

Main Street Business Owners: Tax Strategies that Build Your Wealth



Griffiths, Dreher & Evans, P.S.
Wealth Management CPAs

What's Inside

Joining the 2% Clubp. 2

Evolution: Increasing Your
Tax Savings Over Timep. 3
Stage One—
Sole Proprietorshipp. 3
Stage Two—Incorporate
Your Business.....p. 4
Stage Three—
Buy Real Estatep. 5
Stage Four—
Build a Stock Portfolio.....p. 6
Stage Five—
Create an Exit Planp. 7

Focused on Your Needs:
A Well-Defined Process for Helping
You Reach Your Goalsp. 8

Meet Griffiths, Dreher
& Evans p. 10

Expertise You Can
Count On p. 11

By Tom Griffiths, CPA, PFS, ABV

Success in business isn't always about making more money—it's often about keeping more of the money you earn. By employing smart tax strategies, you can reduce your tax burden and save more money for the future. In this white paper, we'll look at some practical strategies for building wealth by managing your taxes over time.

Whether you're just starting out or running a mature enterprise, you can realize tangible financial benefits from thoughtful tax planning. Remember that building wealth isn't an overnight process. Rather, it's a series of small steps that you can begin taking today. Regardless of where you are in the evolution of your business, it's a good idea to review your tax strategies at least once a year with a CPA Wealth Manager.

A CPA Wealth Manager can offer you a unique advisory experience by combining considerable tax expertise with deep wealth management knowledge. This two-pronged approach—managing your liabilities (by reducing taxes) while growing assets (by optimizing investments)—can be a powerful combination. Think of your CPA Wealth Manager as a financial coach who can help you fine-tune the financial strategies you already have in place, while helping you take your game to a new level.

There are five natural stages of evolution that most successful businesses go through. We'll talk about each of these stages and discuss ways to maximize your tax savings at each step of the growth of your company. When you pay fewer taxes, you'll potentially have more capital on hand to reinvest in the growth of your business, while also beginning to develop wealth outside of your business.

Remember, managing taxes isn't just for the super wealthy. As an ordinary, Main Street business owner, you can build your own wealth every day by making smart decisions about managing and reducing taxes. Your life's work has value—protect that value by taking a proactive approach to managing taxes.

Sincerely,
Tom Griffiths
Tom Griffiths

Joining the 2% Club

As a business owner, you know from firsthand experience that being an entrepreneur involves taking risks. If you've been in business for more than 10 years and are currently well-positioned to leave your business when you want to, you belong to a very small club of successful business owners. In fact, we call this group of business owners the "2% Club" because only 2% of all business owners make it this far.

Consider the following:

- ▣ 40% of new businesses fail the first year
- ▣ 80% of businesses fail within five years
- ▣ 96% of businesses fail within the first 10 years

Of the remaining 4% of business owners still in business after 10 years, only half of those business owners (about 2%) successfully leave their business when they want to. This means they are able to leave on their own terms and receive the net proceeds they're looking for.

While these statistics may seem discouraging for even the most optimistic entrepreneurs, there is a silver lining. If you are reading this white paper, chances are good that you're already on the right track for achieving your financial goals. As a general framework, we notice that business owners with the strongest finances tend to have their wealth divided into three distinct components.

Total Net Worth of Successful Business Owners

1/3 Business Ownership	1/3 Real Estate Holdings	1/3 Stocks and Bonds
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The goal of this white paper is to offer you a practical framework for joining the 2% Club. Some of the tax strategies presented here you may already be familiar with, while others may require some time, education and planning to implement properly.



Evolution: Increasing Your Tax Savings Over Time

Main Street business owners tend to grow their businesses slowly, by building community connections and by providing exceptional service to their customers. If you are Main Street business owner, you have the opportunity to refine your tax strategies as your business grows and develops into a mature enterprise. The following table shows a typical progression—or evolution—of a business owner’s tax strategy over a long period of time, such as 10 to 20 years, or even longer.

