taxes

By Warren Salomon

Go for the Gray

There are two time-honored ways to play the year-end tax game—smart and reckless. If you're smart, you'll go for the gray; if you're reckless, you may go to the slammer.

See if this description fits: You're an honorable, self-supporting, productive individual. When the year's toil is done, you're given a W-2 (or 1099, or some other wretched chit), showing how much the feds have ripped you off, and you're sick of the whole rotten system. So you reach for REASON and eagerly turn to this column, hoping to discover some secret bit of free-enterprise lore that will make it all work out okay—a little magic, like a foreign bank account, or a mail-order preacher's license, or an overlooked but miraculously potent clause of the Constitution, or some special way to fill out your tax return so you'll be free to enjoy the fruits of your labors. Well, you're the reckless type, and you won't like what I'm going to tell you: Forget it!

The secret phrase to utter in Tax Court that will paralyze the judge and make the IRS lawyers run from the room in panic is nothing but a pipe dream. All you can really do is agonize over the fine print in the tax forms as you decide whether you can deduct your kids' acne medication. Tough, but that's the way it is.

The best thing you can do for the year now ending is to avoid the spectacularly stupid mistakes described below. Then, resolve that for the rest of your life you'll go for the gray.

Go for the gray? I'll get to it, but first let's discuss some examples of year-end tax stupidity. Their number is infinite, but here are a few of the more obvious ones:

- "aggressive" (that is, crazy) tax-saving schemes, which always fail in court;
- "abusive" (too-good-to-be-true) tax shelters (a topic worth a future column or two);
- fraud, which we'll discuss in later columns; and
- tax-protester activities, absolutely none of which saves taxes (but also worth some discussion in future columns).

You're groaning. Is there any hope? Sure. You can come away from any bookstand with a long list of items that are deductible on your income-tax return. But that's not where you can save the big bucks. All serious tax dollars are saved in the "gray areas."

Tax forms may look frightfully precise, but the law has lots of nooks and crannies. They're the gray areas, the hidden loopholes where the answers aren't clear, and they're the reason for the existence of tax lawyers. Knowing about and taking advantage of the gray areas is what professional advisors are for.

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For example, in a surprisingly large number of cases, it's a professional judgment call whether some asset you sold was a capital asset, the sale of which generates—you guessed it—capital gain. If it isn't a capital asset, its sale generates ordinary income (or loss, of course).

Consider an everyday transaction—a piece of land someone buys and sells. For that person it might be a capital asset, but maybe not for the outfit the land was bought from. Suppose the original seller subdivided a tract and sold a hundred identical lots. For him it was inventory; therefore selling it generated ordinary income. For the next owner it was an investment; thus its sale generated capital gain. But it's still the *same* piece of property! Now suppose you own a few of those lots and sell one or two. Where does that put you? In the gray area.

If you've got the right facts going for you, and if your lawyer can weave them into a plausible scenario supported by judicial precedents, and if he's willing to put it all in writing and sign his name to it, then you've got a shot at transmuting ordinary income into capital gain.

But at year's end it's already too late, and next April 14 is way too late. You need good tax advice at the very *beginning* of a transaction. You need to deliberately build the gray areas into your deals.

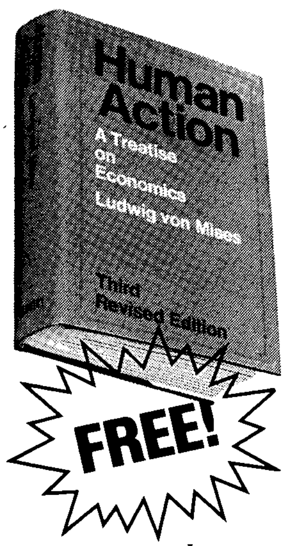
Okay, that's wonderful, but what can you do about the year that's ending now? It's probably too late to do much of anything except get with your advisors to do the traditional nickel-and-dime stuff. These things aren't very exciting, but they can add up to serious money, they're legal, and your accountant already knows what to do, so you don't need to run up any big legal bills. Here are some of them:

- Start an individual retirement account (IRA) if you haven't got one already.
- Consider a Keogh plan.
- Think about taking those painful stock market losses now, while they're still short-term.
- If you're getting married or divorced, do the tax computation both ways. (You may be better off by hastening your status change before the end of the year—or delaying it until next year.)
- If you're keeping your tax books on the cash basis (as opposed to the accrual method) try to shift income into next year. You know what to do—ease up on collecting revenue, speed up on paying expenses. But there are limits to this. For instance, it's December, and you decide to prepay your office rent. But how much can you get away with? One month? Why not. Two? More? That depends. At some point, your advance-rent deduction will be disallowed (if you're audited). A year's prepaid rent should probably be shown as an asset on your books, not an expense. In between is the gray area.

Whatever happens to this year's tax law, gray areas will always be there. And so will the opportunities to save money. So as the year fades away, take my advice and do two things: avoid recklessness, and go for the gray.

