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April 2024

A Time for Appreciation

"The Times They Are A-Changin..."
Bob Dylan

We know we are not as observant as Bob Dylan but we do try to keep up with changing times. We have, for many years, closed our office on the day following the end of tax season – this year, April 15. One thing that has changed is it seems that most of us (staff and partners) now prefer a long weekend over having an isolated day off. Accordingly, we will not be off on April 16, 2024, which will be a regular duty day. We will have our staff Appreciation Luncheon on Thursday, April 18th and will be closed that afternoon and all-day Friday, April 19, 2024, providing an opportunity for a long weekend. We are grateful to our clients for the opportunity of working for them and to our staff for their excellent performance. To both we say, thank you.

Generally True – But Not Precise

The first paragraph of the article concerning *Payable-on-Death Accounts* on the back page of the accompanying Tax & Business Alert is generally true and for Louisiana is probably true except for the last four words – "and even brokerage accounts."

Generally, Louisiana, with specific exceptions, requires assets to be transmitted through probate, which is usually less difficult in Louisiana than in most states. We understand that Louisiana's statutory recognition of non-probate dispositions includes retirement accounts, life insurance, annuities, and deposits and savings accounts, credit union accounts, and savings and loans association accounts. Not included in that list, however, are brokerage accounts.

The Louisiana 4th Circuit Court of Appeal in June of 2020 held that a transfer on death ("TOD") designation form for a brokerage account was valid. The Louisiana 5th Circuit Court of Appeal and the Louisiana 2nd Circuit Court of Appeal, however, have both ruled brokerage account TOD designation forms to be invalid. Accordingly, it appears that the best practice for now is not to rely on payable-on-death or transfer-on-death designation of beneficiary forms to transmit brokerage accounts in Louisiana, but instead to include them in the probate succession through your will.

BUFFETT SAYS

"We want to own either all or a portion of businesses that enjoy good economics that are fundamental and enduring. Within capitalism, some businesses will flourish for a very long time while others will prove to be sinkholes. It's harder than you would think to predict which will be the winners and losers. *And those who tell you they know the answer are usually self-delusional or snake-oil salesman* {emphasis added}."

Warren Buffett
In His 2024 Letter to the Shareholders of Berkshire Hathaway, Inc.

BEATING THE MARKET

It is extremely difficult to achieve long-term investment returns superior to that available to investors in a low-cost, passively managed, broad U.S. stock market index fund such as one tracking the S&P 500 Index. Such funds are available from mutual fund companies including Vanguard, Charles Schwab, Fidelity, and several others.

An article in The Wall Street Journal of January 17, 2024 discloses the returns on the Harvard College endowment fund, which (at about $51 billion) is the largest college endowment in the U.S. It is managed by Harvard Management Company, Inc. Approximately 70 percent of its investments are in private equity and in hedge funds. Only 11 percent is in public equities. The article stated "Harvard's endowment has gained an average of 8.2 percent a year over the past 10 fiscal years ended June 30 and 9.1 percent the past five years." The 500 Index Fund Admiral shares available from Vanguard (one of the largest fund companies) reported an average annual total return for the 10 years ended June 30 of 12.82 percent and for the five years ended June 30 of 12.27 percent. In other words, the Harvard Endowment for the 10-year period underperformed by 4.6 percent and for the five years underperformed by 3.2 percent.

One well-known investor who outperformed the S&P 500 was David Swensen who created the Yale Model, which produced an annualized return of 12.5 percent for the period from 1985 to 2020 outperforming the S&P 500, which returned 9.7 percent over the same period according to an article by Oddmund Groette, published by Quantified Strategies on the Internet. Mr. Swensen generally recommended index funds for the average investor. Similarly, Warren Buffett at Berkshire Hathaway has produced an annualized return above that of the S&P 500 for over 50 years. Mr. Buffett recommends S&P 500 Index investing for most of us. He has informed the trustees of his bequest to his wife to put 90 percent in a very low-cost S&P 500 index fund and 10 percent in government securities.

Investors like Warren Buffett and David Swensen appear infrequently and are difficult to find. Accordingly, it is extremely difficult to "beat the market" (i.e., exceed the investment return of a passive S&P 500 or total stock market fund) over a long period time. Most of us (and possibly some of the college endowments) might benefit from having a large part of our investment capital in such funds.

How can it be that an average investor can invest in a passively managed, broad U.S. stock market index fund and outperform large endowments and pensions funds that hire the very top investment managers? This passive investment allows its investors to participate fully in the American economy (the most productive economy in the world) at a very low cost. Passive investment avoids the high cost of individual stock management (.66 percent per year according to the Investment Company Institute compared to .04 percent or less for passive index funds), hazards of market timing, and the heavy cost of selecting hedge funds, private equity investments, individual stocks, etc. seeking to outperform publicly listed stocks. Additionally, the equity index fund provides significant tax advantages to investors who do not enjoy tax exemption or tax deferral.

We remain convinced that passively managed, broad U.S. stock market index funds will, over the long-term, outperform almost all active money managers.

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Tax & Business Alert

APRIL 2024

TAX RECORDS: WHAT CAN YOU TOSS AND WHAT SHOULD YOU KEEP?

