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Executive Compensation ■ Succession ■ Wealth Transfer Planning

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Calculating Your Break-Even Point

Regardless of their specialties, all business owners have a common goal—profitability. But before you can turn a profit, you first have to break even. Spending more money than you are taking in to produce a product or provide a service can quickly deplete your company's capital. Even if your business has a financial cushion to allow you to operate in the red for a period of time, be conscious of the areas in which losses are occurring and have a plan for steering your company into the black.

As you may already know, the break-even point is the number that must be reached before an investment begins to generate a positive return. To analyze the success of your business, you need to identify the point at which revenues cover expenditures on each of the products and services you provide, as well as on your overall operations. Because these break-even points shift as conditions change, break-even analyses are most useful if performed regularly, such as on a quarterly basis.

Crunching the Numbers

While there are a number of methods for determining a break-even point, one fairly simple approach is to calculate how large the company's gross profit margin needs to be to cover its fixed costs.

To begin, add up all the fixed costs associated with your business operations, such as rent, payroll (including your own salary), debt payments, insurance, and similar overhead expenses. Next, calculate the gross profit margin on the products or services you sell. The gross profit margin is a financial metric used to determine the percentage of funds left over after deducting purchasing and production costs. The gross profit margin can be calculated on a per-unit basis or by subtracting variable costs from the sales price. The break-even point can then be calculated by dividing your fixed costs by your gross profit margin.

For example, imagine you have calculated your expenses and determined that your monthly fixed costs amount to $50,000. Then, assume your business consists of manufacturing gadgets at $3 per unit and selling them at $10 per unit, giving you a gross profit margin of $7 per unit, or 70%. When your fixed costs of $50,000 are divided by your gross profit margin of 70%, the resulting figure is approximately $71,429. This means you would have to sell 7,143 gadgets in a given month to break even. If sales dip below 7,143 units per month, your business is losing money, whereas any sales above this threshold represent profit.

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Steps to Help Ensure Estate Planning Success

For many people, more time and attention are devoted to building their estate than to planning for its ultimate disposition. Understandably, enjoying the fruits of your labor is often more interesting than planning for what might happen when you are no longer here.

However, the Internal Revenue Service (IRS) is interested in your estate, and a lack of estate planning could, at the very least, create stress for your heirs and, more importantly, increase your estate tax liability. With this in mind, here are six estate conservation strategies that can help you avoid some unnecessary pitfalls:

1. **Keep detailed records.** After you die, your heirs will need to sort out your financial affairs. You can help them by maintaining detailed records and letting them know where to find your will, insurance policies, bank statements, and other important documents.
2. **Keep your will up to date.** A will is the most basic legal estate planning document, through which you can specify how your property is to be distributed at your death. In addition, you can appoint an **executor**, who will coordinate the process of probate, the preparing and filing of final income and estate tax returns, and the distribution of assets. Without a will **(intestate)**, the state will determine the distribution of assets according to state inheritance laws.
3. **Plan beyond your will.** A will arranges your estate *after* your death. However, incapacity during your lifetime may affect your ability to make financial and health care decisions. A **durable power of attorney** designates someone to make financial decisions on your behalf, even in the event of incapacity. A **living will** states your wishes for the use of life-sustaining measures under specified conditions. A **health care proxy** (also known as a **medical power of attorney**) designates someone to make important health care decisions on your behalf. A complete estate plan encompasses both lifetime and post-mortem planning.

4. **Take advantage of the applicable exclusion amount.** In 2018, each taxpayer may transfer up to $11.18 million (the estate tax **applicable exclusion amount**) in assets to non-spousal heirs without estate taxation. Your entire estate can pass to your spouse tax free under the unlimited marital deduction. As a result of the enactment of the American Taxpayer Relief Act of 2012, if one spouse dies and does not use the full exemption amount, the remainder can be used by the surviving spouse. With this "portability" option, spouses do not have to split assets between them, or be concerned about who holds the title on various assets.
5. **Use the annual gift tax exclusion.** In 2018, an individual can give away up to $15,000 per year ($30,000 in the case of joint gifts made by a married couple) to an unlimited number of recipients tax free. For individuals with large estates, a regular gifting strategy using this annual exclusion may be an attractive way to transfer appreciating assets, which would otherwise have the potential to increase estate taxes if left in the estate.
6. **Consider life insurance.** Life insurance is often used as a funding method for estate taxes. However, proceeds of life insurance policies are includable in your gross estate for purposes of calculating estate taxes. Consider using an **irrevocable life insurance trust (ILIT)**, which removes the insurance from your estate and therefore potential estate tax exposure.

By preparing in advance, your wishes for property distribution can be executed upon your death. Be sure to consult with your qualified tax, legal, and financial professionals to help ensure your strategies are consistent with your overall objectives. ■

calculating your break-even point

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However, the calculations can become more complicated when multiple product lines are involved or when expenses change frequently. In addition, there are other factors that can affect the financial health of a business over time, such as projected changes in market conditions. Therefore, a break-even analysis can be seen as a basic tool that provides an indication of where a business stands at a given point in time, and it may be best used in conjunction with other financial measures.

Evaluating the Figure

A break-even analysis can provide important preliminary information about the status of your business. If the results of the analysis reveal that your sales are not sufficient to cover expenses, or that your profit margin is smaller than anticipated, there may be ways to lower your break-even point.

