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A BETTER WAY? (No Test – Less Stress)

The accompanying *Tax & Business Alert* includes an article on Page 3, “Stress Testing Your Investment Portfolio,” suggesting that investors should periodically perform a “stress test” on their investment portfolio. The purpose of this activity is to identify vulnerabilities in their investment plan and to understand how their portfolio might react to extreme volatility, a severe or prolonged bear market, increasing inflation, and rising interest rates.

Savers who can accept a long-term philosophy (that is, the capacity to commit savings for the long-term – at least 10 years, preferably 15 years or more) and the discipline to endure the steep market drops, which are certain to happen, may want to consider a simple alternative – buy and hold

equities for the long-term. For such investors, passive investing in index funds should have great appeal. It minimizes fees and income taxes, resulting in after-tax accumulations that, in longer periods, exceed those from active management by the vast majority of individual investors and money managers.

Using the *2021 SBGI Yearbook*[®], which furnishes annual data on U.S. capital market performance by asset class, we have compiled the following compound annual investment returns for all 10-year, 20-year, and 30-year periods from 1926 through 2020 for large cap stocks (S&P 500), long-term corporate bonds, and long-term U.S. government bonds. The results are summarized as follows:

Large Cap Stocks (S&P 500):	30-Years	20-Years	10-Years
Average Return	11.16%	10.83%	10.43%
Highest Return	13.74%	17.88%	20.06%
Lowest Return	8.47%	3.11%	-1.38%

Long-Term Corporate Bonds:	30-Years	20-Years	10-Years
Average Return	6.01%	5.99%	6.11%
Highest Return	10.83%	12.13%	16.32%
Lowest Return	1.79%	1.34%	0.98%

Long-Term US Government Bonds:	30-Years	20-Years	10-Years
Average Return	5.66%	5.67%	5.68%
Highest Return	10.99%	12.09%	15.56%
Lowest Return	1.53%	0.69%	-0.07%

No. of X-Year Periods with the Highest Return:	30-Years	20-Years	10-Years
Large Cap Stocks (S&P 500)	65	65	67
Long-Term Corporate Bonds	0	7	13
Long-Term US Government Bonds	1	4	6
Total Number of X-Year Periods	66	76	86

(Continued on reverse)

We believe the above numbers bear witness to what we have long held to be true. That is, for the long-term investor, buying and holding a broad-based, low-cost equity mutual fund (e.g., one that mirrors the S&P 500 or the entire US stock market) should result in a significantly higher return and accumulation than investing in bonds. Equally important in achieving these long-term investment returns is to continue holding (and buying) the equity investment through months and even years of a down or volatile market and to resist any impulse to react by selling.

One additional thought on equities versus fixed income investments – bonds, certificate of deposits, etc. Conventional advice often recommends that as one gets older, at or near retirement, there should be a reduction of investments in stocks and a transfer to a “safer”

investment in bonds or other fixed income. We suggest, however, that one’s age or retirement status does not necessarily determine one’s investment horizon. On the contrary, financially secure investors (those anticipating leaving a significant estate) might retain an investment horizon longer than their life expectancy as they are investing for themselves and their heirs. Consider the older individual or couple who is confident that they will not outlive their investments and who wish to pass down a financial legacy to family or charities. We believe it is appropriate for that individual or couple to continue a significant portion of their investment portfolio in equities regardless of their age.

In summary, passive equity investing for those who can “stay the course” is the best choice – better results – less stress.

IRS ONLINE

Many, if not most, tax practitioners have concluded over the recent several years that the only operative word in “Internal Revenue Service (IRS)” is revenue – that is, “service” has all but vanished as the result of an antiquated computer system, an inadequate IRS workforce, and the increasing need for communication privacy and identity theft measures. Incredibly long holds on taxpayer service lines (often of more than an hour) and months-long waits for responses to letters and faxes attempting to correct the many IRS notice errors, failure to properly apply payments, etc. have become commonplace. The pandemic has increased the already excessive cost and frustration of communicating with the IRS and resolving tax issues that arise.

Now some good news:

A recent announcement gives us hope that we may see better service in the very near future. The Internal Revenue Service allows individual taxpayers to set up online accounts for accessing certain information about their federal income tax returns and tax payments. Taxpayers who are interested (and technologically confident), will

find that direct access to the IRS account will be helpful in their understanding and in confirming information about their income tax returns and payments.

Taxpayer online accounts now include a welcomed feature that will allow the taxpayer to very quickly grant authority to a CPA or other tax practitioner to directly access the taxpayer’s online IRS records. Quick access will allow resolution of many problems relating to tax returns, payments, taxpayer notices, etc. in less time and at a lower cost. Previously, the only way a tax practitioner could gain access to the taxpayer’s account with the IRS was for a paper Form 2848 or Form 8821 to be filed with the IRS after being executed by the taxpayer and the tax practitioner. Recently, it has taken the IRS months to process the paper form and allow access by the practitioner to the taxpayer (client) record. With this new taxpayer online account feature, the taxpayer may grant “instant” authorization to the taxpayer’s representative. This will be a significant improvement in both tax problem resolution and in complex tax return preparation.

