



# Farmers Trust Company

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## Reflation Is Here

Despite some fits and starts during the past couple of weeks, the stock market has continued to show strong momentum thus far in 2019. Although the benchmark S&P 500 index is up 13% so far this year, it is still more than 4% below the all-time high reached back in September. Nevertheless, many investors are breathing a sigh of relief as their investment accounts have now recovered the bulk of losses realized during the fourth quarter of 2018. What is quite curious about the current equity market rally, however, is that it has happened alongside bond yields falling back down to their 2019 lows. Typically, the stronger prospects for future economic growth that drive stock prices higher also put upward pressure on interest rates. This may lead one to believe that stocks and bonds are currently having a significant disagreement over where the economy is heading. We will offer a slightly different assessment. The market has realized that the U.S. Federal Reserve may be dramatically changing its approach to monetary policy, and will be ready and willing to provide as much liquidity as the market needs, whenever the market needs it.

When there is excess liquidity in the market (or the expectation of such in the future), ALL asset prices rise – stocks, bonds, real estate, commodities. What is excess liquidity? Simply put, it comes down to too much cash chasing too few assets.

This is exactly the situation we have witnessed thus far in 2019. I've already discussed the red hot start for stocks in 2019, but the party hasn't been limited to just equity prices. The Aggregate Bond Index is up 1.5% so far this year (that's a good return for bonds in just two months' time), commodity indices are up more than 10%, and real estate benchmarks are up more than 15%. One theory as to what may be driving this dynamic is a new concept that is being talked about in academic circles called Modern Monetary Theory, or MMT. What this theory essentially states is that a central bank should stand ready and willing to monetize a country's government debt as long as it doesn't put too much downward pressure on its currency – in our case, the U.S. dollar. In other words, because the U.S. dollar has been so strong relative to other currencies, we should therefore use the Federal Reserve Bank to extinguish our government debt and allow for greater flexibility in U.S. fiscal policy, i.e. more government spending. It goes without saying that this policy likely wouldn't take long to generate significant inflationary pressures, and one thing history has taught us is that once the inflation genie is released it is very difficult to put it back into the bottle.

Our investment strategy for the balance of 2019 is likely to be based on the expectation of more modest economic growth alongside accelerating inflationary pressures. Some call this "stagflation". While stocks don't necessarily perform poorly in this environment, it is important to focus on certain sectors and industry groups while avoiding others. Winners tend to include Real Estate, Utilities, and Energy stocks. Losers tend to be the Financials and Consumer Staples sectors. On the fixed income side, we favor Treasury Inflation Protected Securities, or TIPS, as a compliment to a broadly diversified bond portfolio.

## Farmers Trust Company March 2019 Newsletter

Nine Things a Business Owner Should Know After Tax Reform

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## Nine Things a Business Owner Should Know After Tax Reform

As a business owner, you should be aware of some recent federal tax legislation changes. Many of the changes can affect the bottom line for the business as well as you as the business owner — some in a good way and some in a bad way.

**1.** The taxable income of a C corporation is now taxed at a flat 21% rate. Previously, the tax rates generally ranged from 15% to 35% (but some income was taxed as high as 39%). There is no longer a corporate alternative minimum tax.

**2.** Individual income tax rates have been reduced to 10%, 12%, 22%, 24%, 32%, 35%, and 37%. Net long-term capital gains and qualified dividends continue to be taxed generally at 0%, 15%, and 20%, depending on the amount of your taxable income.

**3.** A new pass-through income deduction is available to many owners of sole proprietorships, partnerships, and S corporations. This deduction is for up to 20% of qualified business income (QBI) from such business entities. If your taxable income exceeds certain thresholds, the deduction is limited based on factors such as the wages and qualified property of the business. Additionally, individuals with higher taxable incomes may not be able to claim a deduction if the business involves the performance of services in fields that include health, law, accounting, performing arts, consulting, athletics, and financial services, among others.

**4.** Small businesses have the option of expensing certain purchases under IRC Section 179 rather than depreciating the value of the purchases over time. Up to \$1,020,000 (in 2019) of qualifying Section 179 property can now be expensed. The amount that can be expensed is reduced to the extent that qualifying property exceeds \$2,550,000 (in 2019). These amounts are indexed for inflation and may increase in future years.

