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Securing Personal Assets in Today's Hi-Tech World



On September 7, 2017, Equifax announced a cybersecurity incident, or cyber hack, that could potentially impact approximately 143 million people.

According to Equifax, the breach lasted from mid-May through July. These sophisticated hackers had access to names, Social Security numbers, birth dates, home addresses and, in some instances, driver's license numbers.

It is a tale too often seen or heard as of recently on the news. With all of the obvious conveniences that technology provides – buying your coffee on a smartphone app linked to your credit card – access to personal information on the information super highway has the capability of crippling financial health and cause months, if not years, of clean-up and repair.

As technology continues to advance, concerns regarding who has access to personal information and how to safeguard that information will only continue to grow. These issues are often of particular importance to high net-

worth individuals and families, especially when personal information is entrusted to a family office or other service provider.

While it may be difficult if not impossible to predict or prevent the next cyber hack, there are measures that can be taken to limit exposure.

Subscribe to a credit monitoring service:

- Fee-based credit monitoring sites provide services that offer varying levels of protection.
- These sites monitor activity and send you an alert via email, text message and/or mail if and when your information has been used to open a credit card account, obtain any loan or line of credit or other activity requiring the use of personal information.

Regularly review your credit reports:

- Equifax, Experian and Transunion, the three major credit reporting agencies, all provide free annual reports. Review the reports to correct inaccuracies:
 - Do you recognize all open accounts?
 - Is your personal information shown accurate?
- Run reports for your under-age children or elderly/deceased parent as they are often considered easier targets for hackers.

Monitor your bank and credit card accounts:

- Do you recognize all of the transactions?
- Set-up alerts with your institutions – text messages, emails and/or phone call can alert an individual when a credit card is used, a charge over a specific limit has been made or an account balance is below a specified threshold.

Make security a habit:

- Change passwords every few months.
 - Use unique identifiers and create security questions that are difficult to figure out.
 - Go green - the less mail sent home, often times the better:
 - Turn-on paperless settings and access bank and credit card statements online.

Shred all paper materials with sensitive personal information:

- Invest in a compact shredding machine or enroll with a shredding company to pick-up and shred sensitive documents.

Lastly, consider placing a credit freeze with all three credit agencies. A credit freeze locks an individual's credit until that individual unlocks credit access, usually with a PIN or code. Taking such action will deter someone from opening new accounts or taking out a loan under another person's name. Keep in mind that a credit freeze will not, however, prevent a hacker from making charges to existing accounts.

Related to these security issues is cash management and control. Like cyber security, this is a particularly sensitive issue for individuals and families that have family offices, an accountant or some other individual that handles their finances. To mitigate these control risks, it is critical to have internal controls in place.

Segregation of duties:

- The person that has signing authority for an account should not also have access to blank checks.
- A separate person should be reconciling monthly accounts and verifying charges.

Control access to check stock and accounting systems:

- All checks should be secured.
- Each user should have unique log-in credentials to access accounting systems.
- Limit access to areas of the accounting systems.

Online credentials to existing accounts (bank, brokerage, credit):

- Do not share online credentials with anyone, including a trusted advisor.
- If providing online access to a trusted adviser, create a separate view-only access for this person.

Utilizing various technology:

- Online bill pay:
 - Many banks offer this service for free.
 - Eliminate access to checks altogether.
- Cash management systems allow for one central location to process bills (via check or ACH) and track payments for a nominal fee:
 - Invoices are maintained in PDF format for future access.
 - Different levels of approval are assigned.
 - Checks are mailed directly from this central location and do not show account numbers or signatures.
 - Set-up recurring vendors, such as utilities, mortgage, mobile phone, etc. to be automatically paid with a bank account or credit card.

Although there is no way to completely insulate oneself from these issues in today's world, any of the steps above will help in securing assets and may prevent information from falling into the wrong hands.

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Founders and Execs Part 2: Tips for Negotiating Tax Effective Executive Equity Compensation Packages



Following-up on [For the Record: Founders and Execs Beware Part 1: The Options for Options Costly Tax Trap](#), this article will focus on the practical approaches for negotiating and understanding equity-based components of key executive compensation in the context of a company whose value (perhaps despite being relatively new) is high.

Typical Fact Patterns

Valuable Biotech: Founder has a great idea based on exciting science and market opportunity. In fact, this idea is so good investors flock to the financing, giving the company a large initial valuation even before there are employees in the fold. Founder must now build out the team, necessitating some form of equity compensation. However, grants

of restricted stock, even after considering a quality 409A valuation, will create taxable income and therefore a cash outlay for the employees.