Generally, the IRS has three years to audit a tax return, from the later of the due date of the return, or the date you file. You can also file an amended return within this time frame if you overlooked something. Here's what you need to know about keeping financial records involved in your tax returns.

FEDERAL TAX RECORDS

Despite the three-year guideline, many tax advisors recommend retaining copies of your finished tax returns *indefinitely* to prove that you filed. Even if you don't keep returns indefinitely, at least keep them for six years after the returns are due or filed, whichever is later. It's a good idea to keep the records that support items on your individual tax return until the three-year statute of limitations runs out. Supporting records include canceled checks, charitable contributions receipts, mortgage interest payments and retirement plan contributions. These documents may also support an amended tax return if you find you overlooked something.

So which records can you throw away today? Based on the three-year rule, generally you'll soon be able to throw out most records associated with your 2020 return if you filed by the 2020 due date (which was extended to May due to the pandemic). Extended 2020 returns could still be vulnerable to audit until October of 2024.

Also, some tax issues are still subject to scrutiny after the three years. If the IRS suspects that income has been understated by 25% or more, the statute of limitations for audit rises to six years. If no return was filed or if fraud is suspected, there's no limit of time for the IRS to launch an inquiry.

Certain records that support figures that may affect multiple years, such as carryovers of charitable deductions, should be saved until the deductions no longer have effect. Also, don't toss out records that support deductions for bad debts or worthless securities that could result in refund claims, because you have up to seven years to claim them.

STATE TAX RECORDS

The previous guidelines are geared toward complying with federal tax obligations. We can instruct you regarding your state's statute of limitations.

Plus, states generally have the right to resolve their own issues related to federal tax returns that have been audited. So, hold on to records related to an IRS audit for a year after it's completed.

REAL ESTATE RECORDS

Retain real estate records for as long as you own a property, plus three years after you dispose of it and report the transaction on your tax return. Throughout ownership, keep records of the purchase, home improvements, relevant insurance claims and refinancing documents.

These documents help prove your adjusted basis in the home, which is needed to figure any taxable gain at

the time of sale. They can also support rental property or home office deductions.

INVESTMENT ACCOUNT STATEMENTS

To accurately report taxable events involving stocks and bonds, you must maintain detailed records of purchases and sales. Records should include dates, quantities, prices, dividend reinvestment and related expenses. Keep these records for as long as you own the investments — plus additional time until the statute of limitations for the relevant tax returns expires.

The IRS requires you to keep copies of Forms 8606, 5498 and 1099-R until all the money is withdrawn from your IRAs. It's even more important to retain records of all transactions relating to Roth IRAs, in case you're ever questioned.

PURGE WITH CAUTION

Old tax records take up space and could lead to stolen identities if not properly disposed of. But purging too soon may leave you without a defense if the IRS has questions. When in doubt, hang on to records a little longer than you think is necessary. Contact us with questions. ■

IS YOUR BUSINESS CLOSING? HERE ARE YOUR FINAL TAX RESPONSIBILITIES

Businesses shut down for many reasons. Here are just a few:

- An owner's retirement,
- A lease expiration,
- Staffing shortages,
- Partner conflicts, and
- IIncreased supply costs.

If you've decided to close your business, you might need assistance with some steps in the process, including handling various tax obligations. For example, a final income tax return and related forms must be filed for the year of closing. The correct return to file depends on the type of business. Here's a rundown of the requirements.

Sole proprietorships. You must file the usual Schedule C, "Profit or Loss from Business," with your individual return for the year of closing. You may also need to report self-employment tax.

Partnerships. A partnership must file Form 1065, "U.S. Return of Partnership Income," for the year of closing and report capital gains and losses on Schedule D. Indicate that this is the final return and do the same on Schedules K-1, "Partner's Share of Income, Deductions, Credits, etc."

All corporations. Form 966, "Corporate Dissolution or Liquidation," must be filed if you adopt a resolution or plan to dissolve a corporation or liquidate any of its stock.

C corporations. File Form 1120, "U.S. Corporate Income Tax Return," for the year of closing. Report capital gains and losses on Schedule D. Indicate this is the final return.

S corporations. File Form 1120-S, "U.S. Income Tax Return for an S Corporation" for the year of closing. Report capital gains and losses on Schedule D. The "final return" box must be checked on Schedule K-1.

All businesses. If you sell your business, other forms may need to be filed to report the sales.

WORKER-RELATED DUTIES

Businesses with employees must pay the final wages and compensation owed, make final federal tax deposits and report employment taxes. Failure to withhold or deposit all employment taxes due can result in severe penalties.

Generally, payments of $600 or more to contractors during the calendar year of closure must be reported on Form 1099-NEC, "Nonemployee Compensation."

MORE TAX ISSUES TO CONSIDER

The list of tax issues related to closing a business is long and often complex, but we're available to guide you through the steps. For example, a business that has an employee retirement plan will need to terminate the plan and distribute the benefits to participants. Flexible Spending Accounts and Health Savings Accounts must also be terminated.

