Planning Before, During and After Transition

TRANSITION, ADVANCED TAX AND RETIREMENT INCOME PLANNING
JUNE 21, 2019 – PACIFIC NORTHWEST DENTAL CONFERENCE

BY: Sam Martin, MBA(tax), CFP®, CPA
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Title Partner

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TAX CUTS & JOBS ACT

Impact on Dentists – 2019 and Beyond
Introduction to the Tax Cuts & Jobs Act

- Vast Majority Was Effective in 2018 & Expires after 2025
- Some Items are “Permanent”
- Let’s Look first at What Congress Has Taken Away...
### Meals & Entertainment

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018 Forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entertainment (except staff see below)</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>Meals (Business)</td>
<td>50%</td>
<td>50% (*)</td>
</tr>
<tr>
<td>Employer Provided</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Meals on Premise (for conv. of ER)</td>
<td>100%</td>
<td>50%</td>
</tr>
<tr>
<td>Meals: Travel Away From Home</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Travel (No change)</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Staff Outings, Parties, Etc.</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

We recommend that you separate those accounts in your chart of accounts going forward to capture the different categories – including 0% Entertainment if Applicable.

(*) Congress made an error at the time of eliminating Entertainment Expenses and accidentally eliminated 50% deductible meals. This has been corrected.
Personal & Dependents Exemptions

2017
$4,050

2018 Forward
None
**Itemized Deductions**

**State & Local Tax:**
- Real Estate
- Personal Property
- Either State Income or Sales Tax
- ALL Deductible

**2018 Forward**
- Real Estate
- Personal Property
- Either State Income or Sales Tax
- Limited to $10,000 (Single or joint)

**Mortgage Interest:**
- Interest up to loan of $1.1M
  (Includes $100,000 home equity debt)
- Principal & one other residence
  Acquisition Debt Obtained on or Before December 15, 2017
  Is Grandfathered, Including qualified refinancing

- Interest up to loan of $750K of new acquisition debt
- Principal & one other residence
# Itemized Deductions

## Medical Expense:

<table>
<thead>
<tr>
<th>Prior</th>
<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Out of pocket in excess of 10% AGI</td>
<td>- Out of pocket in excess of 7.5% AGI in 2017 &amp; 2018</td>
</tr>
<tr>
<td></td>
<td>- Back to 10% AGI in 2019</td>
</tr>
</tbody>
</table>

## Miscellaneous:

<table>
<thead>
<tr>
<th>2017</th>
<th>2018 Forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Tax prep fees</td>
<td>- NONE</td>
</tr>
<tr>
<td>- Investment/advisor fees</td>
<td></td>
</tr>
<tr>
<td>- Unreimbursed employee expenses</td>
<td></td>
</tr>
<tr>
<td>- Certain legal expenses</td>
<td></td>
</tr>
<tr>
<td>- Job search expenses</td>
<td></td>
</tr>
</tbody>
</table>

Phase out of 3% of AGI repealed for 2018-2025
Additional Highlights

- No moving expense deductions (retained for active military permanent station change).
- Alimony no longer deductible or included as income of the recipient after 2018. (prior to 2019 grandfathered)
- ACA individual healthcare mandate repealed after 2018.
Additional Highlights

Like-Kind Exchanges:

2017

All Qualified like-kind property

2018

Only applies to qualified real property
Roth Recharacterizations

“Repeal of special rule permitting recharacterization of Roth IRA contributions as traditional IRA contributions”.

- Contributions to traditional IRA can still be converted to Roth. (Backdoor Roth Contribution Continues to Live)
- Contributions to Roth can still be converted to traditional. Just more risk.

**NEW LAW:** Once you convert traditional to Roth, you cannot then recharacterize back to traditional.

- This is a big set-back for early retirement conversions (no more 20/20 hindsight)
### Net Operating Loss Deduction

#### 2017
- Carry back 2 years &
- Forward 20 years

#### 2018 Forward
- Carried forward indefinitely (except farmers)
- NOL deductions will be limited to 80% taxable income
The DPAD deduction has been repealed after 2017
- Applies to CAD/CAM, Manufactured Retainers, Appliances, Etc.
• Now, Let’s See What Congress Has Provided?
## Code Section 179 (Expensing Election)

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018 Forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction</td>
<td>$510,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Cost of Property</td>
<td>$2,030,000</td>
<td>$2,500,000</td>
</tr>
<tr>
<td>Phaseout</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Indexed for inflation
Bonus Depreciation

<table>
<thead>
<tr>
<th>2017</th>
<th>2018 - 2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>50% New Property Only</td>
<td>100% New or Used Property</td>
</tr>
</tbody>
</table>

Assets purchased and placed in service after September 27, 2017 are eligible for the 100% deduction.

The 100% expensing will be phased down as followed:

- 80% for property placed in service in 2023
- 60% for 2024
- 40% for 2025
- 20% for 2026
Section 179 can not create or add to a loss for the tax year.

Section 179 depreciation can be on an asset by asset basis.

Bonus depreciation allows you to create a loss for the year. Bonus depreciation will be automatic unless you opt out. This must be done by class of assets, example - 5 years, 7 years, 15 years, etc. (bonus no longer requires “new” property)

### 179 vs Bonus

<table>
<thead>
<tr>
<th></th>
<th>179</th>
<th>Bonus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Income</td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Before Depreciation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation on</td>
<td>$(50,000 ) (limited)</td>
<td>$(100,000)</td>
</tr>
<tr>
<td>$100,000 of assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Profit (loss)</td>
<td>$0</td>
<td>($50,000)</td>
</tr>
</tbody>
</table>
The new law increases annual depreciation of passenger autos less than 6,000 lbs. gross vehicle weight.

