FALL 2014

Leading EDGE

Kreischer Miller

PEOPLE | IDEAS | SOLUTIONS

ADVICE & INFORMATION TO HELP YOU MANAGE YOUR BUSINESS

IN THIS ISSUE

5 Investment Planning Ideas for High Income Taxpayers

Brian D. Kitchen
Manager
Tax Strategies

Many taxpayers noticed a significant increase in their 2013 tax liability. For most, this increase was attributable to the American Taxpayer Relief Act of 2012 (ATRA 2012). As we move into the fall season, it is time to turn our attention to year-end tax planning and think about what can be done to minimize taxes for 2014 and beyond.

The ATRA 2012 and legislation from the Affordable Care Act increased the highest federal tax bracket to 39.6 percent and the qualified dividend and capital gains tax rates to 20 percent. It also restored the itemized deduction and personal exemption phase-out and implemented a 3.8 percent surtax on investment income. With numerous indirect influences on your income tax liability, your Adjusted Gross Income (AGI) and taxable income become even more important.

Here are five investment planning strategies that can help minimize your AGI, taxable income, and future tax liabilities.

Take advantage of tax-deferred accounts

One of the most efficient investment planning techniques involves holding assets that generate taxable investment income (i.e. interest income and/or dividend income) in tax-deferred accounts, such as a 401(k) or an IRA. When a taxable account holds these assets, the income generated from the investments could be subject to a total tax rate of 43.4 percent (39.6 percent top tax rate plus 3.8 percent investment income tax). If the assets are held in a tax-deferred vehicle, the income would not currently be subject to tax.

Assets that are intended to grow are reasoned to be more efficiently held in a taxable account, since the tax will not be paid until the asset is sold. In addition, minimizing investment income will lower your AGI, which will have the ripple effect of minimizing exposure to the highest tax bracket, as well as the itemized deduction and personal exemption phase-outs.

Consider tax-exempt investments

In instances when you may need a stream of investment income in a taxable account, tax-exempt municipal bonds and federal tax-exempt mutual funds are an efficient choice. For taxpayers in the highest tax bracket and subject to the 3.8 percent surtax, the after-tax yield on taxable investments could be less than yields generated from municipal bonds.

Harvest losses

If you find yourself with large capital gains during a particular year, it is vital to review taxable investment holdings for unrealized losses. There may be opportunities to realize losses on certain assets, thus reducing capital gains for the year. This technique is often called "tax-loss harvesting" and could be an efficient choice to reduce your taxable income. A word of caution, though – the IRS is aware of this technique and has issued rules regarding "wash-sales." It is important to discuss these rules with your investment and tax advisors.

Think about a Roth IRA conversion

There is currently an opportunity for taxpayers who are otherwise disqualified from contributing to a Roth IRA to do so through a Roth IRA conversion. The mechanics are quite simple. You contribute after-tax dollars to a traditional IRA ($5,500/$6,500 age 50 or older) and then immediately convert it to a Roth IRA. The federal tax implications should be minimal if this conversion is completed in a short period of time.

Maximize retirement contributions

Whenever possible, it is prudent to maximize contributions to individual retirement accounts and employee-sponsored retirement plans such as 401(k) plans and Simplified Employee Pension Individual Retirement Accounts (SEP-IRAs).

Investment planning can be an effective way to minimize your tax liability. These are only a few of the opportunities available. We encourage you to speak with your investment and/or tax advisors to determine the best opportunities for your circumstances. **LE**

3 Costly M&A Mistakes to Avoid

Jeremy G. Chapman
Manager
Audit & Accounting

As the market continues its recovery and interest rates remain at historic lows, we have seen a significant increase in M&A activity in both the private and public markets. While no two transactions are the same, most deals go through a similar process. Regardless of whether you are on the buy-side or the sell-side, be on the alert for common mistakes that can prove costly.

Not utilizing non-disclosure agreements (NDAs)

Use an NDA to legally safeguard confidential information and provide an extra level of security for sensitive items such as intellectual property. It is important to be involved in tailoring the terms of the agreement to ensure adequate coverage.

Conducting inadequate due diligence

When going through the due diligence process, take time to thoroughly review financial and nonfinancial details. Ensure that you have a strong understanding of the corporate environment as well as what the financial information represents and how it is captured.

To avoid costly post-close integration issues, fully define the integration process and management's strategy for addressing any issues that may arise. These could include incompatible IT infrastructures and different transactional processing policies, as well as organization and reporting structures and employee responsibilities post-merger.

Spending time pre-close to anticipate how you would address these potential scenarios should greatly reduce the amount of time and resources needed post-close if a situation does arise.

