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SOCIAL SECURITY RETIREMENT BENEFITS – WHEN TO START?

Most of us who are looking toward receiving Social Security benefits face a decision about when to start collecting. Early benefits can begin at age 62. Full retirement traditionally began at age 65 but now ranges between ages 66 and 67, depending on one's birth year. Choosing early Social Security retirement reduces the monthly benefit for life. Delaying Social Security benefits past full retirement (up to age 70) increases the monthly benefit for life.

One significant negative consequence of choosing early retirement is that the monthly benefit is reduced if one continues to work until full retirement age. Once full retirement age is reached, however, there is no benefit reduction for receiving employment or self-employment earnings.

So, how does one decide when to start receiving benefits? There are, of course, many personal factors involved in that decision. At age 62, are you still working? Are your other financial resources limited so that you need the money now for living expenses? Can you afford to defer benefits beyond normal retirement to age 70? In addition, there are future uncertainties that are beyond your control. Are you healthy with a normal life expectancy? What changes in the Social Security system might occur in the future? While we do not know the answers to those questions, we can make some assumptions and do the math to

compare the results of the decision of when to start Social Security benefits.

In our comparison, we assumed that the individual at age 62 does not work so that there is no early benefit reduction. We also assumed that a monthly net benefit of \$1,500 is available in the first year of early retirement (age 62), \$1,989 is the monthly benefit when benefits begin at full retirement age 66, and \$2,625 is the monthly benefit when benefits begin at age 70. We further assumed that the entire monthly benefit amount (subject to annual cost-of-living increases) is not spent but is invested earning an annual four percent return. The resulting accumulations are as follows:

Age	Accumulation		
	Early Retirement (Age 62)	Normal Retirement (Age 66)	Delayed Retirement (Age 70)
70	204,491	142,871	35,797
75	364,066	326,684	222,185
80	566,271	561,008	461,432
85	820,902	857,524	765,868
90	1,139,923	1,230,508	1,150,556
95	1,537,923	1,697,381	1,633,874

While most people will consume much of their net Social Security benefit rather than invest it, we believe this illustrates that a person with at least a normal life expectancy will generally be best served by choosing their normal retirement age to begin Social Security benefits.

"PAY ME NOW OR PAY ME MORE LATER"

The accompanying *Business and Tax Alert* includes a first page article concerning reconsideration by business owners of their choice of business organization. Should we operate as a C corporation, which pays its own income tax at a top federal rate of 21 percent? Or, is it better to operate as a pass-through entity (subchapter S corporation, limited liability company, partnership, sole proprietor) with a top federal tax rate of 28 percent (top individual rate of 35 percent reduced by the 20 percent pass-through reduction = 28 percent) and likely pay less tax on sale or liquidation of the business?

It is impossible to determine the best entity without a detailed analysis of facts and circumstances along with a reasonably accurate prediction of the future. Some owners, after analysis, will pay the lowest current tax (pay me now) and discount the likelihood of paying the larger second tax on the sale or liquidation.

However, after a thorough analysis of the cost of the change and the increased complexity of corporate operation (whether tax paying C corporations or pass-through S corporations), we believe that most owners of limited liability companies, partnerships, and sole proprietors will decide that, all things considered, operating in a pass-through entity is their best choice.

After 17 months of experience with the new business tax rules, we can generalize with another old cliché, "one size does not fit all." Business owners will be well served by considering the details of their situation and their best estimate of their business's future and then choosing accordingly. While operating as a tax-paying C corporation will be the best for some business owners, most will likely conclude that a pass-through entity with a higher current tax rate, less complexity, more flexibility, and lower future taxes is best for them.