Progression	Description	Overview
Stage One	Sole proprietorship	Build your client base, establish profitability
Stage Two	Incorporate your business	Explore your options and convert to a more tax-friendly ownership structure
Stage Three	Buy real estate	Build wealth <i>and</i> get tax write-offs through real estate ownership
Stage Four	Build a stock portfolio	Reduce your tax bill through tax-loss harvesting, while building long-term wealth
Stage Five	Create an exit plan	Structure the sale of your business to minimize taxes and maximize your net proceeds

None of these tax strategies are particularly difficult to execute when working with an experienced tax professional. However, they can be easy to overlook when you get caught up in the day-to-day management of a growing business. Your CPA Wealth Manager will review your tax planning needs with you at least once a year. The role of your CPA Wealth Manager is to help keep you on track and make sure that you are constantly moving forward toward your goals—whatever those goals may be. Each stage represents a progression toward reducing taxes, building wealth and giving you more options for the future.

If you’re just starting out, you can use this table as a roadmap for reducing taxes and building wealth. If you’ve been in business for a while, chances are good that you may already be familiar with several of these strategies. No matter what stage you find yourself at, it’s important to look to the future and consider what comes next. The most successful business owners seek to increase their total net worth by managing taxes and growing their assets.

Stage One—Sole Proprietorship

Build your client base, establish profitability

Tom is a licensed contractor who specializes in replacing windows and doors. After working for a large firm for many years, he decides to start his own independent business. During his first year of business, Tom is his company’s sole employee. He answers the phone, creates invoices and does all installations himself. He doesn’t plan to incorporate until his business is profitable and he begins to hire additional team members. In his first year of business, Tom barely breaks even but he has already laid the groundwork for future growth. He has a strong referral network and he’s become a preferred vendor for some of the big box home improvement stores in his local area.

Tips for Sole Proprietors

- **Look to the future.** You don’t need to incorporate right away, but it’s a good idea to review your ownership structure at least once a year with a CPA Wealth Manager.
- **Maintain good records.** Get in the habit of keeping clear records of income and expenses. Your CPA Wealth Manager can help you create simple accounting systems.
- **Keep your expenses low.** Be frugal with your money, but don’t be afraid to hire extra team members as your business grows. If you’re turning away business because you don’t have enough manpower, it may be time to add more people.
- **Buy assets that appreciate.** A new truck may provide a tax write-off, but it’s a lousy investment because it will lose value over time. Talk to your CPA Wealth Manager about buying assets that may appreciate in value over time, such as real estate, as well as stocks and bonds.



Stage Two—Incorporate Your Business

Explore your options and convert to a more tax-friendly ownership structure

John was 40 years old and a self-employed consultant, he made \$80,000 per year. During an annual review with his CPA Wealth Manager, John discovered that if he converted to an S-Corporation and paid himself a reasonable wage, he could potentially save up to \$5,000 per year on taxes. John plans to work another 20 years. The future value of a \$5,000 annual tax savings for twenty years based on a 10% per year investment return is nearly \$250,000. In just a short consultation, John's CPA Wealth Manager was able to improve his projected retirement wealth by close to a quarter of a million dollars. Repeatable tax savings are a highly underestimated—and often overlooked—source of wealth.

Reducing Social Security taxes

One of the biggest taxes you may face as a business owner is self-employment or Social Security Tax. When you work for someone else, you pay 7.5% of your income in Social Security tax and your employer pays another 7.5%. When you work for yourself, you pay the full 15% on your own. When you incorporate your business, you can lower your taxable salary to a reasonable wage, based on comparable average salaries in your state. In doing so, you can potentially create hefty savings on Social Security taxes.

Finding the right ownership structure

One of the most common and tax-efficient ownership structures for small businesses that decide to incorporate is the S-corporation. The S-corporation is a “pass-through” entity, in which earnings are passed directly through to the company owners, without paying corporate tax. In contrast, a C-corporation is subject to corporate taxes. Your CPA Wealth Manager can help you consider the tax benefits of different ownership structures.

Benefits of an S-Corporation

- ▣ *Establish the value of your business.* Incorporating your business will help document and establish a market value for your business.
- ▣ *Reduce self-employment taxes.* Talk with your CPA Wealth Manager about determining a reasonable wage for yourself in your local area. The wage you set can potentially help reduce your Social Security or self-employment taxes.
- ▣ *Avoid double taxation.* As a pass-through entity, an S-Corporation doesn't pay corporate taxes. Keep in mind that you will pay personal taxes on income received from the business.
- ▣ *Enhance your exit plan.* When you eventually decide to sell your business, an S-Corporation provides an opportunity for a more tax-efficient transaction than other business structures.