**5.** When a business purchases an asset, the business can generally deduct the cost of the asset over a period of time. For qualified property purchased after September 27, 2017, first-year bonus depreciation of 100% is available if the property is placed in service before 2023 (2024 for certain property). The 100% allowance is phased down by 20% each year after 2022 (or 2023 for certain property). The 100% bonus depreciation essentially allows business property to be expensed, rather than deducting the cost of depreciable property over a number of years.

**6.** Under a new provision, an excess business loss cannot be deducted. An excess business loss is equal to the amount by which your total deductions from all of your trades and businesses exceed your total gross income and gains from all of your trades and businesses plus \$250,000 (\$500,000 in the case of a joint return). As before, losses from a passive trade or business activity may be limited under the passive loss rules. The passive loss rules are applied before this new limitation is determined. Disallowed excess business losses are treated as a net operating loss carryover to future tax years.

**7.** A net operating loss generally arises when a taxpayer's deductible expenses for a year exceed its gross income. Previously, a net operating loss for the current year could be carried back to prior tax years and forward to future tax years as a deduction against taxable income. The deduction for a net operating loss for a taxpayer other than a C corporation is now limited to 80% (previously 100%) of taxable income computed without regard to this deduction. Even though a net operating loss can no longer be carried back two years, it can still be carried forward for up to 20 years, subject to the deduction limit in the carryover years. Certain farming losses may now be carried back only two years (rather than five years), as well as carried forward for 20 years.

**8.** A like-kind exchange provision allows property to be exchanged tax-free under certain circumstances. The general like-kind exchange provision now applies only to exchanges of real property held for use in a trade or business or for investment and not to exchanges of personal or intangible property. For example, assume you own your office building without a mortgage. You are interested in moving to a new office building. If you sold your current office building, you would recognize capital gains. If instead you exchanged your current office building for the new office building in a like-kind exchange without receiving any cash or non-like-kind property, you would not recognize any capital gains at the time of the exchange.

**9.** A deduction is no longer allowed for entertainment expenses. Food and beverages provided during entertainment events are not considered entertainment if purchased separately from the event. Taxpayers may still deduct 50% of the expenses for business meals.



*A business owner should be aware of some recent federal tax legislation changes. Many of the changes can affect the bottom line for the business and the business owner. A business owner may wish to reconsider some of his or her tax strategies.*

*Note: The corporate tax provisions have been made permanent, but most other changes affecting individual taxpayers are scheduled to expire after 2025.*



## Key Financial Ratios for Small-Business Owners



*This article is a brief overview of some of the common financial ratios that business owners use to evaluate their organizations' success. It is by no means a comprehensive list. An accountant or financial professional can help you determine the most appropriate ratios for your business and industry.*

Financial ratios are an important tool in any business owner's toolbox. Used to measure a business's condition and performance, financial ratios help you evaluate your organization's financial status and rate of success. They are also used by those evaluating your business for potential investment or lending opportunities.

Generally speaking, there are four categories of financial ratios: liquidity, profitability, activity, and leverage. Your balance sheet and income statement will help you calculate the ratios within each category.

### Liquidity

Liquidity ratios assess your organization's ability to meet its obligations in the short term. Put simply, liquidity measures your firm's ability to pay its bills.

**Current ratio:** This measures the amount of debt relative to total assets (total assets divided by total liabilities). A current ratio of at least 1 (ideally, greater) indicates your business has enough assets to cover its current obligations.

**Acid test or quick ratio:** This ratio measures your organization's ability to pay its current obligations with accessible assets. In other words, it helps you assess its "cash position." The calculation is (cash and cash alternatives plus marketable securities plus accounts receivable) divided by current liabilities. The higher the ratio, the stronger its position. A low ratio could indicate a potential cash crunch.

### Profitability

These ratios help measure how profitable your organization is.

**Gross profit margin:** This ratio determines how much remains after accounting for the cost of goods sold (COGS) to pay for expenses, taxes, interest, etc. It is calculated by dividing gross profit by sales. (Gross profit equals sales minus COGS.)

**Net profit margin:** Net profit allows you to gauge how well your company is performing per dollar of revenue. It is calculated by dividing net income (income after expenses) by net revenue (revenue after adjusting for discounts and refunds). While growing revenue year over year can be impressive, growing revenue alongside a growing net profit margin demonstrates strong overall management.

**Return on assets:** Calculated by dividing net income by average total assets, this ratio shows the organization's ability to generate income relative to overall assets.

Therefore, it helps gauge management effectiveness in putting those assets to use. (To calculate average total assets, add the total assets at the beginning and end of the year and divide by two.)

