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CAROL T. BARNES, C.P.A.
C. WILLIAM GERARDY, JR., C.P.A.
BARRY S. SHIPP, C.P.A.
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TIMOTHY R. DURR, C.P.A.
BAILEY B. BAYNHAM, C.P.A.
ROBERT A. BUSBY, C.P.A.
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GEORGE D. FAUBER III, C.P.A.
R. SCOTT MOORE, C.P.A.
STEPHANIE CARROLL, C.P.A.
ADAM JEFFERSON CAIN, C.P.A.

COLE, EVANS & PETERSON
CERTIFIED PUBLIC ACCOUNTANTS

FIFTH FLOOR TRAVIS PLACE
624 TRAVIS STREET
SHREVEPORT, LOUISIANA 71101-3012

www.cepcpa.com

M. ALTON EVANS, JR.
PARTNER EMERITUS
AUSTIN G. ROBERTSON, JR., C.P.A.
OF COUNSEL

TELEPHONE (318) 222-8367
TELECOPIER (318) 425-4101

MAILING ADDRESS:
P.O. DRAWER 1768
SHREVEPORT, LOUISIANA 71166-1768

AUGUST 2016

"Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."

Judge Learned Hand
Gregory v. Helvering, (1934)

GIFT AND DEATH TAX GOING UP?

The Treasury Department has issued proposed Internal Revenue regulations that would increase transfer tax valuations and, consequently, significantly increase taxes on the transfer by death or by gift of interests in closely held family businesses and investment entities.

For the transfer (death or gift) of a fractional interest in a business, it has long been established law that the value to be used in computing the transfer tax is the fair market value of the actual property interest transferred and not its fractional share of the value of the entire business. Thus, the transfer of a 10 percent interest in an entity worth in total $1 million is, under the current rules, valued at the fair market value of the one-tenth interest actually transferred and not at one-tenth of $1 million or $100,000. The minority status of a 10 percent ownership (it does not control business decisions) causes a 10 percent ownership to always be worth less in the market place than its one-tenth share of the whole. The new regulations, if made final, will seek to prevent the use of the lack-of-control discount in family businesses and require the payment of death and gift taxes on a pro rata part of the value of the whole without recognizing the actual "real world" discount in market value for lack of control.

The discounts for lack of control and lack of marketability are 30 to 50 percent in most cases. Accordingly, for transfers of entity interests consisting largely of real property, land, improvements, timber, etc., the valuation of the minority interest transferred under the proposed regulations would approximately double. For transfers of minority interests in entities principally holding securities, the valuations will increase by approximately 50 percent.

Many tax professionals and commentators believe the proposed regulations are beyond the authority of the Secretary of the Treasury and are an overreach by the Department. Litigation over their validity is likely.

In addition to the uncertainty concerning the validity of the proposed regulations, those planning their estates face the additional uncertainty of actual law changes by Congress as opposed to new regulations. The current presidential candidates have expressed very different ideas on the future of death and gift taxes. One stated that elimination of the taxes is the goal. The other would make death and estate taxes apply to many more people by returning to the 2009 law when the exclusion was $3.5 million per person for death taxes and $1 million per person for the gift tax exemption with both at a 45 percent tax rate, or five percent more than the current tax rate.

The proposed regulations will not take effect until after a 90-day "discussion period" but are expected by some to be effective before year end. Transfers by gift or death occurring before the regulations become effective will not be subject to these new rules. Accordingly, taxpayers who are contemplating significant gifts might want to consider completing the gifts as soon as conveniently possible, but at least by December.

Now is the Time to Act
(on Property Taxes)

The quote of Learned Hand appearing at the top of Page 1 of this newsletter is from his opinion in a landmark federal income tax case. We believe the principle is also fully applicable to local property taxes. Northwest Louisiana has some of the highest property tax rates (millage) in the state, which are fixed by the voters and not subject to individual change. Good stewardship and prudence demand that those paying significant property taxes pay attention to the amount of their property tax assessment (the factor multiplied by the millage to reach the amount of the tax), which can be reviewed and, where in error, can be changed by discussion with the Assessor.