<table>
<thead>
<tr>
<th>Year</th>
<th>Old Law</th>
<th>New Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>$3,160</td>
<td>$10,000</td>
</tr>
<tr>
<td>Year 2</td>
<td>$5,100</td>
<td>$16,000</td>
</tr>
<tr>
<td>Year 3</td>
<td>$3,050</td>
<td>$9,600</td>
</tr>
<tr>
<td>Year 4</td>
<td>$1,875</td>
<td>$5,760</td>
</tr>
<tr>
<td>&amp; beyond</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Documentation continues to be the key.

Note: “Heavy Vehicles” are not impacted by limitations above; however, large deductions are only available if documented business usage is 50% or greater.
Qualified Business Income (QBI) includes sole proprietorships, partnerships, S-corporations, and Most rentals.

Does not include (S) shareholder wages\(^{(1)}\), guaranteed payments\(^{(2)}\) to partners, or investment income (capital gains, dividends, interest).

- This “non-inclusion” language needs to be interpreted by IRS. Two completely opposite conclusion can be made.

- Deduction calculated per each separate business

\(^{(1)}\) Generally, another good reason to claim no more salary than necessary to meet “reasonable compensation” standard

\(^{(2)}\) Partnerships may change “compensation” & “profits” language to avoid disallowance of Guaranteed Payments as QBI
20% Qualified Business Income Deduction

- If taxable income is $315,000 or less ($157,500 if single):
  - Deduction is the lesser of
    - 20% of QBI
    - 20% of taxable income (not including capital gains)

- Available for specified service businesses (but limited)
If taxable income is over $415,000 ($207,500 if single):

- **Deduction** amount is same as before, but limited to the greater of:
  - 50% of allocable W-2 wages paid by business, or
  - 25% of allocable W-2 wages plus 2.5% unadjusted basis of depreciable tangible property

- Not available for specified service businesses
If taxable income is $315,000-$415,000 ($157,500 - $207,500 if single):
- 50% of allocable W-2 wages paid by business, or
- 25% of allocable W-2 wages plus 2.5% unadjusted basis of depreciable tangible property

Deduction is then phased out ratably between the limits shown above

Available for specified service businesses with limitations — phase-out between $315,000 & $415,000 or $157,500 and $207,500 single
Betty & Joe have taxable income of $300,000 after all deductions.

Betty’s practice, (a sole proprietorship/PLLC) has $375,000 of net taxable (Qualified Business) income.

Their deduction is 20% of the lesser of the two above or $60,000 (20% x $300,000).

What if Betty were an S Corporation and Paid herself $175,000?

- Betty only receives 20% of $200,000 - $40,000
- Decision to Elect “S” has a crossover point
20% Qualified Business Income Deduction

- Other considerations:
  - If your business has a loss, that loss carries to next year and "hurts" your 20% deduction calculation.
  - Deduction only for businesses in the U.S.
  - Deduction does not reduce self-employment income.
  - More complex decision to go S Status at the lower end of the phase-out range ($315k-$415k or $157.5k-$207.5k)
  - May Apply to Other Activities in Which You Engage
    - Most rentals
## Individual Tax Rates (2017)

<table>
<thead>
<tr>
<th>Tax Rate</th>
<th>Single Filers</th>
<th>Married Filing Jointly</th>
<th>Married Filing Separately</th>
<th>Head of Household</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>$0 to $9,325</td>
<td>$0 to $18,650</td>
<td>$0 to $9,325</td>
<td>$0 to $13,350</td>
</tr>
<tr>
<td>15%</td>
<td>$9,326 to $37,950</td>
<td>$18,651 to $75,900</td>
<td>$9,326 to $37,950</td>
<td>$13,351 to $50,800</td>
</tr>
<tr>
<td>25%</td>
<td>$37,951 to $91,900</td>
<td>$75,901 to $153,100</td>
<td>$37,951 to $76,550</td>
<td>$50,801 to $131,200</td>
</tr>
<tr>
<td>28%</td>
<td>$91,901 to $191,650</td>
<td>$153,101 to $233,350</td>
<td>$76,551 to $116,675</td>
<td>$131,201 to $212,500</td>
</tr>
<tr>
<td>33%</td>
<td>$190,651 to $416,700</td>
<td>$233,351 to $416,700</td>
<td>$116,676 to $208,350</td>
<td>$212,501 to $416,700</td>
</tr>
<tr>
<td>35%</td>
<td>$416,701 to $418,400</td>
<td>$416,701 to $470,700</td>
<td>$208,351 to $235,350</td>
<td>$416,701 to $444,550</td>
</tr>
<tr>
<td>39.6%</td>
<td>Over $418,400</td>
<td>Over $470,700</td>
<td>Over $235,350</td>
<td>Over $444,550</td>
</tr>
</tbody>
</table>
## Individual Tax Rates 2018 Forward (inflation adjusted)