Tips for Incorporating Your Business

- ▣ *Explore all options.* Discuss the ownership structure of your business with your CPA Wealth Manager on an annual basis.
- ▣ *Take a long-term view.* While incorporating may offer smaller tax savings in the early years, the long-term tax savings can be substantial.
- ▣ *Get advice.* If needed, talk to an attorney about the incorporation process in your state of residence. You can also get information from your state chamber of commerce and may be able to incorporate on your own.



Stage Three—Buy Real Estate

Build wealth and get tax-write offs through real estate ownership

Jennifer owned a successful restaurant and had been in business for three years. She was currently leasing her space and was considering buying a commercial property to operate the restaurant in. When a storefront a few doors down from her current location went on the market, she decided to buy it. The sale price of the property was about \$400,000 and the bank required her to make a down payment of 35% to get the best financing rates. While she had a strong cash position, she decided to make only the minimum required down payment of 35% in order to maintain liquidity for the renovation of the building. During the renovation, she was able to accumulate significant tax write-offs for all of the fixtures, signage and furniture she purchased for the new space.

When the renovation was complete, she moved her restaurant to the new space and her business continued to grow. Her CPA Wealth Manager recommended that she spread out the depreciation of the personal property purchased for the

restaurant over a five-year time period. During the next five years, Jennifer paid very little income taxes on income generated by the restaurant business because of her tax write-offs. Five years later, the building was appraised for \$1 million. Jennifer decided to sell the business to a new owner and keep the real estate, leasing the space to the new owner. She now has an asset that will continue to appreciate over time, while producing an attractive income stream. She has also helped to diversify her personal wealth away from a single source—her original restaurant business. She's presently looking at starting a new restaurant in town.

Benefits of owning the building where you work

- ▣ *Growth potential.* You own an asset that may potentially appreciate in value over time.
- ▣ *Higher tax write-offs.* Owner-occupied commercial real estate is eligible for an even higher level of tax savings than real estate you lease to a tenant.
- ▣ *Defer taxes on capital gains.* The growth in asset value is tax-free until you decide to sell the building. In some cases, you may decide to keep a building for your entire lifetime.

Tips for Buying Real Estate

- ▣ *Have a long time horizon.* Plan to hold the asset for at least 10 years.
- ▣ *Consider using leverage.* Make a down payment that's just big enough to get the best financing. Keep the rest on hand for other opportunities.
- ▣ *Be patient and choose carefully.* Take your time and avoid buying property in neighborhoods where rents or population growth are declining. The average time to identify an attractive property and structure the right deal is about two years.

Stage Four—Build a Stock Portfolio

Reduce your tax bill through tax-loss harvesting, while building long-term wealth

Mark was a successful land surveyor. When he first started his business 15 years ago, he began to slowly buy high-quality stocks through a taxable brokerage account. Ten years ago, one of his clients gave him some land as payment for a work project. His portfolio now contains a mix of stocks, real estate and income from his business.

In 2008, when the stock market plunged by nearly 50%, Mark was dejected over the loss in value in his stock portfolio. He wanted to sell all his stocks and be done with them. Mark's CPA Wealth Manager was more optimistic and encouraged him to stay invested in the market. Taking a long-term view, Mark's CPA Wealth Manager noted that dramatic stock market declines have historically been followed by dramatic rebounds.

Because stock prices were so low, however, Mark's CPA Wealth Manager suggested harvesting some of the paper losses by selling some of the stocks that had experienced the steepest declines. After selling the most battered stocks, they replaced those stocks with similar, but not identical, investment strategies. When the stock market began to rise again in 2009, Mark still had stock market exposure and he enjoyed the benefits of his new investments gaining considerable value. He had also harvested some significant tax write-offs that he could use when it came time to sell the land plots he owned.