August and early September is the best time to correct an over-assessment of real property and business movable property. Once the property tax bills are mailed (usually in November), it is almost impossible to change an assessment. In mid-August, each parish assessor will (as required by law) open the 2016 assessment rolls for public review and inspection for a minimum of 15 days. During this inspection period, property owners can challenge the validity of the tax assessment. Unfortunately, the review period is very short (only 11 business days in Caddo Parish and 12 in Bossier Parish), and there apparently is no recourse if a timely protest is not made.

You can check the assessed value of your real property (as well as that of nearby property for comparison) in Caddo and Bossier Parishes by using the assessors' websites. For Caddo Parish, the web address is www.caddoassessor.org. For Bossier Parish, the assessor's web address is www.bossierparishassessor.org.

Because property tax assessments are a percentage of the fair market value of your property, one way to determine if your property taxes are the appropriate amounts is to compare the assessor's determination of the fair market value of your property with what you believe its fair market value to be. The assessed value of a property is a percentage of the assessor's estimate of its fair market value. Accordingly, you can compute the fair market value that the tax assessor has placed on your property from the notices of assessed values mailed to you by the assessor or by visiting the assessors' websites.

Because 2015 was a reappraisal year, the 2016 assessed values of real estate should generally be different from 2015's assessed values. Business personal property (furniture, fixtures, equipment, and inventory) is reappraised each year by the parish assessors.

If your property is in Caddo Parish, the 15-day review and protest period will start on August 18 and will close on September 1. In early August, the assessor will mail notices showing the amount of the assessments on all property. By using the assessor's website, you no longer have to go to the Caddo Assessor's Office to check your real estate assessment. You can check it now without waiting until August 18. The assessor also encourages you to check your assessment and to come in to discuss it at any time, not just during the public review period.

If your property is in Bossier Parish, the rolls will open for review and protest on August 16 and will close on August 31. By using the assessor's website, you no longer have to go to the Bossier Parish Assessor's office to check the assessment on your real property. If you want to discuss your assessment with the assessor, however, you should go to the Bossier Parish Assessor's office in Benton. The assessor also encourages you to come in to discuss your assessment at any time, not only during the public review period.

If you do find that the determination of the value of your property is excessive and if you are unable to reach an agreement with the assessor as to the value, you should file a written protest before the end of the public review period to preserve your rights to have your assessment reconsidered by the Board of Review. Form 3101 can be obtained from the assessors for use in making a written protest. Form 3101 is also available on the Louisiana Tax Commission's website – www.latax.state.la.us.

Cole, Evans & Peterson, CPAs
www.cepcpa.com

624 Travis Street   Shreveport, Louisiana 71101   (318) 222-8367

Tax & Business Alert

AUGUST 2016

KNOW YOUR OPTIONS FOR BUSINESS INTEREST TRANSFERS

Business owners should always know their options when it comes to their company and its relation to their estate plans. Let's take a look at some commonly chosen vehicles for transferring ownership interests in a business.

THE GREAT GRAT

With a grantor retained annuity trust (GRAT), you transfer business interests or other assets to an irrevocable trust. The trust then pays you a fixed annuity for a specified number of years, and at the end of the trust term the trust assets are transferred to your children or other beneficiaries free of any additional gift tax, even if the property has appreciated while held in trust.

GRATs offer several important advantages. Gift tax is based on the actuarial value of your beneficiaries' future interest in the trust assets at the time the trust is funded. Depending on the size of the annuity payments and the length of the term, this value can be very low and can even be "zeroed out." Also, you remain in control of the business during the trust term. And the annuity payments provide a source of income to fund your retirement or other needs.