<table>
<thead>
<tr>
<th>Tax Rate</th>
<th>Single Filers</th>
<th>Married Filing Jointly</th>
<th>Married Filing Separately</th>
<th>Head of Household</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>Up to $9,525</td>
<td>Up to $19,050</td>
<td>Up to $9,525</td>
<td>Up to $13,600</td>
</tr>
<tr>
<td>12%</td>
<td>$9,526 to $38,700</td>
<td>$19,051 to $77,400</td>
<td>$9,526 to $38,700</td>
<td>$13,601 to $51,800</td>
</tr>
<tr>
<td>22%</td>
<td>$38,701 to $82,500</td>
<td>$77,401 to $165,000</td>
<td>$38,701 to $82,500</td>
<td>$51,801 to $82,500</td>
</tr>
<tr>
<td>24%</td>
<td>$82,501 to $157,500</td>
<td>$165,001 to $315,000</td>
<td>$82,501 to $157,500</td>
<td>$82,501 to $157,500</td>
</tr>
<tr>
<td>32%</td>
<td>$157,001 to $200,000</td>
<td>$315,001 to $400,000</td>
<td>$157,001 to $200,000</td>
<td>$157,501 to $200,000</td>
</tr>
<tr>
<td>35%</td>
<td>$200,001 to $500,000</td>
<td>$400,001 to $600,000</td>
<td>$200,001 to $500,000</td>
<td>$200,001 to $500,000</td>
</tr>
<tr>
<td>37%</td>
<td>$500,000 +</td>
<td>$600,000 +</td>
<td>$500,000 +</td>
<td>$500,000 +</td>
</tr>
<tr>
<td>Tax Rate</td>
<td>Joint</td>
<td>MFS</td>
<td>HOH</td>
<td>Single</td>
</tr>
<tr>
<td>-------------------</td>
<td>----------</td>
<td>---------</td>
<td>---------</td>
<td>----------</td>
</tr>
<tr>
<td>0% - Less Than</td>
<td>$77,200</td>
<td>$38,600</td>
<td>$51,700</td>
<td>$38,600</td>
</tr>
<tr>
<td>15% - At Least</td>
<td>$77,200</td>
<td>$38,600</td>
<td>$51,700</td>
<td>$38,600</td>
</tr>
<tr>
<td>Less Than</td>
<td>$479,000</td>
<td>$239,500</td>
<td>$452,400</td>
<td>$425,800</td>
</tr>
<tr>
<td>20% - More Than</td>
<td>$478,999</td>
<td>$239,499</td>
<td>$452,399</td>
<td>$425,799</td>
</tr>
</tbody>
</table>

- 3.8% Net Investment Income Tax Continues to Apply Above $250,000 / $200,000 AGI
<table>
<thead>
<tr>
<th>If Taxable Income Is:</th>
<th>Then Income Tax Equals:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $2,550</td>
<td>10% of the taxable income</td>
</tr>
<tr>
<td>Over $2,550 but not over $9,150</td>
<td>$255 plus 24% of the excess over $2,550</td>
</tr>
<tr>
<td>Over $9,150 but not over $12,500</td>
<td>$1,839 plus 35% of the excess over $9,150</td>
</tr>
<tr>
<td>Over $12,500</td>
<td>$3,011.50 plus 37% of the excess over $12,500</td>
</tr>
</tbody>
</table>
Kiddie Tax

- Applies to children under age 19 or 24 if full time student.
- Unearned Income: ($1,050 tax free $1,050 @ 10%) – Excess:

<table>
<thead>
<tr>
<th>2017</th>
<th>2018 Forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxed at parent’s rate</td>
<td>Taxed at rates for Trusts &amp; Estates</td>
</tr>
</tbody>
</table>

- Earned income up to $12,000 (up from $6,350)
  - Qualifies for Standard Deduction against Earned Income

- Documentation continues to be the key
## Alternative Minimum Tax (AMT)

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018 Forward</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exemption:</strong></td>
<td>Single $55,400</td>
<td>$70,300</td>
</tr>
<tr>
<td></td>
<td>Joint $86,200</td>
<td>$109,400</td>
</tr>
<tr>
<td><strong>Phase out:</strong></td>
<td>Single $123,100</td>
<td>$500,000</td>
</tr>
<tr>
<td></td>
<td>Joint $164,100</td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>

Winners: Almost everyone in a given year – especially those formerly in the 28% to 35% tax brackets.
## Standard Deduction

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018 Forward</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(inflation adjusted)</td>
<td></td>
</tr>
<tr>
<td>Single</td>
<td>$6,500</td>
<td>$12,000</td>
</tr>
<tr>
<td>Joint</td>
<td>$13,000</td>
<td>$24,000</td>
</tr>
<tr>
<td>Joint – Over 65</td>
<td>$26,600</td>
<td></td>
</tr>
</tbody>
</table>

**Winners:** Everyone who was previously taking the standard deduction or was close to doing so. Kids with earned income. Many retired individuals.
## Child Tax Credit

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018 Forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit</td>
<td>$1,000</td>
<td>$2,000 per child under 17</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$500 other dependents</td>
</tr>
<tr>
<td>Phase out:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single</td>
<td>$75,000</td>
<td>$200,000 (phase-out begins)</td>
</tr>
<tr>
<td>Joint</td>
<td>$110,000</td>
<td>$400,000 (phase-out begins)</td>
</tr>
</tbody>
</table>

Winners: Parents who already qualified. Parents with significantly higher incomes (makes up in part for loss of personal and dependent exemptions).
ADVANCED TAX PLANNING –
June 22, 2018

ADVANCED TAX PLANNING FOR DENTISTS

BY: Sam Martin, MBA(tax), CFP®, CPA
There Are More Than One...
3.8% on Unearned Income

- MAGI in Excess of $250,000/$200,000 (joint/single)
- 3.8% Medicare Tax On Unearned Income
  - Interest, Dividends, Most Capital Gains, Rents, Royalties, etc.
  - Exempt:
    - Qualified Plan/IRA distributions, Tax Exempt Interest, Capital Gain on Sale of Practice (except C Corp), S Corporation Income, Primary Residence Exclusion
Joint Earned Income in Excess of $250,000
  Earned: W-2, Self Employment or Both