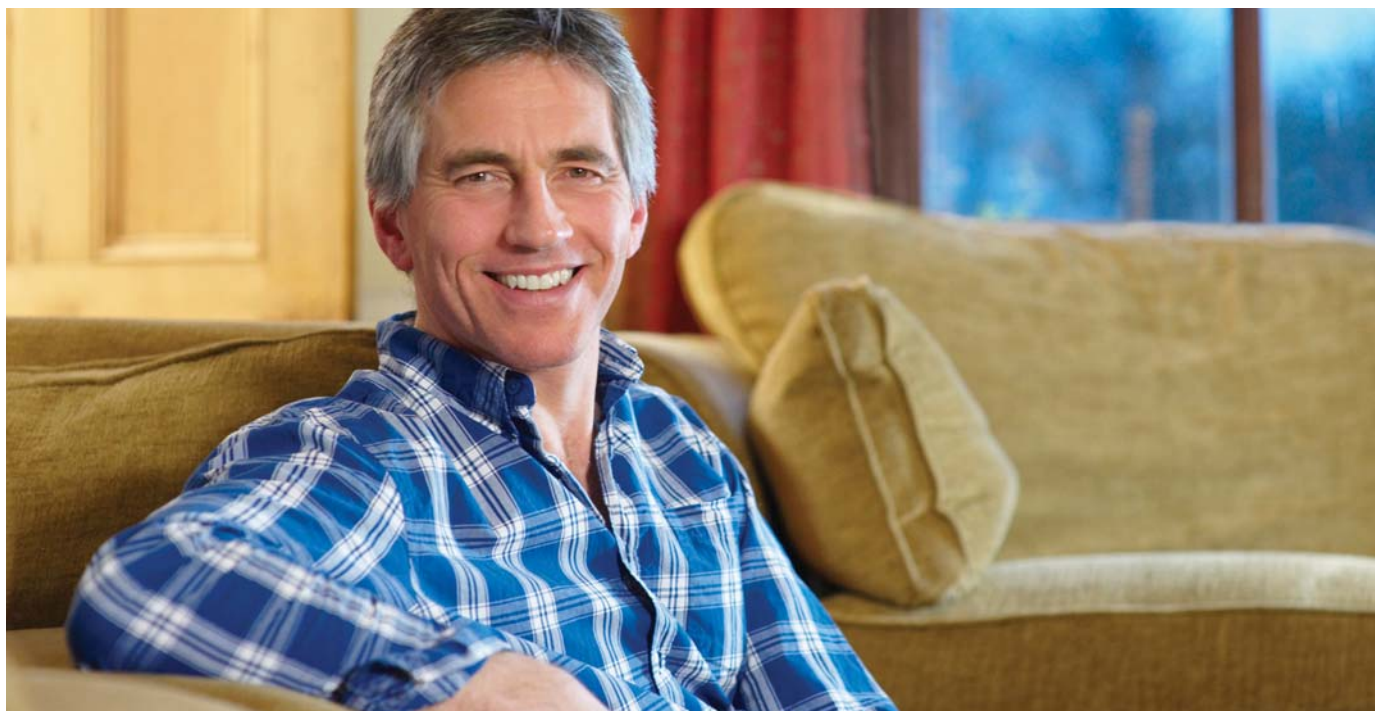
Using losses on his stock investments, he can now sell the real estate plots and avoid most of the capital gains taxes associated with those sales.

Benefits of Investing in Stocks

- ▣ *Growth potential.* You own assets that may appreciate in value.
- ▣ *Opportunities for tax-loss harvesting.* Even down markets have a silver lining for long-term investors. You can take some losses for tax purposes, but still stay in the market.
- ▣ *Passive earnings.* As a stock investor, your CPA Wealth Manager will help you monitor your portfolio. You have to pay attention to your investments, but you don't have to run a business or deal with tenants.

Tips for Stock Investing

- ▣ *Work with a pro.* Your CPA Wealth Manager can recommend stock investments that are right for your risk tolerance and time horizon.
- ▣ *Use taxable and tax-advantaged accounts.* You may want to hold stocks in a taxable brokerage account, as well as tax-advantaged accounts, such as your IRA. Your CPA Wealth Manager can recommend which accounts to use.
- ▣ *Take a long-term view.* Plan to keep stock investments for five to 10 years or longer. Don't panic when markets are down. Stick with your strategy, even while harvesting tax losses.