Not being as detailed as possible in the purchase agreement

The purchase agreement serves as the basis for how the transaction will be executed, so it is very important to ensure that all terms, details, and examples are properly included. This will be especially helpful should a dispute arise post-close. Details should include purchase price adjustment clauses and specific financial metrics on which the adjustments are based - typically net working capital (NWC) or earnings before interest, depreciation, and amortization (EBITDA).

The purchase agreement should also avoid broad statements such as a general reference to GAAP compliance. Go a step further and be specific about the acceptable method of GAAP being used. With multiple acceptable methods of GAAP, especially regarding reserves, be sure that both parties are in agreement about which method is being applied. It may also be helpful to include examples, especially when calculating any purchase price adjustments.

Having specific language for terms and purchase price calculations can limit the potential for certain disputes, but it cannot prevent all of them. As such, it is important for the purchase agreement to outline a dispute resolution process that includes the time period to submit disputes, where and how they must be sent, who will serve as the arbitrator, and how the arbitration process will be conducted.

Agreeing on the arbitrator before executing the purchase agreement may take time, as both parties need to be in agreement. However, having a detailed dispute resolution process in place should help reduce unnecessary costs and allow parties to reach resolution in a more effective manner.

All M&A deals are unique and require time and effort. Be careful not to cut corners during the process. Giving adequate consideration to the items outlined above will increase your chances of a smooth and successful transaction. **LE**

Thinking About Changing Your State Residency?

Beware the Residency Audit

Thomas M. Frascella
Director
Tax Strategies

Our state of residency determines where you pay state personal income tax. Most states define a resident either as someone who is domiciled in the state or as someone who, although not domiciled in the state, maintains a permanent place of abode and spends in aggregate more than 183 days in the state. Individuals who meet the latter test of spending more than 183 days in the state are commonly referred to as statutory residents.

continued on following page

continued from previous page

Changing statutory residency status is more easily accomplished than changing domicile. Domicile refers to the place where an individual intends to create a permanent home. Once a domicile is established, it does not change until the individual moves, with the intention of making the new location his or her permanent home.

At one time, it was relatively easy to establish a new domicile and to make the new location your permanent residence. Changing your domicile usually required a minimum amount of proof such as a new voter registration card, a driver's license from the new state, and a new forwarding mailing address.

During the Great Recession, states became much more suspicious of changes in taxpayer residency status. They began to realize that many taxpayers still maintained significant ties to the state in which they were formerly domiciled, despite a change in the location of their residences. Thus, states began to conclude that the change in location was motivated more by a desire to reduce state tax liability than to make a permanent move. This resulted in a significant increase in residency audits.

Residency audits became a means of holding onto taxpayer dollars during a period of state budget deficits and political demand to hold the line on taxes. States such as Minnesota, New York, and Pennsylvania have begun to implement these audits as part of their return review procedures and have taken taxpayers to task when they do not believe the facts and circumstances support a conclusion that the taxpayers intend to reside in their new location permanently.

Other states and localities are looking at this issue on a more informal basis, but will likely adopt a more formal approach as it becomes clearer that there is benefit to be gained by implementing an audit policy around the issue.

Residency audits focus on the facts and circumstances of your move from one location to another to determine whether you have met the burden of establishing your intent to make the new location your permanent home.

If you are contacted by a state or locality for the purpose of conducting a residency audit, there are several things you can do to make sure you are prepared for and successfully defend the audit.

- Be ready to demonstrate your new location is permanent by showing that it is where you spend the majority of your time and that your prized possessions are there with you.
- Limit the time you are actively engaged in a business enterprise located in your old domicile. Otherwise, you risk the state taking the position that your domicile has not truly changed.
- Resolve any issues related to "trailing" family members. The state will take an unfavorable view of family members such as a spouse or minor children left behind in your former state of domicile for a prolonged period of time.
- Sell your residence in your prior state as quickly as possible after your relocation. **LE**

Big Data Can Play a Big Role in Your Business Improvement Process

Robert S. Olszewski
Director

"Big data" is a popular term to describe our ever-increasing access to information. So far, it has received mixed reviews. On the one hand, others feel that more data leads to more confident decision making and greater accuracy when monitoring desired outcomes. Others believe that too much information can lead to "analysis paralysis," prolonging the decision making process and hampering the ability to effectively implement change. So which viewpoint is correct?

You can make the most of your company's big data through benchmarking. Benchmarking is a useful tool as you strive to continually improve your business processes. Simply put, it helps you find better ways to do what you do. It compares one set of measurements of a process, product, or service to others within your organization or an external organization. Any business process can be benchmarked and it is a valuable exercise whether you are a manufacturer, distributor, service company, non-profit entity, or training organization.