Single Earned Income in Excess of $200,000

.9% Medicare Tax On Excess

Withholding mandatory at $200k

S Corporations: Just became even more valuable for higher incomes (must consider 20% QBID)
We now have five Capital Gains Rates (Brackets)

- 0%, 15%, 18.8%, 20%, 23.8%
Section 179 = $1,000,000 for 2018 forward

- Immediate Expense vs. Depreciate Over 5-7-15-39 Years for Most Dental Practice Assets
- Phase-out Threshold begins at $2,500,000
- Bonus Depreciation: 100% of infinity – 2018-2022
  - Percentage phases down
Cost Segregation - Example

► A typical build-out might look like $125 per foot (depending on the landlord improvement allowance) multiplied by 2,000 square feet for a total cost of $250,000 (before equipment, dental cabinets, computers, etc.)
  ► Under the “default” this cost would be written off at $6,410 per year for the next 39 years.

<table>
<thead>
<tr>
<th></th>
<th>First 10 Year's Write Off</th>
<th>Tax Savings</th>
<th>Net Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Default Version</td>
<td>$ 64,103</td>
<td>$ 25,641</td>
<td>$ 15,755</td>
</tr>
<tr>
<td>Allocated Ver.</td>
<td>194,231</td>
<td>77,692</td>
<td>56,299</td>
</tr>
<tr>
<td>Advantage</td>
<td>$ 130,128</td>
<td>$ 52,051</td>
<td>$ 40,544</td>
</tr>
</tbody>
</table>

► Cost Segregation – Retroactive Catch-up
  ► Purchased, Built-out or remodeled in the past?
  ► You are now allowed to perform a retroactive cost segregation study and take a “Catch-up” deduction on your current return.
So Why Do We Care About Accelerating Our Tax Deductions?

► Do you care if you receive your deduction this year or in five years?
Albert Einstein called the power of compound interest the “8th Wonder of the World”
Let’s say we invest in the practice and purchase $75,000 of practice upgrades in 2018 & 2019 each, and we are in the 35% effective tax bracket.

Let’s take our tax savings and create an additional deduction by increasing our tax deductible retirement contribution:

- Most dentists are not maximizing their retirement contributions and/or
- Are missing out on spousal deductions
- Or, alternatively invest after tax with zero staff cost
WHAT IS THE JOINT LIFE EXPECTANCY OF A 62 YEAR-OLD NON-SMOKING COUPLE?

Audience Participation
29 Years (and that is just average)

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Savings on Retirement</td>
<td>$26,250</td>
<td>$26,250</td>
<td>$52,500</td>
</tr>
<tr>
<td>Contribution</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Years Invested</td>
<td>29</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>Rate of Return (Assumed)</td>
<td>6.5%</td>
<td>6.5%</td>
<td></td>
</tr>
<tr>
<td>Future Value</td>
<td>$163,030</td>
<td>$153,080</td>
<td>$316,110</td>
</tr>
</tbody>
</table>

Thinking and investing strategically: just one year’s investment could provide an additional future year’s retirement income of $80,000 in inflation adjusted dollars!
Retirement Plans
- The right plan and features could save you significant tax
- Make this part of your comprehensive plan

Simple IRA: Great for Starting out
- Dr. savings up $13,000 ($16,000) + 3% of earnings
- Add Spouse – perhaps a grand total $30,000 to $40,000
401(k):
- Dr. savings up to $19,000 (2018) ($25,000) + 3-4\% of earnings
- With spouse $45,000 - $60,000
- With profit sharing an additional $30,000 (perhaps total $85k w/spouse)

Defined Benefit - Cash Balance: $100,000 or more additional above and beyond defined contribution (401k/profit sharing)

Back-door Roth Contributions
- Pick and Roll to 401(k)
**Dr. Mike and Jamie Smith: Addition of Cash Balance Plan**

<table>
<thead>
<tr>
<th></th>
<th>Now</th>
<th>With CB</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Practice Income</td>
<td>500,000</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>CB Deduction</td>
<td>-</td>
<td>(125,000)</td>
<td>125,000</td>
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<td>Personal Deductions</td>
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<td>Tentative Taxable Income</td>
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<td>QBI Deduction</td>
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<td>(60,000)</td>
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<td>46,179</td>
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<td>Marginal Bracket</td>
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<td>24.0%</td>
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<tr>
<td>Effective</td>
<td>23.6%</td>
<td>15.4%</td>
<td>43.16%</td>
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<tr>
<td>Less Staff Cost in CB Plan</td>
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</tr>
</tbody>
</table>
Other Tax Planning

► Deduct More of What You Spend
  ▪ Meals, Entertainment, Travel Auto
  ▪ Home office
    ■ Hard; but not impossible to qualify
    ■ Benefits? Mostly turning commuting into business miles
Other Tax Planning

► S Corporation
  ▪ Could this be the right move for you?
    ▪ Significant savings – more so the higher the income
      ▪ “Reasonable Salary Establishes the Floor”
  ▪ There is legislative risk
  ▪ Is there enough time left in your career to benefit?

