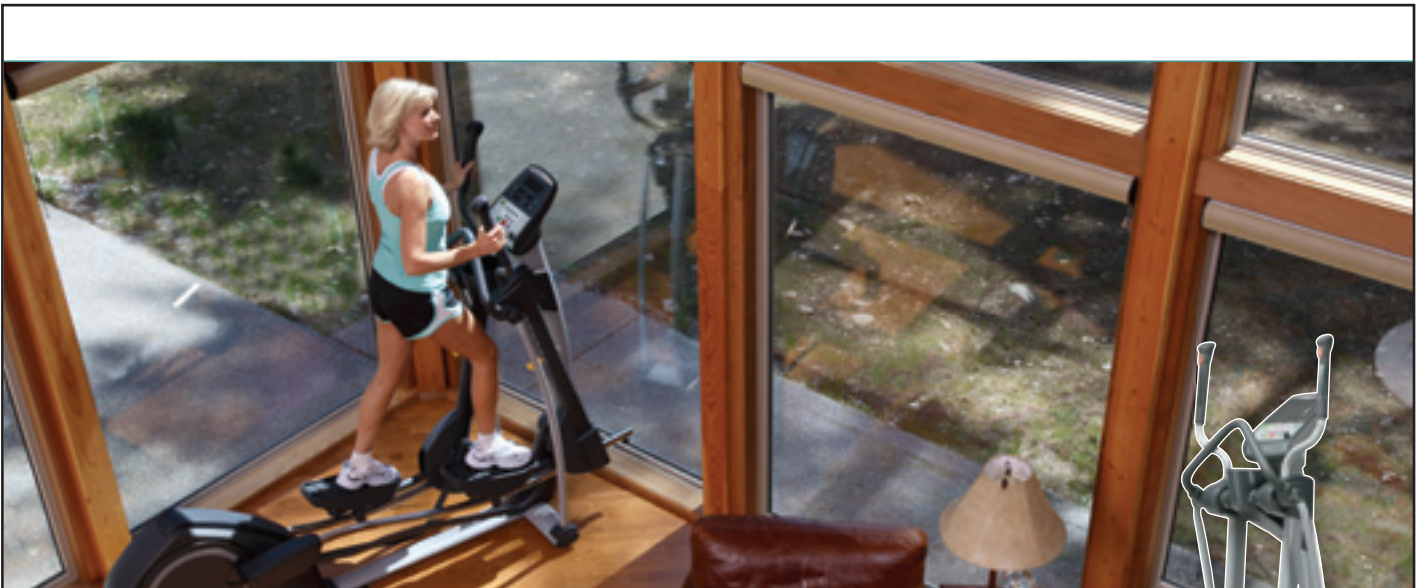
brands Matrix, Horizon and Vision) is in fact an Asian company that has been manufacturing fitness equipment since 1975. So it is by definition a manufacturer not an importer. The company owns a factory in Taiwan and four factories near Shanghai in China. Quality control oversight is guaranteed by the company itself and reinforced by large American retailers.

“All the large sporting goods stores and mass retailers that we sell to audit us on an annual basis. They know that when we ship a product it is going to be on-time and up to specifications,” Mike Olsen, vice president of marketing for Johnson’s Horizon brand, said.

But for Johnson, the coup was building and staffing a North American-based research and development center with American engineers who regularly communicate with and travel to the Asian facilities. The intent, of course, was to outsmart bad quality with closer oversight in North America.

#### OUT OF THE BOX

So what are retailers seeing when the product gets here? (continued on page 6)



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(continued from page 5)

"If anything, it's seemingly gotten better," said Kim Moore, retail sales manager of Exercise Equipment Northwest, a small, four-store chain based in Portland, Ore. "I don't have high expectations on that product in the first place, so I haven't been more disappointed lately than at other times."

Likewise, Michelle Newman, Denver warehouse manager for 11-store chain HealthStyles in Colorado, has seen an improvement in direct freight shipments from Asia. "We haven't had that many problems," she said. "They are concerned with space and packing and longevity. It's when you deal with the local shippers that anything can happen."

And all things being equal, fitness equipment quality control issues do not seem confined to Asian manufacturing.

"This year especially, there seems to be an excessive amount of service that is going on in our industry," said Rick Myers, co-owner of Total Fitness in Connecticut, "and I'm not talking about stuff that is three-, four-, five-years old. I'm talking about stuff right out of the box. With the Asian stuff, it's not one particular thing—there's always something. With the

American-made stuff, it's usually limited to one or two things. But I have seen lower quality across the board."