Happy new year!

Warren Salomon is an attorney in Miami.



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By John Dentinger

Epicurean Entrepreneur

Walking into one of Trader Joe's 24 Southern California specialty grocery stores is like walking into a South Seas trading post. Employees sport Hawaiian shirts; barrels and hatch covers serve as check stands; and the prices are comparably rustic. But not the quality—with bargains such as a quart of virgin olive oil for $2.89, a pound of French Brie cheese for $2.98, and good California wines for $1.99 a bottle.

Presiding over this eccentric grocery empire is Joe Coulombe. He is not the laid-back surfer one might imagine from his stores, but an energetic entrepreneur.

After earning his master's degree in business administration from Stanford University in the early 1950s, Coulombe was hired by the Rexall Drug Company to do research on their ailing retail chain, Owl Drugs. In the course of his research he discovered 7-Eleven stores in Texas, and it was this form of retailing that the young business manager used as president of a six-store, experimental Pronto Market chain opened by Rexall in Southern California. In 1961, when Rexall decided to drop the Pronto chain, Coulombe borrowed the money to buy the six markets, which he expanded to 18 stores.

Then, as he recounts, "in 1966, 7-Eleven came to California. I took one look at their balance sheet and one look at ours and decided I'd better get the hell out of the convenience store business. So I invented 'Trader Joe' and opened the first one in 1967 in Pasadena." They were such a success that he phased out the Pronto Markets, selling some of them to 7-Eleven.

The key to this entrepreneurial success had been a savvy projection of changing consumer tastes. "I designed Trader Joe to take advantage of two demographic trends. The first was the tremendously elevated levels of education in the US" after World War II. "As these people went into the job market and matured," he figured there would be "a change in public tastes away from the station-wagon culture of the 1950s, which had been dominated by *I Love Lucy* and *Gunsmoke*."

And Coulombe saw another catalyst at work. "I knew the jumbo jet, the 747, was going into production, and I felt it would radically drop the cost of foreign travel for Americans. We had observed in Pronto Markets that our customers who had traveled, just to San Francisco, had a greater tolerance for new things."


L.A. HERALD EXAMINER/CHRIS GULKER

Joe Coulombe, a.k.a. Trader Joe

So he picked the name *Trader* to evoke images of the South Seas. "Trader Joe from the beginning featured the exotic. All of our advertising has been literate, always written up, never down. It assumes an open mind and a desire, a thirst, for knowledge."

Part of the attraction of the stores is the humorous, informational soft-sell of the advertising and of the bimonthly mailer, "Fearless Flyer," whose copy Coulombe writes himself. An antique etching of two cows might feature word balloons with these gems: "Did you know Brie has parameters?" "Not if it's pasteurized."

And if you don't hurry in for the latest bargains the Flyer mentions, you may not be able to get them later. "We deliberately lack continuity," says Coulombe. He and his eight buyers snap up odd-lot bargains and pass the savings on to their customers. "We like to sell stuff that's a one-shot deal—with no intention of ever having it back in stock." This not only adds to the sense of adventure in shopping at Trader Joe's; it is the very flexibility that makes the low prices possible.

Changing with the times has kept Trader Joe's afloat while other, "full-service" supermarket chains have hit the rocks. When the chain first opened, much of the stores' business was wine and liquor. When the health-food movement gathered momentum, "without hesitation, we grafted raw milk right on top of bourbon." In 1977 and 1978 came the elimination of California's "fair trade" laws, which had kept retailers from discounting milk and liquor—items accounting for 50 percent of Trader Joe's sales. Coulombe had begun changing the operation even before the laws were struck down, becoming more of a food merchant, selling items of broad consumption but high quality, such as mayonnaise and cooking oil—"safflower oil, walnut oil, grapeseed oil, as opposed to Wesson oil."

Coulombe, who has been known to slip a free-enterprise comment into his advertising copy, doesn't do too much lobbying. But there are issues on which he's vocal, such as bills in the state legislature that would create monopolistic wholesale territories for beer and imported wines. "I believe in free people," he explains, "and I do not believe it is possible to attain political freedom without free markets. Whether you're a big corporation or not, in the long run you harm your own personal freedom if you go running to the government to solve your problems." He frequently votes for Libertarian Party candidates, he notes—not because he expects them to win, but to keep the party on the ballot and able to offer interesting political alternatives.

Coulombe likes to garden, hike, and listen to Mozart. But most of all, he is a voracious reader. He even has his kids bring home books they read at college. "The two books I always quote when I lecture at business schools are *The Revolt of the Masses* by José Ortega y Gasset, and *The Guns of August* by Barbara Tuchman. I just finished reading Jean Renoir's biography of his father." Not the reading of the average businessman? "I don't think the cultural stereotypes of businessmen have kept up with the facts."

John Dentinger is a free-lance writer and a columnist for the LA Daily News.