MANAGEMENT & *TAX CONCEPTS*

INVESTORS, MAKE YOUR TAX-RELATED MOVES NOW

FALL 2019

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Investors, make your tax-related moves now

As you consider year-end strategies for reducing your tax bill, look to your investment portfolio — it's an area that's often ripe for examination. Techniques such as harvesting capital losses are highly effective and can be implemented quickly.

While you review the strategies that follow, keep in mind that your investment decisions should never be driven by tax considerations alone. But if buying or selling a security makes financial sense, it pays to take taxes into account when timing your investment moves.

HARVESTING GAINS — AND LOSSES

As you watch the value of your investments go up and down, remember that these fluctuations exist only on paper. You don't make or lose money until you "realize" these gains or losses by selling an investment. If you've realized net capital gains this year, they'll be taxed at rates as high as 23.8% for long-term gains (on assets held more than a year) and 40.8% for short-term gains (including the 3.8% net investment income tax).

One way to ease your tax burden is to "harvest" capital losses — that is, sell investments that have declined in value and use the losses to offset your gains. And if your losses exceed your gains, you can deduct up to $3,000 of your net capital loss from your ordinary income, such as wages and interest. Plus, the losses that remain are "carried forward" for life.

On the other hand, if you've realized a net capital loss this year, it may make sense to harvest long-term gains. This allows you to sell one or more investments that have appreciated in value without triggering capital gains taxes. One thing you should avoid, though, is offsetting *all* your net loss. If possible, consider preserving up to $3,000 in net loss to reduce your ordinary income.

Clean up your wash sales

As the main article explains, it's possible to sell investments at a loss to reduce your tax bill and then buy them back to preserve the integrity of your portfolio. But the wash sale rule prevents you from buying substantially identical securities within 30 days before or after the sale. If you sell an investment and wait 31 days, there's a risk the price will go up before you buy it back, defeating the purpose of this strategy.

Fortunately, there are techniques you can use to mitigate the risk. For example, you can replace the original investment with one that is similar, but not identical. This could be stock from another company in the same industry. The wash sale rule wouldn't apply, so you could make the purchase immediately.

If you can afford it, another strategy is to double up on your investment. In other words, buy the same number of shares of the identical investment, wait 31 days and sell the original investment. If the price is the same or less, you can deduct the loss without changing your portfolio's makeup. If the price goes up, the additional gain makes up for the lost deduction.

TIMING IT RIGHT

If you plan to sell an investment at a loss, consider the timing carefully. In some cases, you're better off selling a short-term rather than long-term asset. Why? Because in calculating your net capital gain or loss for the year, the first step is to offset short-term gains against short-term losses and long-term gains against long-term losses.

Suppose, for example, that you've realized \$25,000 in short-term gain and \$25,000 in long-term gain this year, and you also own stock, purchased December 15, 2018, whose value has declined by \$25,000. If you sell the stock on December 31, 2019, your \$25,000 long-term loss will offset your long-term gain, leaving you with a \$25,000 short-term gain taxable at ordinary-income rates.

However, if you sell the stock on December 1, you'll generate a short-term loss that erases your short-term gain. And that leaves you with a \$25,000 long-term gain taxed at more favorable rates.

HAVING YOUR CAKE AND EATING IT, TOO

Selling an investment at a loss may be a good tax strategy, but what if you're confident that the investment will rebound in the coming years? It may be possible to harvest the loss for tax purposes and then buy back the investment to keep your portfolio intact.

It's critical to plan carefully, however, to avoid running afoul of the "wash sale" rule. Under that rule, when you sell a stock or other security at a loss, you can't take a current deduction if you purchase a substantially identical security within 30 days before or after the sale. So, to take advantage of this strategy, you must wait at least 31 days before you buy back the investment. This can be risky, because an unexpected price increase could wipe out the tax benefits. There are, however, other techniques you can use to mitigate the risk. (See "Clean up your wash sales" above.)

A BALANCED APPROACH

Your tax and investment advisors can help you develop a year-end plan that balances tax savings with sound investment strategies. •

On FIRE: 5 strategies for retiring *way* early

A new financial movement is afoot in which some people are striving to retire much sooner than the traditional retirement age of 65. Referred to as FIRE — or Financial Independence, Retire Early — the strategy involves saving for retirement very aggressively, mainly by living a super-frugal lifestyle.

In some cases, people are retiring as early as their 30s or 40s by putting FIRE principles into practice. Even if your goal isn't to retire this early, you can still learn a few things from the FIRE movement that could help you ignite your retirement goals.