Stage Five—Create an Exit Plan

Structure the sale of your business to minimize taxes and maximize your net proceeds

For more than 20 years, John has owned and operated an auto detailing shop that specialized in high-end luxury cars. John's shop manager was planning to buy the shop and he had a tentative deal in place to sell the business. When reviewing the terms of the deal, John's CPA Wealth Manager noticed an opportunity to create an additional tax savings of \$225,000 for John before the sale went through. The tax savings was achieved through a change in tax laws that now allows businesses with more than \$1 million in gross annual revenue, but less than \$10 million, to convert their accounting systems from an accrual to a cash basis. By making the conversion prior to the sale of the business, John gets to enjoy the tax break. Otherwise, the tax break would have gone to his buyer. Reviewing the tax implications of his exit plan helped John achieve higher net proceeds on the sale than he might have on his own.

Focus on net proceeds

When selling a business, business owners are often simply focused on the sales price. However, tax considerations are equally important. Your goal should be to generate the highest amount of net proceeds (money in your pocket after taxes) that you can. Sometimes a smaller sale price can result in higher net proceeds because of tax considerations. If you plan for the sale or exit properly, you should pay the least amount of taxes possible. What's more you can intentionally shift the tax benefit to one party or the other.

Consider a phased stock sale

A phased stock sale (gradually selling your business over a period of time, such as five years) can result in both a higher sales price and higher net proceeds. For example, if a business is worth 3 to 5x annual earnings, an immediate sale might result in a sales price that is 3x earnings while a phased stock sale might result in one that is 5x earnings. In addition, by spreading the payments out over five years, you're more likely to have a lower average income and tax rate during the sale period.

Most owners don't realize that they can retain control of the company after the sale by selling most of the company stock as non-voting stock and keeping the voting stock until they are paid. This strategy even works in an S-Corporation. There are many exit planning mechanisms to help manage post-sale financial risk. The best way to eliminate post-sale financial risk is to get the clock started ticking.

Benefits of a sound exit plan

- ▣ *Higher net proceeds.* With a sound exit plan, you're likely to have more money left in your pocket after taxes.
- ▣ *Less financial risk.* You can diversify your wealth away from your business in advance of leaving the business, while also minimizing the risks of the deal itself.
- ▣ *More manageable tax payments.* Planning ahead helps you lower your tax bill and build tax payments (if any) into your exit plan.
- ▣ *Protect your brand.* Business owners often want to ensure that their customers will receive the same care and attention they always have from the new owners. A sound exit plan helps you find and groom the right buyer for your business—and your customers.

Tips for Exit Planning

- ▣ *Develop a buyer early.* You'll generally get the highest price when selling to an insider. An employee who is also the intended buyer needs time to get financing and present himself as a responsible borrower to a bank, a process that may take several years.
- ▣ *Develop wealth outside your business.* Having some of your wealth diversified into real estate and stocks will make exit planning smoother and less risky.
- ▣ *Consult with a CPA Wealth Manager.* Your CPA Wealth Manager can help you position your business today for maximum value in a future sale. He or she can also help you develop an exit plan that makes sense for your needs.