No matter where a product is manufactured, issues can surface because, "that's just the nature of manufacturing," said Horizon's Olsen.

"The question is, how do you deal with those questions when they do come up and how rapidly are you able to remedy them."

As it turns out, the source of problems both in goods manufactured in Asia and in North America may be a lack of oversight from the United States itself.

"It's not just limited to quality control in Asia," said Janet Domenitz, executive director of MASSPIRG, the Massachusetts branch of the federation of state public interest and citizen action groups (www.uspirg.org). "It's the dismantling of regulatory agencies on the federal level that now have less funding, less enforcement and less attention is being paid to them. We are looking at overall compromised public health and safety. The good news is



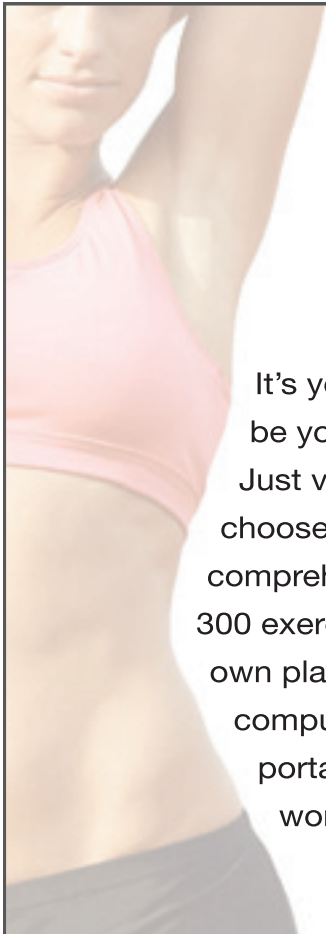
Diamondback's 700Tm treadmills on the assembly line at a manufacturing facility in Taichung, Taiwan.

consumer recalls have jammed up a lot of people to start clamoring for action."

That public clamor may also improve the quality of products manufactured in China as it adapts to a free market system. In theory, public displeasure with low-quality goods will weed out the problem companies and U.S. importers responsible for putting them on the market.

"You have to dump them if they compromise quality," said Kapp. "They have to pay the price. And as the buying companies dump the companies who screw up, there will be a gradual improvement—but it will take a while." (continued on page 7)

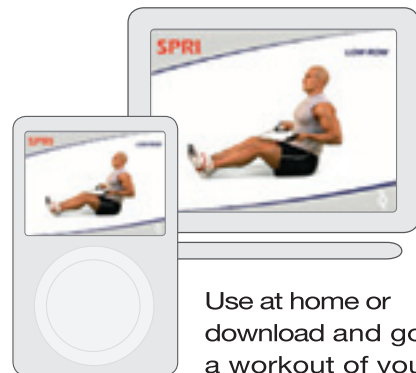
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## » WHAT'S A RETAILER TO DO?

HERE ARE SOME BASIC STEPS RETAILERS CAN TAKE TO ENSURE THEIR CUSTOMERS ARE GETTING THE QUALITY THEY DESERVE:

» **Know your vendor:** When you start working with a new vendor that manufactures in Asia, ask in-depth questions about the company's process and diligence. How long have they been doing business in Asia? What are their defect return rates? Where do they see the future business of their company going in Asia? You want to get a clear picture of how they operate and what their relationships are with Asian suppliers and manufacturers. Companies with more experience in Asia and heavily monitored systems are easier to trust. The best vendors will answer the questions before you even ask them.

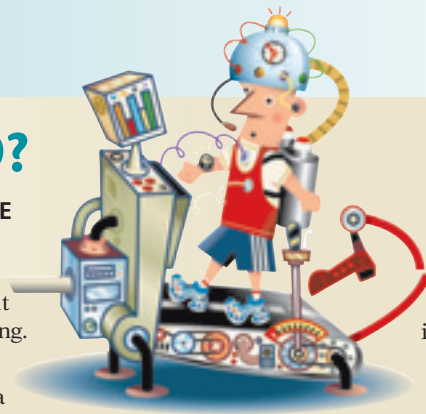
» **Talk to other shops:** Take advantage of the community of fitness specialty retailers. Talk to other dealers about their relationships with vendors and their experiences with quality control and customer service issues. When you are working with a new vendor, ask the rep for a list of its top five dealers, then call them to find out how the relationship works. If you begin to experience problems, keep the communication open with other vendor

customers to find out what they are experiencing.

» **Ask about a trial period:** A test-run is a great way to learn what issues will crop up with a new product over time. "Sometimes we give retailers a trial period," said Ed Banasky, director of sales and marketing at Fitness Master. "If they like it, fine; if not, they send it back."