FUND EARLY AND FULLY

Most of us are generally aware (and usually amazed) at the favorable long-term effects of compounding on tax-deferred (or, for Roth accounts, tax-free) accumulations within IRAs, pension and profit-sharing plans, 401(k)s, etc. For example, an annual investment of \$6,000 (the 2019 under-age-50 IRA contribution limit) on the last day of each year of a 30-year accumulation cycle results in \$981,375 at 9.97 percent (the total return of the S&P 500 Index over the 30 years ended December 31, 2018). An investment on the first day of each year of a 30-year period compounded at the same 9.97 percent total return accumulates to \$1,079,219. Thus, the

early funding of a tax-deferred plan or IRA results in an increase of \$97,844 in the ultimate accumulation under the above assumptions. Accordingly, where funds are available, a saver is best served by the funding of all available tax-favored accounts at the earliest possible time. Although company-sponsored plans (e.g., 401(k), profit-sharing, etc.) might not be available to everyone, every individual under age 70½ with earned income (including dependents) can choose to fund a traditional or Roth IRA. Acquiring the savings capacity and habit early in life is significant in obtaining financial security. Funding investments as early as possible is also very helpful.

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Tax & Business Alert

JUNE 2019

TCJA INSPIRES MANY BUSINESS OWNERS TO RECONSIDER ENTITY CHOICE

For tax years beginning in 2018 and beyond, the Tax Cuts and Jobs Act (TCJA) created a flat 21% federal income tax rate for C corporations. Under prior law, C corporations were taxed at rates as high as 35%.

Meanwhile, the TCJA also reduced individual income tax rates, which apply to sole proprietorships and owners of pass-through entities, including partnerships, S corporations, and, typically, limited liability companies (LLCs). The top rate, however, dropped only slightly, from 39.6% to 37%.

What does all of this mean for business owners? Among other things, it means now might be a good time to reconsider your company's entity choice — if not this year, then perhaps for the 2020 tax year. On the surface, switching to (or staying) a C corporation may seem like a no-brainer. But there are many other considerations involved.

CONVENTIONAL WISDOM

Under prior tax law, conventional wisdom was that most small businesses should be set up as sole proprietorships or pass-through entities to avoid the double taxation of C corporations. A C corporation pays entity-level income tax and then shareholders pay tax on dividends — and on capital gains when they sell the stock. For pass-through entities, there's no federal income tax at the entity level.

Although C corporations are still potentially subject to double taxation under the TCJA, their new 21%

tax rate helps make up for it. This issue is further complicated, however, by another provision of the TCJA that allows noncorporate owners of pass-through entities to take a deduction equal to as much as 20% of qualified business income (QBI), subject to various limits. But, unless Congress extends it, the break is available only for tax years beginning in 2018 through 2025.

SCENARIOS TO PONDER

There's no one-size-fits-all answer when deciding how to structure a business. The best choice depends on your company's distinctive circumstances, as well as your financial situation and objectives as owner.



For instance, if your business consistently generates tax losses, there's no advantage to operating as a C corporation. Losses from C corporations can't be

IS YOUR COMPANY FOCUSED ON GROWTH?

Some companies — particularly start-ups and those in “hot” industries — may turn a profit but hold on to those bottom-line dollars to fund future growth. For these businesses, operating as a C corporation generally is advantageous if the corporation is a qualified small business (QSB).

Why? A 100% gain exclusion may be available for QSB stock sale gains. If QSB status is unavailable, operating as a C corporation could still be preferred — unless significant qualified business income deductions would be available at the owner level. (For more on this exclusion, contact us.)

deducted by their owners. So, converting to a pass-through entity may make sense because, as their name indicates, these business structures allow losses to *pass through* to the owners’ personal tax returns.

Another example involves companies that distribute profits to owners. For a profitable business that does so, operating as a pass-through entity

generally will be better if significant QBI deductions are available. If not, it’s probably a toss-up in terms of tax liability.

MANY CONSIDERATIONS

These are only a few of the issues to consider when rethinking your company’s business structure. We can help you evaluate your options. ■

CONSIDER THE TAX ADVANTAGES OF QUALIFIED SMALL BUSINESS STOCK

While the Tax Cuts and Jobs Act (TCJA) reduced most ordinary-income tax rates for individuals, it didn’t change long-term capital gains rates. They remain at 0%, 15% and 20%.