Focused on Your Needs: A Well-Defined Process for Helping You Reach Your Goals

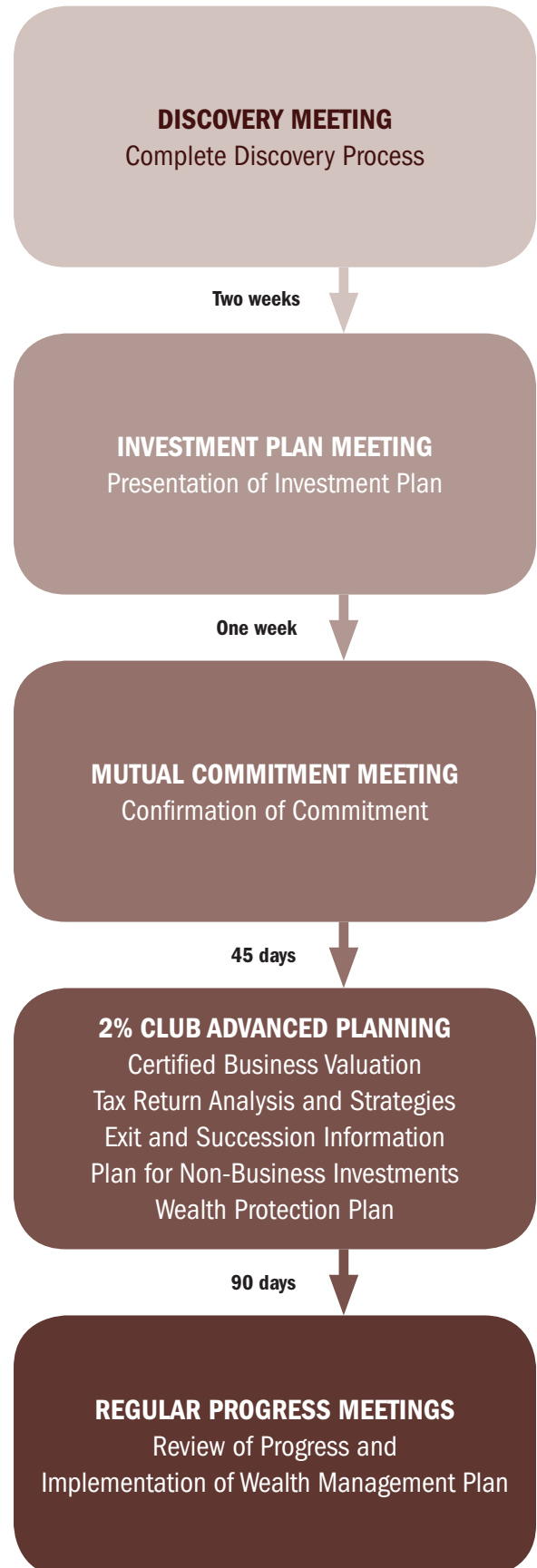
A credible CPA Wealth Manager should have a well-defined process for helping you reach your financial goals. At Griffiths, Dreher & Evans, here are the steps we take to better understand your needs and help you join the 2% Club.

The Discovery Meeting

At the first meeting, we use a systematic, detailed interview process to define your true financial needs, goals and current position. This process will provide us with the information we need to create a Total Client Profile. This is a key tool for communicating your financial picture to a network of specialists we will turn to for help in creating customized wealth management strategies. During the meeting, expect us to work with you to:

- Uncover your values, wants and needs
- Collect information to assess the suitability of working together
- Gather the details necessary to create a wealth management plan

The CPA Wealth Manager Approach



The Investment Plan Meeting

In this meeting, we will present you with a detailed investment plan that describes your needs and risk tolerances and provides benchmarks for tracking progress toward your goals. This plan will serve as the road map that can help enhance the probability of achieving everything that is important in your financial life. Investment plans will likely include these six important areas of discussion:

- ▣ Your long-term needs, objectives and values
- ▣ A definition of the level of risk that you're willing to accept
- ▣ The expected time horizon for your investments
- ▣ Your target rate of return
- ▣ Our recommended asset allocation strategy for your portfolio
- ▣ Our investment philosophy and methodology

The Mutual Commitment Meeting

At this meeting, if you have been pleased with the discussions so far, you will likely become a client. You can ask any questions or voice any concerns about the investment plan. You and the CPA Wealth Manager can then make a mutual decision about whether you should proceed. If you choose to work together, the advisor will ask you to execute all documents needed to begin to implement the investment plan.

2% Club Advanced Planning Meeting

Next our team of CPAs with expertise in business valuation, taxation, exit planning and investments goes to work on your wealth management planning. We complete a business valuation, in-depth tax analysis, exit strategy, and a plan for non-business investments. We meet and apply our expertise to evaluate all aspects of your financial situation and devise appropriate solutions. When needed, we bring in professionals, from our team of outside experts to assist with legal, banking, insurance or other specialized solutions.

Once a plan has been developed, you will receive your Certified Business Valuation, results of our Tax Return & Tax Strategy Analysis, and information you should be aware of regarding any applicable exit planning. We'll also give you our recommendations for developing additional investments outside of your business. Our goals are to help you enhance, protect and eventually transfer your wealth to your beneficiaries.