► Roth Conversions?
  ▪ May make sense in certain situations
  ▪ Especially the “Back Door” Roth Contribution
    ▪ “Pick and Roll” technique
  ▪ Can be very strategic in early retirement
TAXATION OF PRACTICE TRANSITIONS
Taxation of Practice Sale: Identify Your Issues

The goal of this presentation is two-fold:

- Understanding that a smart income tax allocation can save you thousands of dollars
- Identifying ahead of time if you have a special problem (which we will identify)
Outright Sales – General Rules

Tangible Assets
- Taxed at your ordinary income tax rate in most cases (as high as the 37%)
- May not be fully taxed if Not Entirely Depreciated (let’s review your depreciation schedule and also request a “smart” equipment appraisal).

Intangible Assets (Goodwill)
- Taxed at long-term capital gains rates (maximum 20%) if practice acquired prior to August 1993
- If acquired after August 1993, prior amortization subject to recapture at your ordinary income tax rate (maximum 37%)
- Goodwill will often make up 70%-90% of the basic purchase price
- C Corporations: Special Case – See Forward
Outright Sales – General Rules

- Non-Compete (If allocated)
  - Taxed at your ordinary income tax rate in most cases (as high as 37% currently)
  - (Note: This is an unnecessary increase in tax to Sellers)
    - Does not help the Seller
    - Backed up by prior-law court cases

- Assistance
  - Taxed at your ordinary income tax rate in most cases (as high as 37% currently)
  - Subject to FICA Taxes
  - Timing may be very influential depending on circumstances
Outright Sales – General Rules

- Accounts Receivable
  - Taxed at your ordinary income tax rate (as high as 37%)

What could a Sophisticated Allocation Save You?

- Perhaps 5% to 20% of the otherwise tax bill (maybe more?)
  - $500,000 sale – tax estimated at $90,000 - 125,000
  - $1,000,000 sale – tax estimated at $225,000 - $300,000
  - Could be considerably worse if and to the extent Goodwill Recapture Applies
C Corporations (including recently converted S Corps (now 5 years))
(C corporation do not benefit from rate-reduced long-term capital gains)

- **Who Does the “Goodwill” Belong To?**
  - **Martin Ice Cream & Norwalk**
    - Belongs to the Shareholder in most cases
  - **Howard Case:**
    - Spokane Dentist Operating as C Corporation
    - Sold Practice in Asset Sale
    - Had “old” Employment Agreement w/Corporation (incl. Non-compete)
    - IRS Challenged and Court Upheld. Appeals Court also Upheld!
What happened to Howard:

- Assume goodwill portion of sale was $500,000. Howard paid about 15% income (capital gains) tax or $75,000
- IRS required corporation to report: $500,000 x 35% = $175,000
- Dividend to Howard: $325,000 x 35% = $113,750
- Total tax: $288,750 - $75,000 paid = $213,750 + Interest + Penalties

How happy is Dr. Howard’s retirement?
C Corporations (continued)

► With advanced planning – double taxation can be mitigated

► New 3.8% Healthcare Tax Applies to Capital Gain from C Corporation (S Corp and non-incorporated practices exempt on sale of practice)
  - 18.8% above $250,000 and below $479,000 (joint) above $200,000 and below $425,799 (single)
  - 23.8% over $479,000 / $425,799

► Note: S Corporation converted from C Corporation in past 5 years exposed to C Corporation Tax (Built-in gains)
Related Party Sales

- Lineal Descendants/Ancestors/Siblings
  - Does not include In Laws!

- Partners
  - More than 50% ownership (seller) for IRC Section 1239
  - More than 20% ownership (seller) for IRC Section 197
Related Party Sales – Continued

Section 1239
- Makes Goodwill Taxable as Ordinary Income
- 37% vs. 15-20% on the largest portion of your practice sale
- Partnerships (PLLC’s) are more dangerous than corporations but much more useful
  - 50% of ownership or profits
  - Multi-owner corporations are not recommended

Section 197
- Applies to practices purchased or started before August of 1993
- Causes non-deductibility of Goodwill Value to Purchaser
Related Party Sales Continued

Solving Related Party Sale Issues

Section 1239:
- Assuming 50/50 ownership, careful crafting of the operating agreement (income and expense sharing can overcome)
- This should be put together by tax experts in this field
- Some transactions “won’t work” for related parties and require a “different” approach

Section 197:
- Esoteric rule allows professional appraisal (valuation) to carve out intangibles that are not subject to Section 179 Anti-Churning
- Bifurcation is another possible solution
- Compensation shift is another solution
Example (Simplified) (Pre 1993 Practice)

Assuming ordinary income under $450,000

<table>
<thead>
<tr>
<th>Purchase Price Allocation</th>
<th>Dental &amp; Office Equipment</th>
<th>Supplies &amp; Instruments</th>
<th>Goodwill</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 102,500</td>
<td>$ 10,000</td>
<td>$ 637,500</td>
<td>$ 750,000</td>
<td></td>
</tr>
</tbody>
</table>

| Tax Rate (assumed)        | 35%                       | 35%                    | 18.0%      |
| Tax                       | $ 35,875                  | $ 3,500                | $ 114,750  | $ 154,125   |

Effective Tax Rate 20.55%

Some capital gain would be taxed at 15% and Some at 20% depending on overall tax situation
## Example (Simplified) Post 1993 Practice

### Bifurcation of Old and New Goodwill

- Could save as much as $68,000 in this example.
- Run your patient list and determine % from original purchase
  - Specialty practices may be handled differently