An IRS online account allows individual taxpayers and their representative to do the following:

- Access the IRS account transcripts, summary of tax returns, information returns (1099s, etc.)
- View tax payment history
- View any amount due according to IRS records
- Pay tax online (balances due and estimated taxes)
- Approve authorization requests from tax professionals
- Access certain other tax records

To set up an IRS online account, you may register through the following IRS website: <https://www.irs.gov/payments/view-your-tax-account>. Registration should be a relatively quick and simple process, especially if you have a cellphone to accept the IRS's verification texts. Setting up the account will require that you provide certain personal information (explained on the website) to verify your identity, e-mail address, cellphone number (if you have one), Social Security number, tax filing status, mailing address, and certain financial account information.

If you decide to create an IRS online account and would like our assistance, we will be happy to help.

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Tax & Business Alert

AUGUST 2021

KNOW THE NUANCES OF THE NANNY TAX

During the pandemic, more than a few families have hired household workers while schools in many areas have gone virtual and some day care centers have had limited availability. If you've done so, be sure you know the nuances of the "nanny tax."

WITHHOLDING TAXES

For federal tax purposes, a household worker is anyone who does household work for you and isn't an independent contractor. Common examples include housekeepers, child care providers and gardeners.

If you employ such a person, you aren't required to withhold federal *income taxes* from the individual's pay unless the worker asks you to and you agree. In that case, he or she would need to complete a Form W-4. However, you may have other withholding and payment obligations.

You must withhold and pay Social Security and Medicare taxes (FICA) if your worker earns cash wages of \$2,300 or more (excluding food and lodging) during 2021. If you reach the threshold, all wages (not just the excess) are subject to FICA.

However, if your worker is under 18 and child care isn't his or her principal occupation, you don't have to withhold FICA taxes. Therefore, if your worker is really a student/part-time babysitter, there's no FICA tax liability.

Both employers and household workers need to pay FICA. Employers are responsible for withholding the worker's share and must pay a matching employer amount. FICA tax is divided between Social Security and Medicare. Social Security tax is 6.2% for both the employer and the worker (12.4% total). Medicare tax is 1.45% each for both the employer and the worker (2.9% total). If you prefer, you can pay your worker's share of Social Security and Medicare taxes, instead of withholding it from pay.

REPORTING AND PAYING

You pay nanny tax by increasing your quarterly estimated tax payments or increasing withholding from your wages rather than making an annual lump-sum payment. You don't have to file any employment tax returns — even if you're required to withhold or pay tax — unless you own a business. Instead, your tax professional will report employment taxes on Schedule H of your individual Form 1040 tax return.



THE FINER POINTS OF FUTA

If you hire a household worker and pay that person \$1,000 or more in cash wages (excluding food and lodging) in any calendar quarter of this year or last year, you must pay federal unemployment (FUTA) tax. This tax applies to the first \$7,000 of wages. The maximum FUTA tax rate is 6%, but credits reduce it to 0.6% in most cases. FUTA tax is paid only by the employer.

On your return, your employer identification number (EIN) will be included when reporting employment taxes. The EIN isn't the same as your Social Security number. If you need an EIN, you must file Form SS-4.

However, if you own a business as a sole proprietor, you must include the taxes for your worker on the FICA and federal unemployment tax forms (940 and 941) that you file for your business. You

use the EIN from your sole proprietorship to report the taxes. You also must provide your worker with a Form W-2.

A KEEN AWARENESS

Retaining a household worker calls for careful recordkeeping and a keen awareness of the applicable rules. Contact us for assistance complying with your nanny tax obligations. ■

5 KEY POINTS ABOUT BONUS DEPRECIATION

Like most business owners, you've probably heard about 100% bonus depreciation. It's available for a wide range of qualifying asset purchases. But there are many important details to keep straight. Here are five key points about this powerful tax-saving tool:

1. It's scheduled to phase out. Under current law, 100% bonus depreciation will be phased out in steps for property placed in service in calendar years 2023 through 2027. Thus, an 80% rate will apply to property placed in service in 2023, 60% in 2024, 40% in 2025, and 20% in 2026, and a 0% rate will apply in 2027 and later years.

For some aircraft (generally, company planes) and for the pre-January 1, 2027, costs of certain property with a long production period, the phaseout is scheduled

to take place a year later, from 2024 to 2028. Of course, Congress could pass legislation to extend or revise the above rules.

2. Bonus depreciation is available for new and most used property. In the past, used property didn't qualify. It currently qualifies unless the taxpayer previously used the property or unless the property was acquired in specific forbidden transactions. (These are, generally, acquisitions that are tax-free or from a related person or entity.)

