Is the goal of lowering your taxes hurting you financially?

Many entrepreneurs believe they should be rewarded for success to the greatest extent possible, and pay as little taxes as allowed. After all, they have taken considerable risk to start and grow their business. This is reasonable. In fact, the late Supreme Court Justice Learned Hand opined,

> *Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands.*

However, sometimes in pursuing the goal of giving less money to Uncle Sam by taking every possible tax deduction, business owners unwittingly hurt themselves financially.

It is not uncommon for small business owners to lower their income tax liability by reporting “gray” expenses: things that, while business-related, are completely discretionary and are not necessary for the successful operation of the business. For example, a business owner may report meals, golf, sports events, and other entertainment activities with partners, employees, or customers who may also be friends. While they may discuss business to justify the deduction, the activity may have been totally discretionary. Another example might be attending an industry association conference in a tropical location in January that the business owner wouldn’t have chosen to go to had it instead been held in frigid Minneapolis.

When a business broker or investment banker packages a business they will re-cast the financial statements to show discretionary or non-recurring expenses added back. Yet, just because a business sale intermediary makes these adjustments, it doesn’t necessarily mean that buyers will agree to such adjustments when they conduct their own analysis to estimate cash flow and corresponding value.

For every dollar you spend on gray expenses you’ll save a fraction of that dollar in taxes, but you may also be giving up multiples of that dollar in business valuation. If you are within 24 months of putting your business on the market, you may want to focus on reducing all unnecessary expenses, rather than maximizing tax deductions.

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