Regular Progress Meetings

These meetings will likely be held on a regular basis to address issues relating to anything in your wealth management plan as appropriate. You will be able to ask questions at each meeting, and your advisor will review and explain your portfolio's performance relative to your long-term goals.



Meet Griffiths, Dreher & Evans

At Griffiths, Dreher & Evans, we specialize in helping Main Street business owners build long-term financial security. Our services include accounting, tax planning and preparation, business valuation and wealth management solutions. As CPA Wealth Managers, we can help you:

- ▣ Grow and protect your wealth
- ▣ Reduce and manage your taxes
- ▣ Take care of your family and employees
- ▣ Enjoy more choices for how you spend your future

Building a Path to Your Future

As a Main Street business owner, it's important to make decisions that build wealth in the context of your financial past, present and future. The accounting services we provide help you look at your past and present, taking a clear inventory of your assets and liabilities. Our wealth management services help you look toward the future and forge a clear path for getting to where you want to go. We can help you create a plan to manage taxes, build wealth and minimize risk. Our ultimate objective is to help you enjoy the full financial and emotional value of your life's work.

Protecting and Growing the Value of Your Business

We understand that business valuation services play an important role in your financial plan. That's why we provide initial and ongoing certified business valuations to our clients as part of our comprehensive approach to wealth management. We recommend an annual valuation so you can be better prepared for the future and more favorably positioned to achieve all of your financial goals. Based on your annual valuations, we also offer practical guidance and advice for increasing the visible value of your business.

Creating Long-Term Financial Security

Helping you develop investments outside your business puts you on the right track for achieving a broad range of financial goals, while minimizing the risks associated with business ownership. We want you to join the 2% Club—those business owners who stay in business for more than 10 years and ultimately leave the business financially strong and on their own terms. Our proven approach to wealth management creates long-term financial security for Main Street business owners like you.

As a successful business owner, you're probably already on the right track for meeting many of your financial goals. However, there are always opportunities for improving your financial strength and creating a more well-defined path for the future. We encourage you to talk to one of our accounting and investment professionals today about your unique vision of what you want to accomplish in life. We also encourage you to ask us for a list of references. The best way to get to know Griffiths, Dreher & Evans is to talk to some of our existing clients. Our goals are to answer all of your questions and learn more about how we can put our considerable resources to work for you. It's not about the money—it's about helping you achieve your life goals and living the life you've always imagined for yourself.



Expertise You Can Count On

Meet Our Team



Thomas Griffiths, CPA, ABV, PFS
CPA Wealth Manager



Brett Smith, CPA, ABV, PFS
CPA Wealth Manager



J. Shawn Coleman, CPA, ABV, PFS
CPA Wealth Manager



Deanna Dreher, CPA, CFE, PFS
CPA Wealth Manager



Susan Marshall, CPA, CVA, PFS
CPA Wealth Manager



Todd Evans, CPA, CFE, PFS
CPA Wealth Manager

Start Building Your Future Today

To learn more about working with Griffiths, Dreher & Evans, please give us a call at **509.326.4054** or e-mail us at cpa@grifco.com. We welcome the chance to meet you, answer your questions and help you build a stronger financial future.

Putting Your Needs First

As CPA Wealth Managers, we are focused exclusively on helping you achieve your financial goals.

- ▣ *A personal touch*—Our approach is defined by the 6 C's. We strive to be caring, compassionate, character-driven, cost effective, consultative and a good match for helping you create the right chemistry with your team of advisors.
- ▣ *On your side of the table*—We serve as your representative at all times. Our fee-based approach to billing for our services is highly transparent and fully disclosed. We don't make money by working for other parties, such as people selling investment products. We work for you and you only.
- ▣ *Deep accounting expertise*—All of our CPA Wealth Managers have proudly earned the CPA designation, helping you manage your personal and business taxes while growing your wealth.

About the author: Tom Griffiths is a Certified Public Accountant (CPA), Personal Financial Specialist (PFS), is Accredited in Business Valuation (ABV) and is a Certified Exit Planning Advisor (CEPA). He is also the founder of Griffiths, Dreher & Evans, P.S., a Spokane-based certified public accounting & wealth management firm specializing in meeting the needs of today's Main Street business owners. To learn more, contact Tom at 509.326.4054.