» **Service matters:** "It is hard to make money when you are contracting out \$75 bucks on a service call or driving out to someone's house," said retailer Rick Meyers of Total Fitness in Connecticut. The answer? Work with vendors who work for you if you do have a quality control issue. "As important as understanding the quality is understanding the support once the product is in the field," said Scott McDonald, co-CEO of Body-Solid. "If you are missing a bolt to complete a gym, then you need that part in a hurry."

» **Be up front with your customers:** There is no way around the fact that lower price-



point machines, which in general are manufactured in Asia, are not the same quality as high-end machines. Be sure your

customers understand that although they are saving money, there are usually fewer service issues with high-end machines. "I always say that if you go with this price range, you have to lower your expectations and you probably will get to know our service department on a regular basis. I just want to be upfront with that," said Kim Moore of Exercise Equipment Northwest.

» **Leave a paper trail:** If you do have problems, it will be much easier and quicker to deal with your supplier if you can provide documentation. "Document. Document. Document," stressed Michelle Newman, of HealthStyles in Colorado. "Then you can go back and track an issue. You should also try to establish a relationship with one person so they know how you operate, what your needs are, and you also know them." 



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BY JEFFREY TAKSEY  
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# tax time



# W

**Year-end tax planning is upon us. Use these action items to start the process.**



ith the end of the year approaching, a quote from Benjamin Franklin comes to mind: "In this world nothing is certain but death and taxes." Surely, old Ben would agree that now is the ideal time for business owners to engage in year-end tax and business planning. This planning sets the stage for business owners to not only save taxes in the current year, but in future years as well. It is a must for any business, be it a sole proprietorship, partnership, Limited Liability Company (LLC), S corporation or C corporation.

Since business and tax planning can be somewhat overwhelming, this article will be presented in three parts. The second and third parts will follow in the SNEWS® Training Center in November ([www.snewsnet.com/trainingcenter](http://www.snewsnet.com/trainingcenter)). This first article deals with projecting your current operational outcome and understanding the pros and cons of choosing available business entities. There are a few reasons why you need to consider these things early in the process. First, you need solid financial projections to plan your taxes. Second, you may need to take legal action to change business entities before the end of the current year. Also, regulations may require that you make tax elections within the first two-and-a-half months of the following year. Bottom line: The things we'll discuss in this article should be first on the to-do list as you build your tax strategy.

### PLAN OF ACTION

The first thing you need to do is put together a checklist of all the steps you'll need to take in the future to reduce taxes as much as possible.

*(continued on page 9)*



## THE PROS & CONS OF BUSINESS ENTITIES

The type of entity chosen by a business can have serious tax, financial and legal implications. The following are the main types of business entities and some of the advantages and disadvantages of each:

To start, prepare a tax projection for the business. You should do this by using current financial information and projecting the taxable income of the business through the end of the year. It is very important that the business keep its accounting records current and accurate. An accurate tax projection provides the information necessary to do year-end tax planning and allows business owners to plan for future tax liabilities.

Now, it's time to put together your list of strategies to minimize current-year taxes. The following year-end tax planning strategies should be considered:

1. Business owners should determine whether income and expenses should be accelerated into the current year or deferred until next year. Normally, a business with significant taxable income will attempt to defer revenue and accelerate expenses. However, there are situations where a business may want to do the opposite. For example, if a business has low income in the current year and is expected to have higher income in the following year, accelerating income and deferring expenses may produce a lower overall tax. The following examples illustrate ways to defer income and accelerate expenses:

- » Cash basis businesses can slow down collections of income by delaying billings to customers.
- » Accrual basis businesses can delay until the following year by finishing a job or delivering merchandise.
- » Cash basis businesses can pay all deductible bills by the end of the year. This includes bonuses paid to employees and owners. The business can also prepay bills up to 12 months in advance.
- » Accrual basis businesses can incur expenses this year for merchandise or services that are received. This includes accruing bonuses to employees to be paid within two-and-a-half months after the end of the year.

2. An accrual basis business should review the accounts receivable and write off all bad debts. It should also review its inventory and adjust the books for shrinkage or perishable items.

3. Consider funding a retirement plan. Most retirement plan contributions can be made after the end of the tax year and still be deductible in the current year. But several types of retirement

*(continued on page 10)*

### SOLE PROPRIETORSHIP

#### Advantages +

- Ease of setup and operation.
- Business income is taxable to owner using individual tax rates.
- Owner can deduct losses to offset other income subject to passive activity and at-risk rules.

