MANAGEMENT & *TAX CONCEPTS*

SUMMER 2018

Early retirement

HOW TO MAKE THIS DREAM A REALITY

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Early retirement

How to make this dream a reality

Traditionally, many Americans have viewed 65 as a target retirement age. However, there's usually no legal requirement that you retire when you turn 65. Most Americans are free to retire either after or before this age, if they have the financial resources to do so.

Many people dream of retiring early so they can pursue activities other than work, such as volunteering, traveling and participating in their hobbies. But making this dream a reality requires careful planning and diligent saving during the years leading up to the anticipated retirement date.

MAX OUT RETIREMENT ACCOUNTS

Retirement savings accounts like IRAs and 401(k)s are the main source of retirement income for many Americans. One of the best ways to retire early is to build up these accounts as quickly as possible by contributing the maximum amount allowed by law each year.

In 2018, you can contribute up to $18,500 to your 401(k) if you're under the age of 50. If you're 50 years of age or over, you can make an additional catch-up contribution of $6,000, bringing the total annual 401(k) contribution limit up to $24,500 this year.

Additionally, you can contribute up to $5,500 to your traditional or Roth IRA this year if you're under the age of 50 and meet other requirements. If you're 50 years of age or over, you can make an additional catch-up contribution of $1,000, bringing the total annual IRA contribution limit up to $6,500 this year. Depending on your income, you may qualify to contribute to both a 401(k) and a deductible IRA or Roth IRA.

Keep in mind that, if you plan to tap into your 401(k) or IRA to retire early, you may be subject to an early withdrawal penalty. This depends on how old you are when you retire: If you're under age 59½ when you start making withdrawals, you may have to pay a 10% early withdrawal penalty on distributions from a 401(k) and a traditional IRA.

LOOK AT OTHER INCOME SOURCES

Also consider other potential sources of retirement income, such as a company pension plan. If your employer offers a pension plan, talk to your human resources contact to find out if you can receive benefits if you retire early. Then factor this income into your retirement budget.

Of course, you're likely planning on Social Security benefits comprising a portion of your retirement income. If so, keep in mind that the earliest you can begin receiving Social Security retirement benefits is age 62.

And if you start receiving Social Security retirement benefits before reaching your "full retirement age" — which is 67 if you were born in 1960 or later — your monthly benefit amount will be

smaller than if you wait until your full retirement age. How much smaller?

According to the Social Security Administration, your monthly retirement benefit will be permanently reduced as follows if you start claiming benefits early:

- 30% at age 62,
- 25% at age 63,
- 20% at age 64,
- 13.3% at age 65, and
- 6.7% at age 66.

The flip side of planning to ensure adequate retirement income is reducing your living expenses during retirement. For example, many people strive to pay off their home mortgages early, which can possibly free up enough monthly cash flow to make early retirement feasible.

START PLANNING EARLY

It's never too soon to start planning for retirement. This is especially true if you want to retire early.

By saving as much money as you can each year in your retirement savings accounts, carefully planning your Social Security distribution strategies and cutting your living expenses in retirement, you just might be able to make this dream a reality. •

Professional services and the new pass-through deduction: Does your firm qualify?

The recently enacted Tax Cuts and Jobs Act (TCJA) added Section 199A to the tax code, providing a new 20% deduction for owners of "pass-through entities." The deduction is designed to help these entities compete with C corporations, which now enjoy substantially reduced corporate tax rates. It's available from 2018 to 2025.

Although the concept is simple, the new tax break is one of the more complex provisions of the TCJA, particularly for professional services firms. Here is an introduction to the deduction and guidance on determining whether your firm qualifies.

SEC. 199A IN A NUTSHELL

The deduction is available to all entities whose owners report business income on their individual returns. This includes pass-through entities — such as S corporations, partnerships and LLCs — as well as sole proprietorships. So "pass-through deduction" is a bit of a misnomer because a sole proprietorship isn't legally an entity.

Generally, the deduction is equal to the *lesser* of:

- 20% of an owner's qualified business income (QBI) from the entity, or
- 20% of an owner's taxable income, less any net capital gains.

QBI generally refers to an owner's allocable share of net qualified items of income, gain, deduction and loss from the entity. "Qualified items" excludes capital gains, dividends and non-business-interest income. QBI doesn't include reasonable compensation received by S corporation shareholders or guaranteed payments received by partners.

The write-off is a "below-the-line" deduction — that is, it's subtracted from adjusted gross income (AGI) in calculating taxable income. But it's not an itemized deduction, so it can be claimed in addition to the standard deduction.

LIMITATIONS AND PHASEOUTS

Here's where things get complicated. The deduction is subject to two important limitations: a W-2 wages limit, which may reduce or eliminate it, and a phaseout of the deduction for specified service businesses, including most professional services providers other than architects and engineers. (See "What is a specified service business?" at right.)

Neither limitation applies, however, unless a business owner's taxable income exceeds a threshold amount (currently, $315,000 for joint filers and $157,500 for others).