Keep in mind that for a GRAT to succeed you *must* survive the trust term, and your business must generate enough income to cover the annuity payments. Also, be aware that legislation has been proposed that would limit the benefits of a GRAT.

THE INTRIGUING IDGT

An intentionally defective grantor trust (IDGT) is an irrevocable trust designed so that contributions to the trust are considered completed gifts for gift and estate tax purposes even though the trust is considered a "grantor trust" for income tax purposes. (That's the "defect.") But the trust is very effective because the trust assets won't be included in your estate. Selling your business to an IDGT, rather than giving it to your beneficiaries outright, allows you to retain control over the business during the trust term while still enjoying significant tax benefits.

Maintaining grantor trust status is important for two reasons: First, *you* pay income taxes on the trust's earnings. Because those earnings stay in the trust rather than being used to pay taxes, you're essentially making additional tax-free gifts to your beneficiaries. Second, because a grantor trust is considered your "alter ego" for income tax purposes, distributions you receive from the trust generally will be tax-free.

4 MORE OPTIONS FOR TRANSFERRING OWNERSHIP INTERESTS

In addition to GRATs and IDGTs (see main article), there are several other options for transferring family business interests to the younger generation, including:

1. **Outright gifts.** If you're willing to relinquish control, you can transfer substantial interests tax-free using the $5.45 million exemption.
2. **Installment sales to family members.** These offer significant gift and estate tax savings, provided you're ready to part with the business.
3. **Self-canceling installment notes.** These require the buyer to pay a significant premium. But, if the seller dies before the note is paid off, the remaining payments are canceled without triggering additional gift or estate taxes.
4. **Family limited partnerships.** These arrangements enable you to transfer large interests in the business to family members at discounted gift tax values, while retaining management control. The IRS does scrutinize them closely, however.

THE NEED FOR A PLAN

For business owners, strategic planning and estate planning should go hand in hand. To achieve your goals, develop an integrated approach that addresses ownership and management succession issues together with estate planning issues. For help gathering the right information and making the best choice for you, please contact us. ■

ARE YOU *SURE* YOU WANT TO TAKE THAT 401(K) LOAN?

With summer headed toward its inevitable close, you may be tempted to splurge on a pricey "last hurrah" trip. Or perhaps you'd like to buy a brand new convertible to feel the warm breeze in your hair. Whatever the temptation may be, if you've pondered dipping into your 401(k) account for the money, make sure you're aware of the consequences before you take out the loan.

PROS AND CONS

Many 401(k) plans allow participants to borrow as much as 50% of their vested account balances, up to $50,000. These loans are attractive because:

- They're easy to get (no income or credit score requirements),
- There's minimal paperwork,
- Interest rates are low, and
- You pay interest back into your 401(k) rather than to a bank.

Yet, despite their appeal, 401(k) loans present significant risks. Although you pay the interest to yourself, you lose the benefits of tax-deferred compounding on the money you borrow.

You may have to reduce or eliminate 401(k) contributions during the loan term, either because you can't afford to contribute or because your plan prohibits contributions while a loan is outstanding. Either way, you lose any future earnings and employer matches you would have enjoyed on those contributions.

Loans, unless used for a personal residence, must be repaid within five years. Generally, the loan terms must include level amortization, which consists of principal and interest, and payments must be made no less frequently than quarterly.

Additionally, if you're laid off, you'll have to pay the outstanding balance quickly — typically within 30 to

90 days. Otherwise, the amount you owe will be treated as a distribution subject to income taxes and, if you're under age 59½, a 10% early withdrawal penalty.

HARDSHIP WITHDRAWALS

If you need the money for emergency purposes, rather than recreational ones, determine whether your plan offers a hardship withdrawal. Some plans allow these to pay certain expenses related to medical care, college, funerals and home ownership — such as first-time home purchase costs and expenses necessary to avoid eviction or mortgage foreclosure.