#### Disadvantages -

- No legal liability protection.
- Income subject to self-employment tax.
- Limitation on deductions of fringe benefits.

### GENERAL PARTNERSHIP

#### Advantages +

- Ease of setup and operation.
- Business income is subject to tax at the owners' individual tax rates.
- Generally, no taxability on contributions of property to a general partnership.
- Owners can deduct losses to offset other personal income subject to basis, at-risk and passive activity rules.
- Distributions of appreciated property to partners generally not taxable to partners.
- Special allocations of profits and losses allowed.

#### Disadvantages -

- No personal legal liability protection.
- Income subject to self-employment tax.
- Limitations on deductions for fringe benefits.
- Must use a calendar year.

### Limited Liability Company or Limited Liability Partnership **LLC or LLP**

#### Advantages +

- Legal liability protection.
- Business income is subject to a single tax at the owners' individual tax rates.
- Generally, no taxability on contributions of property to an LLC or LLP.
- Owners can deduct losses to offset other personal income subject to basis, at-risk and passive activity rules.
- Distributions of appreciated property to partners generally not taxable to partners.
- Special allocations of profits and losses allowed.

#### Disadvantages -

- Income generally subject to self-employment tax.
- Limitations on deductions for fringe benefits.
- Costs of formation and maintenance.
- Must use a calendar year.

### S CORPORATION

#### Advantages +

- Legal liability protection.
- Business income is subject to a single tax at the owners' individual tax rates.
- Business income not subject to self-employment tax.

#### Disadvantages -

- To deduct corporate losses, shareholder must have personal money invested or loaned.
- Distributions of property by corporation to shareholder is taxable.
- Allocation of profits and losses must be pro rata to stock ownership.
- Limitations on deductions for fringe benefits.
- Costs of formation and maintenance.
- Must use a calendar year.

### C CORPORATION

#### Advantages +

- Legal liability protection.
- Certain income levels may be taxed at a lower rate than the individual owner's tax rates.
- Very few limitations on fringe benefits.
- Businesses can possibly use a fiscal year for tax deferral purposes and allow for inventory and other year-end procedures to occur at an optimal time of the year.

#### Disadvantages -

- Income subject to corporate tax and dividends paid to shareholders subject to individual tax (double tax).
- Losses not deductible by owners.
- Costs of formation and maintenance.
- Non-personal service businesses must use accrual method of accounting if over \$5 million of average annual revenue.



plans have to be set up (not funded) by the end of the tax year to allow for current-year deductions.

- 4. Businesses that are C corporations should determine if taxes were paid in the prior two years and consider creating a net operating loss carry back from the current year to recover prior year taxes paid. After two years, taxes paid cannot be recovered.

### PROTECTING YOUR ASSETS

In addition to reducing taxes, there is another issue to consider early in the tax-planning process—your business entity. Normally, one of the main objectives in forming a business entity is to obtain legal liability protection. Thus, most businesses are formed as LLCs, S corporations or C corporations. As shown in the sidebar on page 9, each type of entity has its set of pros and cons. In the small and medium-sized business arena, LLCs and S corporations are used frequently due to the single level of tax at the individual owner level. S corporations have more restrictive rules than LLCs, now the entity of choice in many situations.

C corporations require more planning because profit retained by the corporation is taxed at the corporate level in lieu of the individual tax. Subsequent distributions of the profit to the shareholders will be taxed a second time. Nevertheless, there are situations where a C corporation may be desirable. For example, a growing business that wishes to retain its profit for expansion purposes may pay less tax in the early years because of the lower C corporation tax rates. It would then be possible to convert to an S corporation when growth stabilizes. The double tax that a C corporation may have to pay in the event of a sale of the business often causes it to be the least desirable choice.

When forming a business, owners should thoroughly review the different entity options and choose the one that best fits the situation. Once the type of entity is chosen, it is often difficult to change to another type of entity without a significant tax consequence. So, careful consideration must go into the initial decision.

At this point, you should be thinking about the entity you have and investigating if it is the best fit for the future. Articles to follow in the SNEWS® Training Center

will consider accounting methods, as well as retirement and fringe benefits plans and succession or sale of the business. Some decisions need to be deployed 10 years before a sale to preclude the government from collecting a double tax. Accordingly, visiting the issue annually with your accountant and attorney can avoid a trap from robbing you of the best result.

Don't be afraid to ask your accountant for help projecting your year-end operating results. With a little input from you, the accountant can minimize the effort required to achieve a reasonably accurate result. The projection can be a work in progress that is updated as the real numbers come in. 📈

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