W-2 wages limit. Owners of all businesses, including specified service businesses, are subject to a W-2 wages limit. When taxable income exceeds a specified threshold, the deduction is limited to 50% of an owner's allocable share of the entity's W-2 wages. The limit is phased in gradually, beginning at $157,500 of taxable income ($315,000 for joint filers), and reaches full force once taxable income reaches $207,500 ($415,000 for joint filers).

Note: There's an alternative limit equal to 25% of W-2 wages plus 2.5% of the original cost basis of

What is a specified service business?

Owners of specified service businesses aren't entitled to claim the pass-through deduction if their taxable income exceeds a certain threshold. "Specified service business" is defined as:

- Any trade or business involving the performance of services in the fields of:
  - Accounting,
  - Actuarial science,
  - Athletics,
  - Brokerage services,
  - Consulting,
  - Financial services,
  - Health,
  - Law, or
  - Performing arts,
- Any trade or business whose principal asset is the reputation or skill of one or more of its employees or owners, or
- Any trade or business involving the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests or commodities.

The definition expressly excludes architecture and engineering.

qualified depreciable property. This limit benefits capital-intensive businesses with little or no W-2 wages, but generally is not relevant to professional services firms.

Phaseout for specified service businesses. For owners of specified service businesses, including most professional services firms, the deduction is reduced when taxable income exceeds $157,500 and eliminated once it reaches $207,500. For joint filers, the phaseout range is $315,000 to $415,000.

ARE YOU ELIGIBLE?

If your firm is organized as a sole proprietorship or pass-through entity, it's important to determine whether, and to what extent, you're eligible for the 20% deduction. If your taxable income is below the threshold amounts discussed above, you should be entitled to the tax break regardless of your industry or whether you pay any W-2 wages.

If you're above the threshold, however, the deduction may be reduced or eliminated by the W-2 wages limit, the specified service business phaseout, or both. In that case, you might consider strategies for optimizing the deduction. For instance, a sole proprietor prevented from claiming the deduction by the W-2 wages limit might hire a contractor as an employee or convert to an S corporation and pay himself or herself a salary. •

Charitable IRA rollover eases tax pain of RMDs

One downside of a traditional IRA is that, once you reach age 70½, you must begin taking required minimum distributions (RMDs) — and pay taxes on those distributions — whether you need the money or not. But if you're charitably inclined, you can use a qualified charitable distribution (QCD) to avoid taxes on up to $100,000 in RMDs.

Also known as a "charitable IRA rollover," a QCD is a direct transfer from your IRA to an eligible charity. It counts as a distribution for RMD purposes, but it's excluded from your income. And that allows you to avoid taxable distributions for the year, up to the $100,000 limit.

ADVANTAGE OF QCDs OVER ORDINARY DONATIONS

When you receive an RMD, it's taxable to the extent it's attributable to deductible contributions and earnings on those contributions. (Amounts attributable to nondeductible contributions are tax-free.) One strategy for reducing these taxes is to donate the taxable portion (or an equivalent amount) to charity. If the donation is fully deductible, it will offset the taxable income that's generated by the distribution.

> *A QCD is a direct transfer from your IRA to an eligible charity.*

Depending on your tax situation, however, this strategy may be less effective than a QCD. For one thing, a charitable deduction will benefit you only if you itemize. And that's less likely now that the Tax Cuts and Jobs Act (TCJA) has nearly doubled the standard deduction. Second, even if you itemize, adjusted gross income (AGI) limits may reduce your charitable deductions.

For instance, deductions for cash gifts to public charities are currently limited to 60% of AGI. Finally, by boosting your income, IRA distributions may trigger AGI-based rules that punch up certain taxes or deflate the benefits of certain tax breaks.

A QCD avoids these issues because it bypasses your income altogether. It allows you to take the equivalent of a charitable deduction — regardless of your income level or whether you itemize — and it won't increase your AGI. Another advantage of QCDs is that they're deemed to come from the taxable portion of your IRA first, increasing the portion of the remaining balance that's nontaxable.

QCD REQUIREMENTS

If you're considering a QCD, you must meet several requirements:

- You must be at least 70½ at the time of the distribution. (Reaching that age during the tax year isn't enough.)
- The IRA must distribute the funds *directly* to an eligible charity — generally, a public charity, private operating foundation or "conduit" private foundation.
- The donation must be "otherwise deductible." In other words, it would have been fully deductible (disregarding AGI limits) had you funded it with non-IRA assets. If you receive something of value in exchange for your gift (tickets to an event, for example), it's not a QCD.
- The distribution must be "otherwise taxable." It's not a QCD to the extent it would be tax-free if distributed to you directly.

In addition, QCDs are subject to the same substantiation requirements as other charitable donations.

A TAX-EFFICIENT STRATEGY

If you don't need your IRA funds for living expenses, and you plan to donate to charity anyway, a QCD offers a tax-efficient strategy for satisfying your RMD requirements. The TCJA may enhance the advantages of QCDs because it increases standard deduction amounts, but keep in mind that these amounts are scheduled to return to their previous levels in 2026. Your tax advisor can help you adjust tax-planning strategies accordingly. •

Eyeing a merger or acquisition

Merging with, or acquiring, another company is one of the best ways to grow rapidly. You might be able to significantly boost revenue, literally overnight, by acquiring another business. Achieving a comparable rate of growth organically — by increasing sales of existing products and services or adding new product and service lines — may take years.