<table>
<thead>
<tr>
<th></th>
<th>Dental &amp; Office Equipment</th>
<th>Supplies &amp; Instruments</th>
<th>Goodwill Amortized</th>
<th>Excess Goodwill</th>
<th>Total</th>
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<td>400,000</td>
<td>$ 237,500</td>
<td>750,000</td>
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<tr>
<td>Tax Rate (assumed)</td>
<td>35%</td>
<td>35%</td>
<td>35%</td>
<td>18.0%</td>
<td></td>
</tr>
<tr>
<td>Tax</td>
<td>$ 35,875</td>
<td>$ 3,500</td>
<td>140,000</td>
<td>$ 42,750</td>
<td>$ 222,125</td>
</tr>
<tr>
<td>Effective Tax Rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>29.62%</td>
</tr>
</tbody>
</table>
Timing is Everything

- Due to the now graduated capital gains tax and phase-outs of deductions
- It may make a very large difference what time of year you sell your practice!
- Recent Real Life Example: $900,000 sale saved approximately $52,000 sold in January versus December.
Your practice is a key part of your overall plan

- Short Term
- Long Term
- You cannot “sell” your practice if you cannot transfer the lease!
  - Lender’s may require 5-10 years of term + options
  - Negotiate a flexible assignment clause
    - Try to minimize exposure to post-sale guarantee

- Own Office
  - Appropriate “Appraisal” (Broker’s Opinion)
  - FMV Rental
  - May require adjustment to your overhead/cashflow
Now

- Do you want to:
  - Maximize the price
  - Quality of the Buyer
  - Sell it quickly
  - Have flexibility with the sale

- Update Your Retirement Income (Financial) Plan
Consider the nonfinancial / legal items that will impact the sale

- Office Space and Feel
- Age of Equipment
- Lease Term and Assignment Terms (essential to be in good order)
- Review legal documents and address any issues
Consider the cash flow and profitability

- Revenue
- Overhead
- Debt
- Taxes
Consider other business changes
- Staffing / Family on Payroll

Clean up & get tidy
- Books & Tax Returns
- Credit Balances
- A/R – Clean them up – it’s in everyone’s best interest!
- Discounts
Consider what an educated (or well represented) buyer will be looking at
As You Transition

- Have your Important Legal and Financial Documents ready
- Determine the Value of the Practice & how quickly you want it sold
- Reach out to your dental attorney early in the process.
Use a Tax Advisor that understands the nuances of selling a dental practice.

Understand the difference between sales price and the dollars you will get after paying off remaining expenses, cost of transition, taxes, etc.

This is a key item in your financial plan. What are the after tax, selling costs and residual practice expense proceeds?
The Transition Process

- Gather all of your information
- Establish the Asking Price
- Prepare the Opportunity Portfolio
- Market the Practice
  - Unless buyer is already known
- Vet the Candidates
- Show the Practice
- More Vetting
The Transition Process

- Offer Made by Letter of Intent
- After Acceptance
  - Lending, Legal, Lease, Insurance, Insurance
    - Do not underestimate the importance of the lease transfer – landlords have been known to delay transactions
  - Updating Data Reports
  - Creating Exhibits
  - Coordinating the Closing
  - Office Transition Checklist
The Transition Process

- Closing
  - Sign documents
  - Cashier Employees
  - Receive Payment
  - Send Patient Letters
  - Accounts Receivable Report
  - Credit Balance Report
  - Closing Checklist (notify vendors, county & others)
The Transition Process

- Post Closing
  - Wrap-up Treatment in Process
  - Assist Buyer (usually limited basis unless workback)
  - Reserve $$ for Taxes (having a tax projection is very helpful)
  - Pay Final Month’s bills
  - Contact or file with the County (Personal Property Tax)
  - Live a Happy Life. You have planned for it and of course you deserve it!
Conclusion

- Optimizing Profit and Value and Planning ahead to minimize taxes can greatly enhance your:
  - Overall Plan
  - Your Post Career Income
  - Your Quality of Life
WEALTH MANAGEMENT STRATEGIES
FOR DENTISTS & THEIR FAMILIES
OPTIMIZE ACHIEVING YOUR GOALS

Address Who and What is Most Important to You
TWO SIMPLE LESSONS ON LONG-TERM INVESTING

What Wall Street really Doesn’t Want you to Know!
HOW MANY CORPORATE PENSION PLANS OUTPERFORMED A PASSIVE BENCHMARK?

Consulting firm FutureMetrics analyzed U.S. corporate pension plans covering the period 1988–2005. Of the 192 firms in the analysis, 137 plans (71 percent) failed to outperform a simple benchmark.
Subsequent Performance of Top 25% of U.S. Equity Funds

Data supplied by Dimensional Fund Advisors. Information from sources deemed reliable, but its accuracy cannot be guaranteed. Performance is historical and does not guarantee future results.

The left column represents all U.S. equity funds in the CRSP Mutual Fund Database with a complete return history for 2002–2006. The funds are sorted by performance relative to their benchmarks. Funds in the top quartile are then tracked and directed to their subsequent performance quartiles in the following five-year period (2007–2011), or to the “Did Not Survive” category. Quartiles in the following period reflect all funds with a complete return history. Percentages may not total 100 percent due to rounding.

Source: CRSP Survivor-Bias-Free U. S. Mutual Fund Database.
Cumulative Cash Flows by Morningstar Rating

Source: Morningstar as of 12/31/14
Positive Past Performance Can Mean Disappointing Future Returns

The highest rated funds lagged their benchmarks by the greatest amount over the subsequent three years. The funds with the lowest ratings had the best performance relative to their benchmark.