Valuable Tech Company: In this fact pattern, founder has a highly successful business with solid revenue and profitability. The business is valuable today, but the founder expects the value to increase dramatically in the future. With an IPO or acquisition as possible options, a more senior team needs to be attracted and compensated. Stock options may seem like the best compensation plan as their grant causes no taxation. In addition, as long as the executive exercises and immediately sells, the strike price (out-of-pocket purchase price at the time of grant) and the resulting tax bill on the spread between the strike price and fair market value at exercise can be covered with proceeds. However, the income recognized would be at ordinary tax rates, almost double what the long-term capital gains tax would be.

This company and the founder have a few powerful, but little understood, alternatives to consider. Assume that the objective is to grant an executive \$1 million of stock so he or she can participate in value accretion above \$1 million. The traditional option approach would grant stock options on \$1 million worth of shares and create an obligation to pay \$1 million at the time of exercise. If this approach is taken, the executive pays the strike price and an ordinary income tax on any increase in value between the grant date and the exercise value.

If the executive negotiates for options that can be exercised immediately upon grant and makes a Section 83(b) election, the only out-of-pocket cost is the strike price. Since there is no difference between the value and strike price on date of grant, there is no income tax event. This exercise would also start the holding period on the stock. After one year, the gain on any sale of that stock would be taxed at the more favorable capital gains rates. What is critical in this strategy, however, is that the grant of the options agreement must allow the early exercise and the executive must have the ability to pay the strike price.

It should be noted that private companies may loan executives the money needed to pay for their option exercise, which would not impact company cash-flow as the money loaned immediately comes back to the company as part of the exercise. This loan would however have to be paid back if and when approaching an IPO.

A Different Approach

In certain circumstances, there is a way for a profitable, tax-paying company to grant its executives stock for *free*, cover their personal tax bill and be out of pocket zero cash. As above, assume the objective is to grant \$1 million of stock to an executive. For ease of illustration, also assume a 50% tax rate for both the company and the executive. The company would grant the executive \$1 million of stock and a \$1 million cash bonus, resulting in \$2 million of taxable income and \$1 million of tax to pay. This tax would be paid with the \$1 million cash bonus, essentially making the grant tax-free. From the company's perspective, it receives a \$2 million deduction for the compensation paid, which then reduces its tax bill by \$1 million, the amount of cash bonus paid. As a result, this transaction is cash-neutral for the company as well.

Although this transaction looks easy on paper, in practicality there are several issues to consider. First, the company must have taxable income as building a net operating loss inside the company will not help generate the cash needed to pay the bonus. In addition, the stock valuation should not be driven by net income, as the bonus payment would impact the stock value, preventing equalization between stock value and cash paid. From a non-tax/cash-flow perspective, the company must also be willing to agree to this arrangement. Often if an executive is joining an existing company whose team has already grown its value, the owners (and team) may not want give what they have invested in and created to a new person without requiring that the stock be paid for.

There is no question that acquiring talented executives is critical for growing companies and that equity compensation remains a key component in that acquisition. However, thought and care must be given when considering the types of compensation packages offered as there is no "one size fits all" plan.

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How to Avoid Underinsurance and Reduce the Economic Impacts of a Natural Disaster



Over the past few months, we have witnessed the devastation of communities from hurricanes along the Atlantic and Gulf coasts, earthquakes in Mexico and fires in Northern California's wine country.

These recent natural disasters have underscored how important and necessary it is to be properly insured. Reports by risk assessment groups indicate that over half of all businesses are underinsured, an estimated 75% of small businesses lack proper levels of insurance and 40% of small businesses having no insurance at all. This lack of insurance may be the result of a calculated decision to save money or, more concerning, it could be due to lack of information on the part of the insured. Whether intentional or inadvertent, underinsurance can have major economic consequences. To avoid business interruption or other economic loss after a natural disaster, it is important to understand what it means to be underinsured and to take steps to remedy the situation.

Underinsurance Can Affect Individuals and Businesses

Underinsurance can be an issue for both individuals and businesses that own property. Underinsurance occurs when the amount of coverage for the insured property is less than the replacement cost of such property. Although there are insurance policies that use fair market value as the basis for determining the premium, this is not common and not usually advised. In general, property should be insured on a replacement or reproduction cost basis. *Replacement cost* represents the amount needed to replace property with similar property, and functionality is the driving force. *Reproduction cost* represents the amount needed to replicate the property, making use of all the same materials/capacities, to the extent possible. On the other hand, *fair market value* measures the replacement cost and then deducts all forms of depreciation. Fair market value generally yields the lowest of the three values, while reproduction cost usually yields the highest.