And this year could turn out to be a ripe year for M&A activity. According to a report in the journal *Transaction Advisors*, corporations and private equity firms expect a step-up in merger and acquisition activity in 2018 — both in the number and size of those transactions. (More than 1,000 executives at corporations

and private equity firms with annual revenues of $10 million or greater were surveyed.)

WHAT ARE THE POTENTIAL BENEFITS AND DRAWBACKS?

There are, of course, multiple factors to consider before making such a move. On the plus side, an acquisition might enable your company to expand into new geographic areas and new customer segments more quickly and easily. You can do this via a horizontal acquisition (acquiring another company that's similar to yours) or a vertical acquisition (acquiring another company along your supply chain).

There are also some potential drawbacks to completing a merger or acquisition. For example, it's a costly process, from both a financial and a time-commitment perspective.

Thus, you should determine how much the transaction will cost and how it will be financed *before* beginning the M&A process. Also try to get an idea of how much time you and your key managers will have to spend on M&A-related tasks in the coming months — and how this could impact your existing operations.

You'll also want to ensure that the cultures of the two merging businesses will be compatible. Mismatched corporate cultures have been the main cause of numerous failed mergers, including some high-profile megamergers. You'll need to plan carefully for how two divergent cultures will be blended together.

CAN YOU REDUCE THE RISKS?

The best way to reduce the risk involved in buying another business is to perform solid due diligence on your acquisition target. Your objective should be to confirm claims made by the seller about the company's financial condition, clients, contracts, employees and management team.

The most important step in M&A due diligence is a careful examination of the company's financial statements — specifically, the income statement, cash flow statement and balance sheet. Also scrutinize the existing client base and client contracts (if any exist) because projected future earnings and cash flow will largely hinge on these.

Finally, try to get a good feel for the knowledge, skills and experience possessed by the company's employees and key managers. In some circumstances, you might consider offering key executives ownership shares if they'll commit to staying with the company for a certain length of time after the merger.

A PENT-UP DEMAND

There may be a merger wave depending on what happens with the economy. The result may be a release of a pent-up demand for acquisitions among private equity firms and strategic buyers. Consider your options. •

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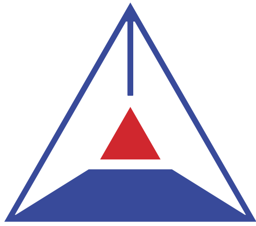


CYBERTROL ENGINEERING

CONTROL & INFORMATION SYSTEMS INTEGRATION

Manufacturing facilities continue to invest in automation today to meet new requirements and remain competitive tomorrow. To that end Cybertrol focuses on plant-wide automation solutions. Cybertrol Engineering brings a plant-wide approach to each project with the goal of enabling plant-wide visibility and control with common underlying software and hardware infrastructure. We design for operational efficiency, openness, and maintainability.

Since it was founded in 1996, Cybertrol Engineering has been involved in over 3,000 projects in over 450 client locations across the US, Mexico, and Canada and extending to Europe, Asia, Australia and Africa. These projects have encompassed a wide variety of applications and a broad range of industries. Ben Durbin joined Cybertrol in 1997 as a project engineer and has held lead engineering and sales management positions before being named President of the Company in 2007.

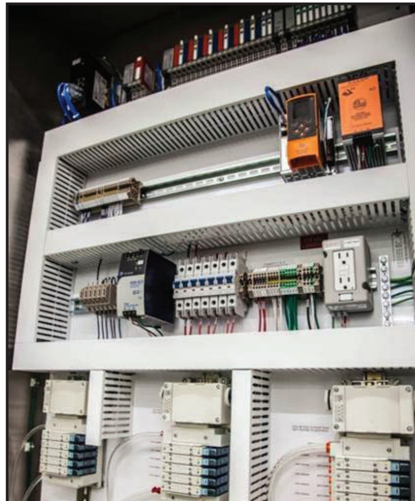
Cybertrol provides full-service computer and control systems integration, with expertise in PLC/HMI based applications, software applications, data acquisition, batch control, manufacturing execution systems, and Internet/Intranet-based applications.

We work in many industries worldwide. Our dedicated, experienced staff has a proven track record integrating control systems projects for major corporations and up-and-coming operations. We can handle project scopes from small upgrades and retrofits to large expansions and new facilities.

Our structured methodology includes strong internal hardware and software design standards and methods. This is combined with peer design reviews at key project steps to provide continuity in design and a seamless look and feel across all areas.

Our goal is to be the most sought-after partner for control and information systems integration by those who value excellence and strive for world-class manufacturing.

Cybertrol is currently headquartered in a 23,000 square foot facility in Plymouth, Minnesota. More information about Cybertrol Engineering can be found at www.cybertrol.com.



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