Benchmarking historically focused solely on financial performance and information was limited to key executives and shareholders. More recently, successful organizations have seized the opportunity to share information more broadly and they have come to rely on big data for much more than the financials. They use it to:

- Enhance the probability of success
- Change the company's culture from inward-looking to outward-facing
- Improve the quality and quantity of performance information
- Drive accountability by making key performance indicators more visible

Measurements taken before implementation confirm that a problem really exists and set a baseline to measure future performance. After the solution is implemented, the measurement is conducted again. The variance tells you the degree of success of the project. Examine the measurement carefully before rushing to conclusions and to avoid data overload. You cannot know if your plan succeeded unless you thoroughly measure the quantitative results.

One of the common mistakes companies make when benchmarking is only looking at their own industry group or companies in their back yard. However, most business processes are common across industries. For example, Toyota would have similar fundamental Human Resource processes for recruitment and staff training as an accounting firm. So consider benchmarking your business against a company that is well known for being a high performer in a particular area.

The benchmarking process involves nine basic steps:

1. Identify what you want to benchmark.
2. Identify comparative companies.
3. Determine your data collection method and collect the necessary data.
4. Communicate expectations and gain acceptance from your team.
5. Project future performance levels.
6. Establish functional goals.
7. Develop action plans.
8. Implement specific actions and monitor your progress.
9. Recalibrate your benchmarks as necessary.

Technological advancements have given companies access to so much data that it can be overwhelming. The best place to begin is by addressing your major issues first; isolate the significant few from the trivial many. Identify a select number of issues and begin the benchmarking process. Then use your "big data" to evaluate the results and effectively implement lasting change. **LE**

LEA global

leading **edge** alliance

innovation • quality • excellence

Kreischer Miller is a member of the Leading Edge Alliance. Members are leaders in many key markets, including:

Alabama
Albania
Afghanistan
Argentina
Atlanta
Australia
Azerbaijan
Bahrain
Baltimore
Bangladesh
Belgium
Bolivia
Boston
Brazil
British Virgin Islands
Buffalo
Bulgaria
Cayman Islands
Chattanooga
Chicago
Chile
China
Cincinnati
Cleveland
Colombia
Croatia
Cyprus
Czech Republic
Dallas
Dayton
Denver
Dominican Republic
Ecuador
Egypt
El Salvador
Finland
Fort Lauderdale
Ghana
Germany
Greece
Guatemala
Harrisburg, PA
Hartford
Hong Kong
Honolulu
Houston
Hungary
India
Indiana
Indonesia
Iowa
Ireland
Israel
Italy
Jordan
Kansas
Kazakhstan
Kenya
Knoxville
Korea
Kuwait
Las Vegas
Latvia
Lebanon
Lexington
London
Los Angeles
Luxembourg
Macedonia
Madison, WI
Malaysia
Malta
Mauritius
Memphis
Mexico
Miami
Michigan
Minneapolis/St. Paul
Missouri
Moldova
Montenegro
Montreal
Morocco
Nashville
Nebraska
Netherlands
New Orleans
New Jersey
New York
New Zealand
North Carolina
Norway
Orange County, CA
Oregon
Pakistan
Palestine
Panama
Paraguay
Paris
Peru
Philadelphia
Phoenix
Philippines
Pittsburgh
Poland
Providence
Puerto Rico
Richmond
Reno
Romania
Russian Federation
San Francisco
Saudi Arabia
Scotland
Seattle
Senegal
Serbia
Singapore
Slovakia
Slovenia
South Carolina
Spain
Sweden
Switzerland
Taiwan
Thailand
Tokyo
Toronto
Tucson
Tunisia
Turkey
Ukraine
United Arab Emirates
Uganda
Uruguay
U.S. Virgin Islands
Venezuela
Washington, D.C.
Vietnam
Virginia
West Virginia

The Leading Edge Alliance is an international network of independently-owned accounting and consulting firms. Membership in The LEA gives us access to the resources of a multibillion dollar global professional services organization that provides technical resources, industry specialization, professional training and education, and peer-to-peer networking opportunities—nationally and globally, around the corner and around the world.

Our affiliation with The LEA enables us to expand our capabilities and provide a greater depth and breadth of advice and services to our clients. The bottom line? Our clients benefit from the size and scope of a large multinational firm with the high-touch, high-quality service of a local firm.

Leading Edge Alliance Fast Facts

- 190 leading accounting and consulting firms
- 102 countries
- 586 offices worldwide
- 2,056 partners
- 16,640 professional staff
- $2.9 billion in total revenues

100 WITMER ROAD, STE. 350
HORSHAM, PA 19044

ADDRESS SERVICE REQUESTED