When You Wish Upon a Morningstar

Annualized 36-Month Median Fund Performance Relative to Benchmark

<table>
<thead>
<tr>
<th>Rating</th>
<th>Percentage Points</th>
</tr>
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<tbody>
<tr>
<td>5-star</td>
<td>0</td>
</tr>
<tr>
<td>4-star</td>
<td>-0.2</td>
</tr>
<tr>
<td>3-star</td>
<td>-0.4</td>
</tr>
<tr>
<td>2-star</td>
<td>-0.6</td>
</tr>
<tr>
<td>1-star</td>
<td>-0.8</td>
</tr>
</tbody>
</table>

Source: Vanguard

THE BAM ALLIANCE
### Can You Pick the Next Winner?

**Asset Class Returns 1998–2017**

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<th></th>
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<tr>
<td>S&amp;P 500 Index</td>
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<td>66.4</td>
<td>49.7</td>
<td>28.6</td>
<td>32.1</td>
<td>66.9</td>
<td>34.2</td>
<td>34.5</td>
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<td>3.6</td>
<td>63.4</td>
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<td>25.6</td>
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<td>51.2</td>
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<td>2.1</td>
<td>18.7</td>
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<tr>
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<td>26.3</td>
<td>19.9</td>
<td>12.3</td>
<td>-2.1</td>
<td>61.6</td>
<td>26.0</td>
<td>25.2</td>
<td>30.4</td>
<td>6.0</td>
<td>-37.4</td>
<td>49.2</td>
<td>28.1</td>
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<td>39.5</td>
<td>8.3</td>
<td>1.4</td>
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<tr>
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<td>8.2</td>
<td>24.1</td>
<td>12.6</td>
<td>2.7</td>
<td>-6.0</td>
<td>56.3</td>
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<td>13.8</td>
<td>24.8</td>
<td>5.5</td>
<td>-39.2</td>
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<td>-2.9</td>
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<td>-4.4</td>
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<tr>
<td>MSCI EAFE Value Index</td>
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<td>45.3</td>
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<td>-43.3</td>
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<td>20.4</td>
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<td>17.7</td>
<td>27.3</td>
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<td>-5.6</td>
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<td>16.0</td>
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<tr>
<td>DFA Int’l Small Cap Index</td>
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<td>-11.9</td>
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<td>-44.1</td>
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<td>DFA U.S. Micro Cap Index</td>
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<td>-15.9</td>
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<td>17.3</td>
<td>6.7</td>
<td>15.8</td>
<td>-11.9</td>
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<td>9.0</td>
<td>-13.6</td>
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<td>-14.6</td>
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<tr>
<td>DFA U.S. Small Cap Value Index</td>
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<td>-30.6</td>
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<td>-22.1</td>
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<tr>
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<td>1.6</td>
<td>-5.6</td>
<td>11.6</td>
<td>16.0</td>
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</tbody>
</table>

All returns are percentages. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio nor do indices represent results of actual trading. Information from sources deemed reliable, but its accuracy cannot be guaranteed. Performance is historical and does not guarantee future results. Total return includes reinvestment of dividends and capital gains.
The shear weight of evidence based investing is shown through peer reviewed academic research with Nobel Prize Winning foundations.
## The Power of Diversification

### Portfolios Rebalanced Quarterly:
January 1982 - December 2017

<table>
<thead>
<tr>
<th>Portfolio</th>
<th>P1</th>
<th>P2</th>
<th>P3</th>
</tr>
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<tbody>
<tr>
<td>ICE BofAML 1-Year US Treasury Note Index</td>
<td>40%</td>
<td>40%</td>
<td>40%</td>
</tr>
<tr>
<td>MSCI EAFE Index (net div.)</td>
<td>24%</td>
<td>12%</td>
<td>6%</td>
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<tr>
<td>S&amp;P 500 Index</td>
<td>36%</td>
<td>18%</td>
<td>9%</td>
</tr>
<tr>
<td>CRSP Deciles 9-10 Index</td>
<td>18%</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>Dimensional International Small Cap Index</td>
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<tr>
<td>MSCI EAFE Value Index (net div.)</td>
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<td>Dimensional US Small Cap Value Index</td>
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<td>6%</td>
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<td>Dimensional US Large Cap Value Index</td>
<td>6%</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>Dimensional International Small Cap Value Index</td>
<td>9%</td>
<td>6%</td>
<td></td>
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</table>

**Performance**

<table>
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<th></th>
<th>P1</th>
<th>P2</th>
<th>P3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annualized Return (%)</td>
<td>8.8</td>
<td>9.3</td>
<td>10.0</td>
</tr>
<tr>
<td>Annualized Standard Deviation (%)</td>
<td>10.5</td>
<td>11.1</td>
<td>11.1</td>
</tr>
<tr>
<td>Growth of $1</td>
<td>$20.63</td>
<td>$24.85</td>
<td>$31.13</td>
</tr>
<tr>
<td>Sharpe Ratio¹</td>
<td>0.54</td>
<td>0.55</td>
<td>0.61</td>
</tr>
</tbody>
</table>

A diversified portfolio can provide higher expected returns without a significant increase in risk.

Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio nor do indices represent results of actual trading. Information from sources deemed reliable, but its accuracy cannot be guaranteed. Performance is historical and does not guarantee future results. Total return includes reinvestment of dividends and capital gains. Returns are annualized from quarterly data. All portfolios rebalanced quarterly. Dates chosen due to availability of data.

