Ideas for Your Success

Fourth Quarter 2008

Taking stock: Year end is time to review your portfolio

Like most investors, you undoubtedly have been wringing your hands over how the soft economy and unsettled stock market are affecting your investments. Year end is a good time to sit down with your financial advisor and review your portfolio. While doing so, consider the following three strategies that can help strengthen your portfolio and reduce income tax liability.

1. Consider cost basis

As you built your portfolio, you likely bought stocks or mutual funds at different times and at different prices. When you sell them, the amount of gain or loss depends on your cost basis.

If you sell less than all your shares in a particular investment, there are various methods for determining your basis, including the first-in, first-out (FIFO) and average cost methods.

> **"Identify poorly performing investments that you can sell at a loss to reduce your 2008 tax bill."**

But to minimize your gains or maximize your losses, you'll want to sell the shares with the highest basis. The "specific identification" method allows you to direct your broker or financial advisor to sell specific shares.

2. Use unrealized capital losses

As you review your portfolio, identify poorly performing investments that you can sell at a loss to reduce your 2008 tax bill. Why? You can reap significant tax savings by "harvesting" some of your unrealized capital losses and using them to offset capital gains you've already recognized this year (including capital gains distributions from mutual funds).

This strategy is particularly valuable if you have short-term gains, which are taxable at federal ordinary income tax rates as high as 35%. Plus, if you have a net capital loss for the year, you can use it to offset up to $3,000 of ordinary income. Unused capital losses may be carried over indefinitely into future tax years.

3. Rebalance your portfolio

Year end is a good time to rebalance your portfolio without incurring additional taxes. Typically, when you develop a long-term financial plan, you select an asset allocation formula that reflects your investment goals, time horizon and risk tolerance. But over time, this

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Two methods to account for employee expenses

Employee expenses are among the costs that many companies regularly incur. To account for these costs, businesses have two options: 1) implement a per diem method, or 2) use an accountable plan.

Per diem method

The per diem method is simpler than an accountable plan and requires less record keeping. It may better suit if you have a small company and don't incur a large amount of employee expenses regularly.

Using this method, you consult IRS tables for lodging, meals and incidental expenses during out-of-town travel, or just for meals and incidental expenses. (If you don't go with the per diem method for lodging, you'll need receipts to substantiate those expenses.)

If you prefer not to consult the IRS tables, you may implement a simplified high-low method within the continental United States to reimburse employees up to $237 a day for high-cost localities and up to $152 for other localities. This option is available for lodging, meals and incidentals only. It's not available for just meals and incidentals — lodging must be part of the expenses.

Accountable plans

An accountable plan is a formal arrangement under which you advance, reimburse or provide allowances for business expenses. Under IRS rules, for your plan to qualify, it must meet four criteria:

1. The payments must be for "ordinary and necessary" business expenses (such as airfare and lodging charges).
2. You must pay expenses that would otherwise be deductible by the employee.
3. Employees must substantiate these expenses — including amounts, times and places, and purposes — ideally at least monthly.
4. Workers need to return any advances or allowances they can't substantiate within a reasonable time, typically 120 days.

If you fail to meet these criteria, the IRS will treat your plan as nonaccountable, transforming all reimbursements into wages taxable to the employee, subject to income and employment taxes — though potentially deductible by the employee.

Don't procrastinate

The key to successfully handling business expenses is to account for them as soon as employees turn them in. These expenses can seem like little things at the time, but they can add up fast and lead to widespread exasperation if these amounts start driving up your and your employees' tax bills.

There's no "I" in teamwork

Create a collaborative culture to boost productivity, profits

In sports, teamwork is necessary to win championships. In business, it's essential to providing high-quality products and services and, ultimately, a profitable bottom line. But creating a collaborative environment isn't always easy.

Because managers can get wrapped up in their individual responsibilities, it's easy for them to become isolated from one another. Developing an office culture that encourages collaboration is important. For example, your marketing and design teams can work together to create a marketing campaign based on your latest product's innovative design. Doing so leverages and builds on each department's experience and skills.

Open communication is a must when trying to foster a collaborative environment. Establish a process for continuous exchange of information and ideas among management members, such as during regular activities status meetings.