MAXING OUT RETIREMENT SAVINGS

FIRE strategies start with maximizing retirement savings. It's commonly recommended that individuals set aside at least 10% of their gross income for retirement. But retiring in your 30s or 40s could require saving much more than this. For example, some people practicing FIRE are saving 70% or 80% of their income for retirement.

Here are five strategies that can help you maximize your savings and retire on your timeline, whatever it is.

1. Set (and prioritize) aggressive savings goals. It's one thing to set aggressive goals such as saving half of your income for retirement. For many people, the challenge lies in following through and making these goals a priority.

Start by putting your savings goals in writing. For example, if you want to save half of your income for retirement, determine exactly how much money this is and write it down. Then set benchmarks for how much money you should have saved by the time you reach certain ages so you can monitor your progress toward your long-term retirement goal.

2. Slash your expenses. When they look carefully at their expenses, many people are surprised at how much money they spend on nonessential items. Scrutinize your monthly budget in search of wasteful and unnecessary expenses.

For example, can you cut the cable TV cord or downgrade your cable or satellite package? Cut way back on entertainment, eating out and expensive cups of coffee? Keep your vehicles well maintained so you can drive them for 10 years or longer instead of getting a new car every few years?

3. Save and invest with discipline. A good way to accomplish this is to sign up for automatic investing into a retirement plan (such as a 401(k) plan) at your place of work. This way, funds will be automatically transferred into your retirement account each pay period with no action required on your part. Consider contributing a fixed percentage of your earnings rather than a fixed dollar amount. By doing so, with each raise or bonus a portion will go to your retirement, presuming you're not at the maximum allowed. Also, don't neglect a match offered by your employer.

4. Boost your income. There are many ways to earn extra income in today's "gig" economy. For example, can you start an online retail business by selling merchandise on sites like Amazon, eBay or Etsy? Drive for a ride-sharing service like Uber or Lyft? Or offer pet-sitting services to friends and neighbors when they travel?

5. Eliminate your debt. Carrying excessive consumer debt is one of the biggest obstacles to retirement for many people. Strive to eliminate your nonmortgage debt as soon as possible, starting with high-interest credit cards. Many FIRE devotees also put extra money toward their mortgage principal each month in an effort to be mortgage-free by the time they retire, thus eliminating their largest monthly expense.

Start by maximizing retirement savings.

DIFFICULT, BUT POSSIBLE

There's no question that retiring in one's 30s or 40s is rare and difficult to accomplish. However, implementing some of these strategies could help you achieve your retirement goals no matter when you plan to retire.

Your financial advisor can provide more retirement planning guidance based on your specific situation and goals. •

A valuation may be what your business requires

With the economy currently healthy, but its future uncertain, many U.S. companies face challenges. Chief among these is financing — which isn't easy to secure, because lenders imposed tough standards after the last recession and fear another hit.

A business valuation conducted by an outside expert can help you present lenders with timely, in-depth financial data. This will make it easier for bankers to understand how your business runs. And the valuation's discounted cash flow section will show how your expected future cash flows will build value.

PREPAREDNESS IS A WEAPON

A valuator also will turn up important company-specific information, including your and your managers' awareness of market conditions and specific risks you face. This will be the time to evaluate your contingency plan to mitigate those risks. Additionally, some company weaknesses may come to light during the valuation process. Armed with that information, you can then take steps to strengthen your "soft spots."

As a business owner, you never know what proverbial winds may blow your way. For example, your partner might, unexpectedly, want to leave the business. He or she might decide to retire early, or need to cash out for personal reasons. Or health concerns may enter the picture.

VALUATIONS AND BUY-SELL AGREEMENTS

For these reasons and more, it's important to draft and maintain a buy-sell agreement. This contract among a business's owners sets guidelines for the transfer of their ownership interests. The agreement gives the remaining owners (or the business itself) the right to buy an exiting owner's interest if a "triggering" event takes place. In addition to an owner's desire to leave the company, such events include divorce, disability, retirement, death, or loss of a professional license or certification.

So, what does all of this have to do with a business valuation? A valuation of your company plays a key role in the creation and maintenance of a buy-sell agreement. Specifically, it could help you address the preferred valuation method, the appropriate standard of value, the effective valuation date, and the applicability of valuation discounts and premiums.