The economic impacts of underinsurance can perhaps best be understood through an example. Suppose a manufacturing company had operations that were affected by one of the recent hurricanes. Due to the storm, the company experienced substantial damage and losses involving the company's buildings, inventory and manufacturing equipment. Although the company had insurance, the policy as written was based on fair market value. Knowing the risks involved, the company had unfortunately neglected to inform the insurer regarding updates and changes to the facility. As a result of this omission, the company would not likely have sufficient coverage to appropriately compensate for the losses incurred.

Evaluate Policies and Property Regularly to Prevent Underinsurance

To prevent underinsurance, start with an existing policy to determine not just the type of policy in place, but also what the policy utilizes in terms of value basis when there is a loss. If the value basis is anything other than replacement or reproduction cost, it is important to understand why, and to weigh the risks. Next, determine how the value basis is being calculated. Consider whether the number derived is now coming from outdated documentation. Ensure that proper procedures are in place to report changes such as additions and/or removals. For purposes of determining a premium, an appraisal may be useful. Once a starting point has been established, updates to the value can be more easily processed as changes occur. After five to ten years or after a significant number of changes have taken place, another appraisal might be needed. To prevent underinsurance, it is critical to perform a periodic review of your insurance coverage and report updates and/or adjustments affecting your property as those changes occur.

In short, to prevent underinsurance be sure to:

- report to the insurer the cost to rebuild the property, not just the fair market value or consideration paid to purchase the property;
- perform regular reviews of the business and property and record any changes;
- review the insurance policy yearly (at a minimum) to ensure proper coverage;
- increase coverage annually to reflect inflation; and
- report additions and/or changes to the insurance company.

When the amount of coverage for the insured property is greater than the replacement cost of such property, overinsurance may be the result. While there are not many risks involved with over-insuring property, it does come at a greater expense to the insured. Following the steps above—and also reporting assets that are removed, retired or obsolete—will keep coverage up to date and minimize the potential for overinsurance as well as the risk of underinsurance.

The Takeaway

With proper planning, and with measures in place to regularly evaluate property and insurance levels, underinsurance (and overinsurance) can be avoided. It is import to not wait until after damage has occurred to consider important decisions related to insurance, or underestimate the impact underinsurance can have on your business or economic position. Although no one wants to think about a major loss event, it is important to be proactive and know your status now so that you can fix that gap and be prepared for potential future disasters ahead.

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Trump Tax Reform: Capitalizing on Anticipated Tax Reductions



Trump Tax Reform: Capitalizing on Anticipated Tax Reductions

If Republican tax reform efforts are ultimately successful, a 20% tax rate for C corporations and a 25% tax rate for small and family-owned pass-through businesses could be effective as early as 2018. While predicting what Congress will ultimately agree may be next to impossible, it would however be foolish to not consider tax planning opportunities in the event that tax rates on business income are reduced. For example, if properly prepared for, businesses can realize significant permanent tax benefits by accelerating depreciation into tax years with higher income tax rates. Such planning presents a unique cash-flow opportunity for businesses that have a significant carrying value in tax assets, especially those that have sizeable real estate or leasehold improvement assets on their books.

How can corporate taxpayers currently benefit from future tax rate reductions?

Businesses recover capital investments in real estate through depreciation to offset their income tax liability over stated tax lives. Commercial real property is recovered over a 39-year tax life, whereas residential property is recovered over a 27.5-year tax life. Irrespective of the calculation method, those scheduled deductions are only as valuable as the tax rate for any given year. Consider the following example:

ABC Corporation purchased an office building five years ago with a depreciable basis of \$20,000,000. This results in a yearly depreciation allowance of approximately \$513,000, and an after-tax cash benefit of nearly \$180,000 per year, assuming a 35% tax rate. If the corporate tax rate were reduced from 35% to 20%, the value of that annual deduction would decline from \$180,000 to only \$100,000. Understanding that this tax rate reduction may occur, the corporation decides to maximize its depreciation deductions by harvesting missed depreciation through a cost segregation study (CSS). The CSS results in a reclassification of \$4,000,000 of the building basis into five-year property. In recalculating its depreciation, the Company has identified \$3,300,000 in depreciation it did not take over the last five years that it can claim on its 2017 tax return as a one-time cumulative catch up deduction, also known as an IRC Sec. 481(a) adjustment. The tax cash value of that depreciation difference at the 35% tax rate is \$1,165,000. This planning essentially increases the value of future deductions that would be otherwise realized at lower rates because the corporation accelerated the deductions into a tax year when a higher tax rate is in effect.