It's also beneficial to instill a common purpose among your managers. Define and explain the overall goals, performance expectations and roles of your managers as a unified team.

If you're finding it difficult to change the culture of your company to a more collaborative one, you're not alone. Consider having an outside consultant conduct a management team assessment to help you better understand their strengths and weaknesses. The consultant may also be able to suggest opportunities for increased interaction.

What's my company worth?

A business valuation can give you the answer

As a business owner, you know it's important to obtain a business valuation in preparation for your retirement. But did you know that appraising your company's worth has several other important uses?

Selling the company (or buying another one)

If you're selling your company or buying another one, you need to put a dollar amount on the deal. As a seller, a valuation will not only estimate how much your company is worth, but also offer insights into how you can improve it. If you're a buyer, your appraiser can scrutinize any assumptions the seller's appraiser uses to justify the sale price.

> **Business appraisers typically use one or more methods to value a company that's up for sale.**

Business appraisers typically use one or more methods to value a company that's up for sale: 1) a market approach, which takes data from the sales of comparable businesses and then adjusts it to account for the differences between the subject company and the comparable firms, 2) an income approach, which forecasts the company's future net cash flow or earnings and adjusts them to present value using a discount, or capitalization, rate that takes into account risk, and 3) an asset-based approach, also called the adjusted book value method, which establishes the value of all assets and liabilities.

Creating or updating a buy-sell agreement

A buy-sell agreement is an important tool for succession planning. Sudden death or disability, withdrawal from employment or a divorce can all throw a business into chaos if such an agreement isn't in place.

A professional appraiser can help establish a clearly defined standard of value for your buy-sell agreement and determine (and regularly update) a formula for calculating that value. Doing so can prevent any number of conflicts down the road.

Pending divorce

The end of a marriage can be a particularly chaotic and emotional time, increasing the risk that business issues go ignored or mishandled. For this reason, obtaining a valuation during a divorce can serve as a critical protective measure.

Appraisers generally apply so-called going concern valuation methods (such as those discussed for selling the company) to functioning businesses that are expected to continue operations following a divorce.

Creating or updating your estate plan

Whether you're planning to gift or sell ownership interests in your business to your heirs during your lifetime or the interests will remain in your estate at your death, a professional appraisal is a must. A company's value affects the tax-related costs of selling, gifting or bequeathing interests in it.

Failing to estimate value properly may leave your heirs on the hook for a sizable estate tax bill that could force them to sell your company after your death.

Weighing the pros and cons

Even though engaging a professional appraiser can be costly and time consuming, a business valuation is necessary for a variety of business and personal reasons. Consult with your tax and business advisors to best determine when a business valuation is needed.

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allocation may shift as certain asset classes outperform others or your goals change.

Perhaps your plan calls for you to place 70% of your portfolio in stocks and 30% in fixed-income investments, but the strong performance of your equity investments a few years ago has pushed your stock holdings to 80%. If there are some poor-performing stocks in the bunch that you're already planning to sell at a loss to reduce your 2008 taxes, reinvesting the proceeds in bonds allows you to rebalance your portfolio tax free.

Ride out the storm

In an uneasy economy and roiling stock market, you may be tempted to radically adjust your asset allocation to weather the storm. While some adjustments may be necessary, don't sacrifice long-term fiscal fitness for short-term remedies. Your financial advisor can help you determine how to best allocate your assets depending on your specific situation.

Understanding the "wash sale" rule

Selling off some of the poorer-performing investments in your portfolio may allow you to take advantage of tax benefits. But what if you're not ready to give up on those investments?

If you're confident about a stock's long-term prospects, can you sell it at a loss to generate a tax deduction and then buy it back to keep your portfolio intact? The short answer is "yes," but you need to plan carefully so you don't run afoul of the IRS's "wash sale" rule.

The wash sale rule prohibits you from deducting a loss on a security if you acquire a substantially identical security within 30 days before or after the sale. You won't lose the deduction permanently, though. Instead, you add the loss to your cost basis in the replacement security, reducing the gain on that security when it's sold later.

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