Begin by investigating ways to reduce the cost of purchasing or producing your products, or providing your services. Is there another supplier that could provide raw materials at a lower cost? Are there options for production that are more affordable?

Next, think about ways to trim overhead expenses without compromising your operations. Finally, consider raising prices. Small, incremental price increases are likely to be tolerated by your customers, especially if you offer consistently superior quality and service. Implementing small changes in one or more of these areas may enable you to reset your business's break-even point and move your company toward greater profitability. ■

Reaching the Sunny Side of 50

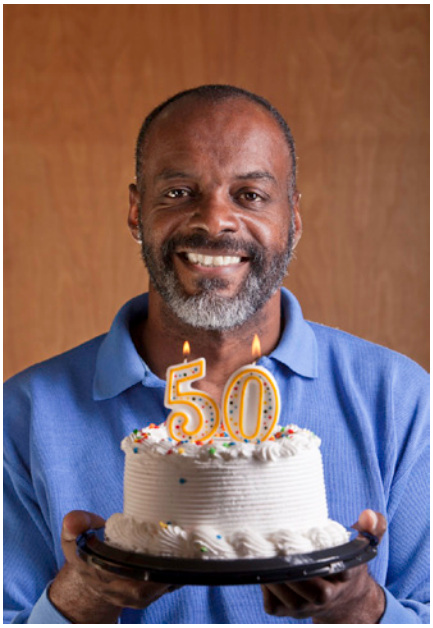
Reaching the sunny side of 50 today is not what it used to be. With advances in preventive medicine and wellness education, 50-somethings may now look forward to living longer and feeling better than ever before.

Perhaps for the first time in their lives, many people in their 50s may find themselves in an ideal position to achieve a better balance in their lives. Careers are well underway, children are about to reach college age or have graduated, and aging parents are still able to manage on their own.

If you have been focusing on work—either by necessity or choice—to the exclusion of everything else, *now* may be the time to begin developing other facets of your personality and pursuing your interests. "Workaholics" may sometimes later regret having missed out on the important stages in their lives. So, if you would like to spend more time with your spouse, children, or grandchildren, pursue a passion, or become involved in community service through volunteering, this may be the perfect opportunity to do so.

Does life really begin at 50? The answer may well depend on whether you are prepared *financially* to comfortably maintain your current lifestyle into possibly several decades of retirement. If you are not yet in the financial position to reduce hours in your work schedule, it is never too late to start planning a strategy to make some adjustments for the future. Be sure to consult with your financial professional to help you stay on track to achieving your overall financial objectives.

Your horizons are limited only by your imagination and your personal finances. Reassessing your goals and desires in mid-life can be a



challenge, but self-examination can also lead to a more fulfilling future. Remember, reaching 50 can be the milestone to expand and enrich your world while you still possess the good health and vitality to enjoy all that life has to offer. ■

Getting to the Bottom of Inherited IRAs

Naming a beneficiary for your **traditional Individual Retirement Account (IRA)** need not be a difficult task. Most people choose their spouse, if married, or another loved one. However, the rules governing the distribution of IRA assets to beneficiaries are not as simple. They generally involve two separate issues: 1) the *age* of the IRA owner at the time of death, and 2) the *identity* of the IRA **beneficiary**.

Under IRS regulations, taxpayers who own an IRA must begin taking **required minimum distributions (RMDs)** by April 1 of the year following the calendar year during which they reach age 70½. If an IRA owner dies *before* RMDs have begun, a spousal beneficiary can choose to withdraw all IRA assets within five years, to maintain the IRA under the deceased spouse's name, or to treat the IRA as his or her own.

Suppose Alan (a hypothetical case) dies and his wife, Monica, is the beneficiary of his IRA. If Monica maintains the IRA in Alan's name, minimum distributions do not have to begin until December 31 of the later of 1) the year following the year of Alan's death, or 2) the year in which Alan would have reached age 70½. However, distributions would be based on Monica's life expectancy. If Monica chooses to treat the IRA as her own, she is entitled to name new beneficiaries, and the rules governing RMDs would be the same as

if the IRA were originally her own. Therefore, distributions would have to begin by April 1 of the year after the year in which she turns 70½, and the required amount would be based on her life expectancy.

If Alan were to die *after* RMDs had begun, the options for Monica would be different. She could choose to continue receiving distributions based on Alan's life expectancy or her own, whichever is longer. As another option, Monica could opt to **roll over** Alan's assets into her own IRA. (Note that this option is not available for IRAs that have been annuitized.)

Suppose Alan had named his son, Ryan, as the beneficiary of his IRA. Nonspousal beneficiaries may not treat IRAs as their own and cannot name additional beneficiaries. If Alan were to die before RMDs had begun, all assets in the account must be distributed by the end of the fifth anniversary year of his death. Alternately, Ryan may elect to receive distributions over his own life expectancy. The amount of distributions is based on Ryan's life expectancy, and distributions must begin by December 31 of the calendar year immediately following the calendar year of Alan's death. If Alan were to die after RMDs had begun, the assets must be distributed over a period not exceeding the larger of Alan's or Ryan's life expectancy.

Be sure to consult your qualified tax professional for more information about inherited IRAs. ■

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