Cost Segregation Study

Cost segregation is an IRS-recognized technique of combining tax and engineering strategies to identify and segregate the costs of short-lived property from real property. Short-lived assets are not always apparent. In certain instances the costs for plumbing connections, electrical infrastructure, site improvements, and heating, ventilation and air conditioning systems, which would otherwise be considered real property, qualify for shorter tax recovery periods. Through a detailed and systematic accounting and engineering-based analysis, taxpayers can accelerate depreciation through a CSS related to new construction, purchased property, leasehold improvements, or remodeled/expanded property. Furthermore, a CSS can be done for properties placed in service in prior tax years, whether they were newly constructed or acquired. For these properties, missed depreciation from prior tax years can be taken in the current tax year by filing Form 3115, Application for Change in Accounting Method.

Although results will vary depending on the type of property, the additional deductions in the first two years from a CSS can total over \$700,000 for every \$1 million in assets reclassified from 39-year to five-year property. Further, because cost segregation is generally associated with commercial property, any entity owning real estate or leasehold improvements can benefit from a cost segregation study, regardless of the industry.

The Take Away

Both in general and in light of potential tax changes, asset-intensive businesses should consider having a tax professional review their depreciation schedules to identify property that could have its depreciation deduction accelerated through a cost segregation study. While a CSS traditionally benefits taxpayers through a long-term net present value benefit (i.e., time value of money), reductions in future tax rates could result in permanent tax savings.

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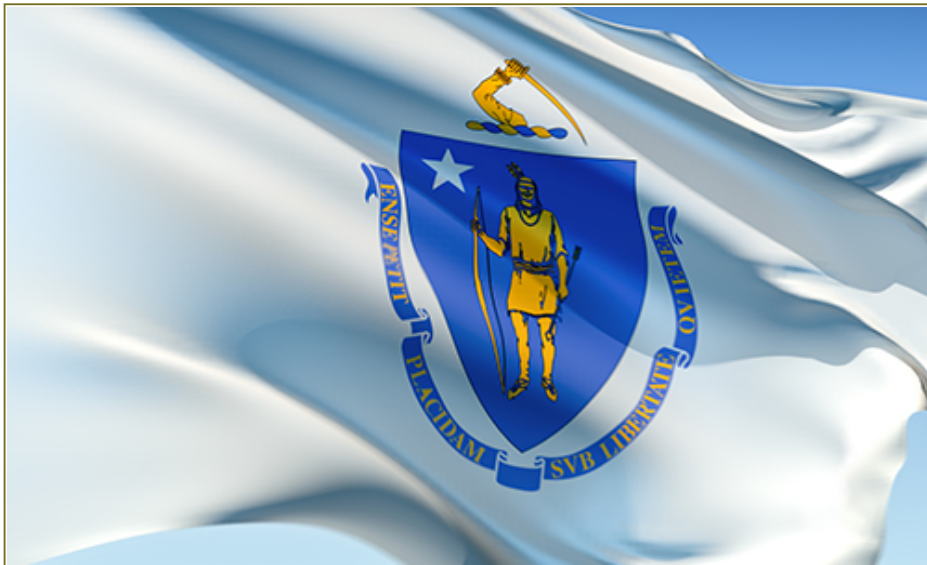
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Taxachusetts Welcomes You!



Over this past summer, while many were enjoying the sun and warm weather, the Massachusetts State Legislature voted to move the Fair Share Amendment, commonly known as the Millionaire's Tax, to a popular ballot vote in November of 2018.

What you need to know about the Massachusetts Millionaire's Tax

The Fair Share Amendment proposes to amend the Massachusetts state Constitution by adding a four-percentage point rate increase to income taxes already in place on annual income in excess of \$1 million. Currently, personal income is taxed at two rates by the Commonwealth – 12% on short-term capital gains and 5.1% on everything else. Therefore, this measure could result in Massachusetts tax rates as high as 16% on some income. If approved, the measure will take effect for tax years beginning on or after January 1, 2019. As a simple example, if a taxpayer has

\$2 million of ordinary income taxed in Massachusetts today, his or her state income tax will be \$102,000. If the Fair Share Amendment passes the same taxpayer's bill to the Commonwealth in 2019 would be \$142,000.