Business value starts here

Quick! What's your business worth? Don't expect your balance sheet to tell you. The appraisal process is complex, and valuation pros consider a slew of factors, starting with the:

1. **Purpose.** Value can vary depending on whether it's for sale, tax, estate, divorce, strategic planning or another use.
2. **Standard of value.** Fair market value is most common. But if, for example, you're merging, "strategic" value may be relevant.
3. **Basis of value.** This refers to control and marketability — or the abilities to direct management decisions and convert an interest to cash.

> *Some company weaknesses may come to light during the valuation process. Armed with that information, you can then take steps to strengthen your "soft spots."*

IS IT TIME?

There's no getting around the fact that a key reason for seeking a valuation is to prepare for a business transfer. Even if you aren't sure you want to buy, sell or gift a business interest, an evaluation may help you get a better sense of whether now is the time.

Most valuators subscribe to transaction databases that report recent selling prices of similar private businesses. In conjunction with input from other professionals, the information gleaned from the valuation can help you come up with a creative deal structure — one that minimizes taxes, provides you with income to fund retirement and meets other transfer objectives.

IN GOOD STEAD

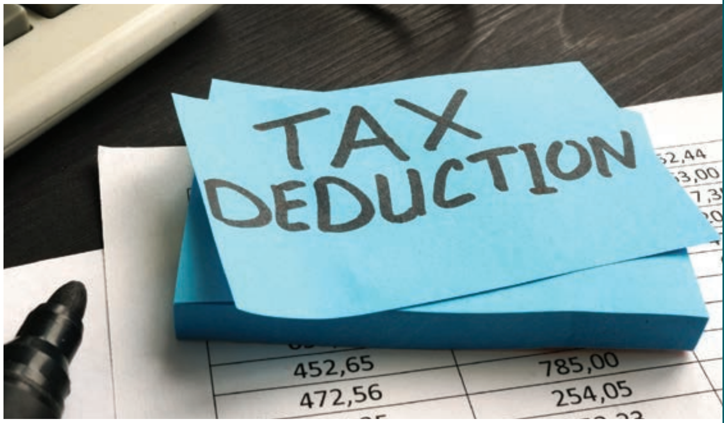
In the eyes of a potential buyer, a formal valuation adds credibility to your asking price. And if you're gifting business interests, it's a must-have to survive IRS scrutiny.

Alternatively, if you're able to buy out a competitor or other business, a valuation should play a critical role in your due diligence. An evaluator can scrutinize the seller's asking price, including the reasonableness of cash flow and risk assumptions, when negotiating the final sale price. •

Business tax planning

Can you deduct 2020 bonuses this year?

You may be familiar with the rule that permits a business to deduct employee bonuses this year if it pays them within 2½ months after the end of the tax year. It's an attractive year-end planning technique that benefits your business and your employees: You enjoy a tax deduction this year, while your employees needn't report the income until next year.



These tax benefits aren't always available, however, so it's important to understand the requirements. Here's a quick review:

ACCRUAL-BASIS TAXPAYERS ONLY; NO RELATED PARTIES

If your business uses the *cash* method of accounting, you must deduct bonuses in the year they're paid, even if they're earned in the previous year. To accelerate bonus deductions into this year, your business must be on the *accrual* method of accounting.

Favorable tax treatment is limited to bonuses paid to unrelated parties. For a corporation, a related party is an individual who owns more than 50% of the company. For S corporations, partnerships and LLCs, related parties include any of their shareholders, partners or members.

FIXED AND DETERMINABLE

Even if the first two requirements are met, you can't deduct a bonus this year unless it's fixed and determinable as of December 31. Generally, that means that:

- The recipient has earned the bonus,
- All events have taken place that establish the company's liability to pay it, and
- The amount of the bonus can be determined with reasonable accuracy.

Many companies get tripped up by the "fixed and determinable" requirement because their bonus plans condition payment on the recipient's continued employment through the payment date. If employees who leave the company before the payment date forfeit their bonuses, the company's liability isn't established by year end.

There may be a way to avoid this problem, however. Under IRS guidance, it's possible to deduct bonuses earned this year, even if there's a risk of forfeiture. The solution can be to use a properly designed bonus pool. For this strategy to work, the aggregate amount in the pool must be fixed by the end of the year. And, any forfeited bonuses must be reallocated among the remaining employees.

HANDLE WITH CARE

If you wish to accelerate deductions for bonuses paid next year, consult your CPA to make sure that you meet the requirements. It's critical to design your bonus plan carefully to avoid any language that suggests bonuses aren't fixed by the end of the year, such as retaining discretion to modify or cancel them or conditioning payment on board approval. •

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