¹The Sharpe Ratio is a measure of the risk-adjusted return of an investment. A higher ratio indicates a greater return for a unit of risk. It is calculated as the average annual portfolio return less the average annual risk-free rate (One month T-bills) divided by the portfolio’s annualized standard deviation.
Diversification of Risky Assets: Lack of Correlation

RISKY ASSET #1

RISKY ASSET #2

A PORTFOLIO OF BOTH
Educated Investing: Evidence Based
Sane Investing During Insane Times
(Portfolios for All Markets)
Key Concepts for Investment Success Today & the Future
Sane Investing Principals

• Evidence Based Investing
  • Academic, Peer Reviewed Approach (Modern Portfolio Theory)
  • Foundational Principals are Nobel Prize Winning (including Eugene Fama – 2013)
  • “Efficient” Portfolios – Balancing Risk & Reward (for each client)
  • Low Cost – Tax Efficient & Tax Managed
  • Globally & Strategically Diversified
The Carhart Study

Study Details

- A 1997 study by Mark Carhart of the University of Chicago showed that common factors in stock returns and investment expenses almost completely explain continuity in equity mutual funds’ returns.

Relevant Study Findings

- Most funds underperform by the amount of their investment expenses.
- The investment costs of expense ratios, transaction costs and load fees all have a direct, negative impact on performance.


Information from sources deemed reliable, but its accuracy cannot be guaranteed. Performance is historical and does not guarantee future results.
Retirement Planning
(Cooley, Hubbard and Walz)
Odds (%) of Not Running Out of Money Over a 30-Year Time Period

<table>
<thead>
<tr>
<th>Asset Allocation</th>
<th>3%</th>
<th>4%</th>
<th>5%</th>
<th>6%</th>
<th>7%</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% Equity</td>
<td>100</td>
<td>95</td>
<td>85</td>
<td>68</td>
<td>59</td>
</tr>
<tr>
<td>75/25</td>
<td>100</td>
<td>98</td>
<td>83</td>
<td>68</td>
<td>49</td>
</tr>
<tr>
<td>50/50</td>
<td>100</td>
<td>95</td>
<td>76</td>
<td>51</td>
<td>17</td>
</tr>
<tr>
<td>25/75</td>
<td>100</td>
<td>71</td>
<td>27</td>
<td>20</td>
<td>5</td>
</tr>
<tr>
<td>100% Fixed Income</td>
<td>80</td>
<td>20</td>
<td>17</td>
<td>12</td>
<td>0</td>
</tr>
</tbody>
</table>

“The presence of bonds in the portfolio increases the success rate for low to mid-level withdrawal rates. However, the presence of common stocks provides upside potential and holds the promise of higher sustainable withdrawal rates. In other words, the addition of bonds helps increase certainty but at the expense of potentially higher consumption.”

Information from sources deemed reliable, but its accuracy cannot be guaranteed.

1Represents 30-year time periods between 1926–1995. Assumes that the initial withdrawal % is applied against the portfolio value and that dollar amount is inflated in subsequent years based on the actual inflation.

2Philip L. Cooley, Carl M. Hubbard and Daniel T. Walz, Retirement Savings: Choosing a Withdrawal Rate That Is Sustainable. AAII Journal. Data from Ibbotson Associates. Stocks are representative of S&P 500 Index and bonds are representative of long-term, high-grade corporates.
Assertive Tax Management

• Strategic Location
  • Using tax deferred accounts to house tax inefficient assets & locating tax efficient asset classes can provide a significant increase in after-tax return just by rearranging the deck chairs (Ex. Taxable vs. Muni Bonds)
  • This can also have a very beneficial result in post-death taxation (ordinary income tax to heirs vs tax free)

• Tax Loss Harvesting (throughout the year)
  • One of two silver linings to a down market — or even just a down position
  • Done correctly there is no material economic cost or change to the portfolio — but the losses can be reported on your tax return — offset other capital gains, $3,000 of regular income and carryover indefinitely

• Avoid Short-term Gains
• Use Tax Managed Funds
• Specific Lot Identification
• Retirement Tax Planning for Social Security and Required Minimum Distributions
• “Chasing Income”
  • Many degrade the overall effectiveness of their portfolio by chasing “income”. “After all, where will my income come from” A well-crafted Asset-Allocation is thrown aside for an over-allocation to Bonds and/or dividend paying stocks or expensive and incomprehensible insurance products

• What Does the Peer Reviewed Academic Literature Tell Us?
  • Using the “Total Return” approach preserves your strategic asset allocation and augments portfolio cash flow through creating necessary cash through periodic rebalancing and “scraping off” the excess into cash for distribution
  • In our office rebalancing during the withdrawal phase (retirement) is conducted about every six-months. Monthly withdrawals are automated and electronic
Six Key Concepts to Investment Success

1. Use diversification effectively to reduce risk.
2. Dissimilar price movement diversification enhances returns
   - Strategic diversification
   - Lack of correlation among asset classes results in lower volatility
   - Adding the right mix of riskier asset classes can increase expected return while REDUCING risk (volatility) (or holding return steady while further reducing risk (volatility))
3. Employ asset class investing
4. Allocation to High Credit Short-Intermediate Term Fixed Income and Global diversification reduces risk
5. Design efficient portfolios
6. Apply advanced tax management techniques
Six Key Concepts
to Long-Term Financial Success

1. Make a comprehensive plan for your practice, your transition, your retirement income and all of the Advance Planning Areas.
2. Your plan should be based on goals and concerns of you, your spouse and your family.
   Who and what is most important to you
3. Don’t let “investments” dominate your plan – your investments work for your plan (and your plan works for you)
4. Work with trusted advisors who are consultative and provide a fiduciary relationship
5. Establish a routine for periodic review and update
6. Stick to your plan, ignore the noise of Wall Street and focus on who and what you love
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