### Activity

Also known as efficiency ratios, activity ratios measure how effectively your organization manages its assets.

**Accounts receivable turnover ratio:** This ratio is used to evaluate the quality of receivables and to help determine how successful your organization is in collecting outstanding payments. It is determined by dividing net sales by average receivables outstanding over a given time period. (Average receivables outstanding is calculated by adding the beginning and ending balances of accounts receivables over a period of time and dividing by two.)

**Inventory turnover ratio:** This ratio can help determine whether your company is efficiently managing inventory. It is calculated by dividing the COGS by the average inventory (the average of the beginning and ending inventories over a period of time). A high ratio may indicate that inventory typically runs low and may present a risk of "selling out." By contrast, a low ratio may indicate that product is overstocked or not moving well for a particular reason that might warrant further investigation.

### Leverage

Also known as debt, coverage, or solvency ratios, leverage ratios can help assess whether debt levels are appropriate.

**Debt to asset ratio:** This ratio measures the percentage of assets that is financed with debt, rather than equity. The calculation is total debt divided by total assets.

**Debt to equity ratio:** This ratio compares an organization's total debt to its total equity. The calculation is total liabilities divided by total equity. A high ratio may indicate a business has assumed a great deal of risk.

### Understand your industry's benchmarks

Before evaluating your organization's financial ratios, it may be helpful to understand ratio benchmarks within your industry. What may seem like a high or low ratio on its own may actually be in line with other, similar operations in your field.

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## How can I get a tax break for child care?

More than 60% of children under age six in the United States have two parents in the workforce.<sup>1</sup> Many of these working parents must spend a burdensome share of their earnings on child care, especially if they don't have relatives who are willing and able to help out.

The following tax benefits may help you offset some of the costs paid for a nanny, babysitter, day care, preschool, or day camp, but only if the services are used so you can work.

### Child-care tax credit

Families with one qualifying child (typically age 12 or younger) can claim up to \$3,000 per year in child-care expenses; those with two or more qualifying children have a \$6,000 annual limit. The credit is worth 20% to 35% of eligible child-care expenses, depending on income. As income rises, the credit amount drops until it hits a minimum of 20% for households with \$43,000 or more in adjusted gross income.

For example, families with one qualifying child can receive a credit of \$600 to \$1,050; those with two or more children can receive a credit of \$1,200 to \$2,100. A tax credit lowers a family's tax liability dollar for dollar.

### Dependent-care flexible spending account (FSA)

Higher-income families may realize a bigger tax benefit from an FSA if it is offered by an employer. Up to \$5,000 a year can be set aside to cover eligible child-care costs for qualifying children, and this money is free of federal income tax and Social Security and Medicare taxes. You are not allowed to use pre-tax money from an FSA and take a credit for the same expenses. However, after spending \$5,000 from an FSA, you may take a tax credit for up to \$1,000 in additional child-care expenses if you have more than one child.

<sup>1</sup> Child Care Aware® of America, 2017



## What records do I need to file my taxes?

Tax season is a good time to get your financial records in order. And whether you are doing it on your own or hiring a tax preparer to assist you, you'll want to make sure that you have all of your information organized to make the process of filing your taxes easier.

Sometime in January you should have received your W-2 form from your employer. Your W-2 form lists your gross income, taxable income, and the amount of state and federal taxes withheld from your pay. It also will show any 401(k), health insurance, and flexible spending account contributions you have made.

Around the same time that you got your W-2, you should also have received 1099 forms from financial institutions for any dividend and interest income. And if you have a mortgage, your mortgage servicer sent you a 1098 form, which contains information on interest paid along with other mortgage-related expenses.

In addition to the above-referenced forms, you'll need to provide your personal information, including your date of birth and Social Security or tax ID number. If you are married and/or have children, you will need their information as

well. You should also have documents that list any additional sources of income, such as self-employment, rental, retirement, or unemployment income.

Depending on whether you qualify for any tax deductions or credits, you may also need the following information:

- Records of cash and noncash charitable donations
- Amounts paid toward medical, dental, and vision expenses
- Federal, state, and local taxes paid (including quarterly estimated tax payments)
- Dependent-care provider information
- Receipts for education-related expenses

Make sure that you keep all your financial records in a safe and easy-to-find place. Being organized is not just a good idea during tax time, but is also helpful at other times of the year (e.g., when you apply for a loan or financial aid for college).



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