Even if your plan allows such withdrawals, you may have to show that you've exhausted all other resources. Also, the amounts you withdraw will be subject to income taxes and, except for certain medical expenses or if you're over age 59½, a 10% early withdrawal penalty.

Like plan loans, hardship withdrawals are costly. In addition to owing taxes and possibly penalties, you lose future tax-deferred earnings on the withdrawn amounts. But, unlike a loan, hardship withdrawals need not be paid back. And you won't risk any unpleasant tax surprises should you lose your job.

THE RIGHT MOVE

Generally, you should borrow or take hardship withdrawals from a 401(k) only in emergencies or when no other financing options exist (and your job is secure). For help deciding whether such a loan would be right for you, please call us. ■

HOW TO ASSESS THE IMPACT OF A CHILD'S INVESTMENT INCOME

When they're old enough to understand the concepts, some children start investing in the markets. If you're helping a child learn the risks and benefits of investments, be sure *you* learn about the tax impact first.

POTENTIAL DANGER

For the 2016 tax year, if a child's interest, dividends and other unearned income total more than $2,100, part of that income is taxed based on the parent's tax rate. This is a critical point because, as joint filers, many married couples' tax rate is much higher than the rate at which the child would be taxed.

Generally, a child's $1,050 standard deduction for unearned income eliminates liability on the first half of that $2,100. Then, unearned income between $1,050 and $2,100 is taxed at the child's lower rate.

But it's here that potential danger sets in. A child's unearned income exceeding $2,100 may be taxed at the parent's higher tax rate if the child is under age 19 or a full-time student age 19–23, but not if the child is over age 17 and has earned income exceeding half of his support. (Other stipulations may apply.)

SIMPLIFIED APPROACH

In many cases, parents take a simplified approach to their child's investment income. They choose to include their son's or daughter's investment income on their own return rather than have him or her file a return of their own.

Basically, if a child's interest and dividend income (including capital gains distributions) total more than $1,500 and less than $10,500, parents may make this election. But a variety of other requirements apply. For example, the unearned income in question must come from only interest and dividends.

MANY LESSONS

Investing can teach kids about the time value of money, the importance of patience, and the rise and fall of business success. But it can also deliver a harsh lesson to parents who aren't fully prepared for the tax impact. We can help you determine how your child's investment activities apply to your specific situation. ■

COLE EVANS & PETERSON
624 TRAVIS ST STE 500
SHREVEPORT, LA 71101-3014

HEADS UP! ITEMIZED DEDUCTIONS MAY BE AHEAD

Year end may seem far away. But now's a good time to start looking ahead to what itemized deductions you may be able to claim for the 2016 tax year.

Following is a list of selected deduction and exclusion items to consider. Don't use the list as a tax planning worksheet. Rather, think of it as an exercise to help with your tax planning efforts and a good conversation starter for the next time we visit. Bear in mind that various limitations may apply to the items listed.

DEDUCTIBLE UNREIMBURSED EMPLOYEE EXPENSES

- Business travel expenses.
- Business education expenses.
- Professional organization or chamber of commerce dues.
- License fees.
- Impairment-related work expenses.
- Depreciation on home computers your employer requires you to use in work.

DEDUCTIBLE MONEY MANAGEMENT COSTS

- Tax preparation fees.
- Depreciation on home computers used to produce investment income.
- Investment interest expenses.
- Dividend reinvestment plan service charges.
- Loss of deposits due to financial institution insolvency.

DEDUCTIBLE PERSONAL EXPENDITURES

- Income, real estate and personal property taxes (state, foreign and local).
- Medical and dental expenses.
- Qualifying charitable contributions.
- Personal casualty and theft losses.

INCOME EXCLUDABLE FROM TAXABLE INCOME

- Health and most life insurance proceeds.
- Military allowances and veterans benefits.
- Some scholarship and grant proceeds.
- Some Social Security benefits.
- Workers' compensation proceeds. ■