There may be debt cancellation issues to wrestle with. Other possibilities include dealing with net operating losses, passive activity losses, depreciation recapture and possible bankruptcy issues.

You need to be aware of how long to retain business records. And finally, you may need to know how to navigate payment options if your business is unable to pay the remaining taxes owed.

WE CAN HELP

Closing a business typically brings up a lot of questions. Contact us for the answers. ■

4 WAYS CORPORATE BUSINESS OWNERS CAN HELP ENSURE COMPENSATION IS "REASONABLE"

If you own a C corporation, you know there's a tax advantage to taking money out as compensation rather than as dividends. The reason: A corporation can deduct the salaries and bonuses that it pays executives, but it can't deduct dividend payments. Therefore, if funds are paid as dividends, they're taxed twice, once to the corporation and once to the recipient. Money paid out as compensation is taxed once — to the recipient employee.

However, the amount of money you can take out of the corporation this way is limited. Under tax law, only compensation deemed to be reasonable can be deducted. Any unreasonable portion isn't deductible, and may be taxed as if it were a dividend paid to a shareholder. Keep in mind that the IRS is generally very interested in unreasonable compensation payments made to someone "related" to a corporation, such as a shareholder-employee or a member of a shareholder's family.

STEPS TO HELP PROTECT YOURSELF

There's no simple way to determine what's reasonable. If the IRS audits your tax return, it will examine the amount that companies in similar industries would pay for comparable services under comparable circumstances. Factors considered include the employee's duties and the amount of time spent on those duties, as well as the employee's skills, expertise and compensation history. Other factors that may be reviewed are the complexities of the business and its gross and net income.

There are steps you can take to make it more likely that the compensation you earn will be considered "reasonable," and therefore deductible by your corporation. For example, you can:

1. Keep compensation in line with what similar businesses are paying their executives (and keep whatever evidence you find about what others are paying).

2. Contemporaneously document the reasons for compensation paid in the minutes of your corporation's board of directors. For example, if compensation is being increased in the current year to make up for earlier years when it was low, be sure the minutes reflect this. Cite any executive compensation or industry studies that back up your compensation amounts.

3. Avoid paying compensation in direct proportion to the stock owned by the corporation's shareholders. This can look like a disguised dividend and will probably be treated as such by IRS.

4. Pay at least some dividends if the business is profitable. This avoids giving the impression that the corporation is trying to pay out all of its profits as compensation.

The challenges are many, but you can avoid some problems by planning ahead. Contact us if you have questions or concerns about your situation. ■

TAX CALENDAR

April 15
Individuals must file (or extend) their 2023 personal returns and pay any tax due.

- Individuals, trusts and calendar-year corporations must pay first-quarter estimated taxes.
- Individuals must file a 2023 gift tax return or file for an extension and pay any gift tax due.
- Calendar-year trusts and estates must file 2023 returns or file for an extension.
- Calendar-year corporations must file a 2023 income tax return or file for an extension and pay any tax due.
- Individuals must file FinCEN Form 114 ("Report of Foreign Bank and Financial Accounts"), if required, but an automatic extension to October 15 applies.
- Individuals must make contributions to IRAs for 2023. SEP and profit-sharing plan contributions are also due if the return isn't being extended.

April 30
Employers must file Form 941 for the first quarter (May 10 if all taxes are deposited in full and on time). Also, employers must deposit FUTA taxes owed through March if the liability is more than $500.

May 15
Calendar-year exempt organizations must file (or extend) their 2023 Forms 990, 990-EZ or 990-PF returns.

June 17
Individuals, calendar-year corporations, estates and trusts must pay second-quarter 2024 estimated taxes.

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PAYABLE-ON-DEATH ACCOUNTS: BENEFICIAL TOOLS IF USED CORRECTLY

Payable-on-death (POD) accounts can provide a quick, simple and inexpensive way to transfer assets outside of probate. They can be used for bank or credit union accounts, certificates of deposit and even brokerage accounts.

Setting up such an account is as easy as providing the financial institution with a signed POD beneficiary designation form. Upon your death, your beneficiaries just need to present identification to the bank, provide the bank with a certified copy of a death certificate, and the money or securities will be theirs.

POTENTIAL PITFALLS

Be aware, however, that POD accounts can backfire unless they've been coordinated carefully with your estate plan. You want to prevent conflict with your will and other estate planning documents. For example, suppose Jack divides his assets equally among his three children in his will. He also sets up a POD account leaving $50,000 to his oldest child. That creates a conflict that may have to be resolved in court, delaying distribution of the estate and adding substantial legal fees.

Another potential problem with POD accounts is that, if you use them for most of your assets, the remaining assets may be insufficient to pay debts, taxes or other expenses. Your executor would then have to initiate a proceeding to bring assets back into the estate.

One way to use a POD account is to hold a modest amount of funds to pay funeral expenses, bills and other pressing cash needs while your estate is being administered. Utilizing these accounts for more substantial assets may lead to intrafamily disputes or costly litigation.

TURN TO US

If your estate plan includes POD accounts, be sure to review the rest of your plan carefully to avoid potential conflicts. We can help you coordinate the use of POD accounts with your estate plan. ■

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