The amendment, while sparse in language, appears to be written broadly enough that it will apply to any income of any Massachusetts taxpayer, including wages, active trade or business income from a flow through entity, or portfolio income such as capital gains. The amendment does not single out residents of the Commonwealth only, meaning that even non-residents who earn wages in Massachusetts or own a business with Massachusetts nexus could face higher tax rates on business profits that are apportioned to the Commonwealth in excess of \$1 million. The amendment also does not appear to distinguish between income earned by individuals or trusts that are Massachusetts resident trusts.

In addition, the Fair Share Amendment also creates a so-called *marriage penalty* in Massachusetts that previously did not exist. Since Massachusetts is generally a flat-tax state there, is not a big difference between two taxpayers filing as single persons or as married filing jointly. However, since the Fair Share Amendment makes no distinction between single and married taxpayers, it appears that those who file joint returns and combine their income could be subject to the tax where two single taxpayers would not. For example, two single taxpayers who each earn \$1 million would pay only the 5.1% tax on their respective incomes. However, those same taxpayers filing a joint return would pay a 9.1% on half of their income.

Many are wondering, *will this measure pass?* While it is impossible to say for sure, what is true is that this measure will be voted on by the entire state population but only affect a small percentage. Also, a constitutional amendment approved by popular vote is required to enact this change because the state Constitution currently mandates that a class of income must be taxed at a uniform rate for all taxpayers. Since this bill represents a fundamental transformation from a flat tax to a graduated tax, the amendment is required. In the months leading up to the vote there surely will be lobbying on both sides of the issue. The text of the Fair Share Amendment proposes that funds raised by this levy would be used to fund spending on quality public education and infrastructure improvement, common goals that everyone can rally behind. However, it is expected that business groups will argue that the amendment will do more fiscal harm than good, pointing to high-taxed states that have lost jobs and wealthy taxpayers to more tax-friendly locales as evidence. Further, there are others who believe the amendment's constitutionality is debatable because it appears to appropriate revenue for specific purposes, which is not allowed on a ballot initiative. Finally, the merits of moving from a fundamentally flat tax system to a graduated rate system and whether the state is opening a door to further progressive changes will surely be debated. How this all plays out remains to be seen.

While determining if this bill is passed may be limited to their vote, Massachusetts taxpayers and their advisers can start thinking now about life when and if the Fair Share Amendment passes.

- Flow through businesses (partnerships LLC's and S corporations) with nexus in more states than just Massachusetts should review how they apportion income to the state. Resident taxpayers may evaluate what it takes to become a non-resident. Under Massachusetts law, there are two ways the Commonwealth will classify an individual as a resident:
 - Physical presence: If a taxpayer has and maintains a home within the state (owned, rented, or leased) and is physically present within the Commonwealth on any portion of 183 days in a year, then that taxpayer will be considered a statutory resident for that year and pay tax on 100% of his or her income in Massachusetts. This statutory residency is a bright line test and one the Department of Revenue has been more aggressive in asserting.

- Domicile: The Commonwealth can also argue that an individual is domiciled in Massachusetts, and therefore a resident for income tax purposes, if that individual's center of vital interests are here. Such interests include family, social and religious ties, business activity, as well as a variety of other factors. For an individual to terminate residency in state, that individual must break domicile and show closer connections to another state, which often requires a major change in lifestyle (i.e., simply spending more time at the lake in New Hampshire is not enough).
- Individuals who cannot change their domicile can think about how to manage portfolio assets to minimize annual income recognized in Massachusetts, in particular capital gains, or possibly use trust planning to minimize exposure to Massachusetts taxes.
- Married taxpayers may consider filing separately in the Commonwealth as it is possible to file jointly for federal purposes and separately for state purposes. Resident spouses may want to consider how investment assets are allocated and which spouse recognizes capital gains to keep both spouses under the \$1 million threshold.
- Trustees should evaluate whether earnings on trust assets will be subject to the tax. Massachusetts residency rules for trusts are different than for individuals, and often some basic planning can help minimize exposure to state income taxes for established trusts.

Whether resident here or not, Massachusetts taxpayers should start talking with their tax advisers now regarding these potential changes. Having a good set of plans in place will be critical, as the Massachusetts Department of Revenue will be on the lookout for taxpayers trying to avoid the rules.

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