3. Taxpayers should sometimes elect to turn it down. Taxpayers can elect to reject bonus depreciation for one or more classes of property. The election out may be useful for certain businesses. These include sole proprietorships and business entities taxed under the rules for partnerships and S corporations that want to prevent "wasting" depreciation deductions by applying them against lower-bracket income in the year property was placed in service — instead of against anticipated higher bracket income in later years. Note that business entities taxed as "regular" corporations (in other words, those that aren't S corporations) are taxed at a flat rate.

4. Bonus depreciation is available for certain building improvements. Before the 2017 Tax Cuts and Jobs Act (TCJA), bonus depreciation was available for two types of real property: 1) land improvements other than buildings, such as fencing and parking lots,



and 2) qualified improvement property, a broad category of internal improvements made to non-residential buildings after the buildings are placed in service.

The TCJA inadvertently eliminated bonus depreciation for qualified improvement property. However, the CARES Act of 2020 made a retroactive technical correction to the TCJA. The correction makes qualified improvement property placed in service after December 31, 2017, eligible for bonus depreciation.

5. 100% bonus depreciation has reduced the importance of Section 179 expensing.

If you own a smaller business, you've likely benefited from Sec. 179 expensing. This is an elective benefit that — subject to dollar limits — allows an immediate deduction of the cost of equipment, machinery, off-the-shelf computer software and some building improvements. Sec. 179 has been enhanced by the TCJA, but the availability of 100% bonus depreciation is economically equivalent and has greatly reduced the cases in which Sec. 179 expensing is useful. ■

STRESS TESTING YOUR INVESTMENT PORTFOLIO

Many banks conduct regular “stress” tests to predict the impact of adverse external events on their earnings, capital and loan portfolios. Banks use the results to shore up any revealed weaknesses. Investors should periodically perform similar stress tests on their investment portfolios.

Stress testing is the ultimate “what if” analysis. It uses modeling techniques to predict the impact of an economic downturn, financial crisis or any number of other “worst case” scenarios on your wealth. By analyzing this information, you can identify vulnerabilities in your financial plan and make changes to enhance its probability of success.

There's virtually no limit to the scenarios you can test. Common examples include extreme market volatility, a severe or prolonged bear market, increasing inflation, and rising interest rates. Think about current events, too. How would, say, a fuel crisis driven by a massive cyberattack affect your portfolio?

One useful exercise is to take the contents of your actual portfolio and calculate the outcome had you owned the identical investments on the eve of a historical financial crisis. Such testing can reveal potential weaknesses in your portfolio and help you pinpoint strategies to mitigate them.

For example, you might change the assumptions in your scenario analysis to see how your portfolio would respond if it were more heavily allocated to bonds rather than equities, or if it were more diversified by region, sector or other factors. While there are no guarantees, this type of stress testing can help you identify asset allocations that increase your probability of weathering various storms and ultimately meeting your financial goals.

Stress testing tends to focus on negative scenarios, but don't ignore the positive. Incorporating positive market developments in your scenario analysis — such as the resurgence of a struggling sector or improved stability in a volatile market — can help you ensure that you're invested in the right vehicles to maximize upside potential.



Of course, stress testing can tell investors only so much. During the recent pandemic, many stocks soared despite economic conditions that would suggest they'd be under greater downward pressure. So, talk with your financial advisors about the potential benefits — and limitations — of stress testing. The goal is to develop a resilient financial plan that's customized to your specific circumstances and goals. ■

COMPILING A MARITAL BALANCE SHEET IN DIVORCE

Divorce is difficult for almost everyone. Being organized can help facilitate the process. A financial expert can help you with the first step, which is generally to compile a marital balance sheet. This document shows the assets owned and the liabilities owed by the couple.



Typical assets include the money in savings and checking accounts; vehicles and equipment; and principal residences, vacation homes and other real property. The balance sheet will also show 401(k) accounts, IRAs, pensions and other retirement savings, as well as marketable securities. In addition, jewelry, artwork, furniture and other personal assets will be listed. If either of the couple (or both) own private business interests, those will be reflected as well.

Examples of marital liabilities include credit card debt, student loans, home mortgages and lines of credit, vehicle loans, and retirement account loans. Whether the couple's individual assets and liabilities are includable in the marital estate is generally a matter of law, which varies by state.

Values must be assigned to the assets and liabilities cataloged. The value of bank accounts, retirement accounts and debts can be taken from the latest account statement. But other items, such as real estate, collectibles and private business interests, may require an independent outside appraisal.

If the parties own an interest in a closely held business, selling usually isn't an option. Instead, a business valuation expert should be used to determine its "fair value." Any value not attributable to net tangible assets and identifiable intangible assets is considered "goodwill." The treatment of goodwill in divorce varies from state to state. Ultimately, it's critical to have a qualified financial expert determine what should and shouldn't be includable in a marital estate based on the specific facts and circumstances. ■