The capital gains rates now have their own statutory bracket amounts, but the 0% rate generally applies to taxpayers in the bottom two ordinary-income tax brackets (now 10% and 12%). And, you no longer must be in the top ordinary-income tax bracket (now 37%) to be subject to the top long-term capital gains rate of

20%. Many taxpayers in the 35% tax bracket also will be subject to the 20% rate.

So, finding ways to defer or minimize taxes on investments is still important. One way to do that — and diversify your portfolio, too — is to invest in qualified small business (QSB) stock.

QSB DEFINED

To be a QSB, a business must be a C corporation engaged in an active trade or business and must not have assets that exceed \$50 million when you purchase the shares.

The corporation must be a QSB on the date the stock is issued and during substantially all the time you own the shares. If, however, the corporation’s assets exceed the \$50 million threshold while you’re holding the shares, it won’t cause QSB status to be lost in relation to your shares.

TWO TAX ADVANTAGES

QSBs offer investors two valuable tax advantages:

- 1. Up to a 100% exclusion of gain.** Generally, taxpayers selling QSB stock are allowed to exclude a portion of their gain if they’ve held the stock for more



than five years. The amount of the exclusion depends on the acquisition date. The exclusion is 100% for stock acquired on or after Sept. 28, 2010. So, if you purchase QSB stock in 2019, you can enjoy a 100% exclusion if you hold it until sometime in 2024. (The specific date, of course, depends on the date you purchase the stock.)

2. Tax-free gain rollovers. If you don't want to hold the QSB stock for five years, you still have the opportunity to enjoy a tax benefit: Within 60 days of selling the stock, you can buy other QSB stock with the proceeds and defer the tax on your gain until you dispose of the new stock. The rolled-over gain

reduces your basis in the new stock. For determining long-term capital gains treatment, the new stock's holding period includes the holding period of the stock you sold.

MORE TO THINK ABOUT

Additional requirements and limits apply to these breaks. For example, there are many types of businesses that don't qualify as QSBs, ranging from various professional fields to financial services to hospitality and more. Before investing, it's important to also consider nontax factors, such as your risk tolerance, time horizon and overall investment goals. Contact us to learn more. ■

VACATION HOMES: DO YOU UNDERSTAND THE TAX NUANCES?

Owning a vacation home can offer tax breaks, but they may differ from those associated with a primary residence. The key is whether a vacation home is used solely for personal enjoyment or is also rented out to tenants.

SORTING IT OUT

If your vacation home is not rented out, or if you rent it out for no more than 14 days a year, the tax benefits are essentially the same as those you'd receive if you own your primary residence. In this scenario, you'd generally be able to deduct your mortgage interest and real estate taxes on Schedule A of your federal income tax return, up to certain limits. Also, you may exclude all your rental income.

But the rules are different if you rent out your vacation home for 15 or more days annually. First, the rental income must be reported. Second, in this scenario, the IRS considers your vacation home to be an investment property and, thus, allows deductions related to the rental of the property, with certain limitations. In addition to mortgage interest and real estate taxes, these deductions generally include insurance, utilities, housekeeping, repairs and depreciation. Also, the deduction for certain categories of expenses cannot exceed the rental income.

If you exceed this number of days of rentals and use your vacation home for personal use, these deductions will be limited by the ratio of actual rental days to the total days of use of the home. Suppose, for example, that you personally use your vacation home for 25 days and rent it for 75 days in a year, so the



home is used for 100 total days. Here, you would be allowed to deduct 75% of the expenses listed above as rental expenses. Be aware that a portion of the mortgage interest and real estate taxes may be deductible on Schedule A. In certain circumstances, however, the personal portion of your mortgage interest may not be deductible.

BOTTOM LINE

If you want to maximize the tax benefits of your vacation home, limit your personal use of the home to no more than 14 days or 10% of the total rental days. If you want to personally use the home more than this, you can still realize some limited tax benefits. Contact our firm for details about your specific situation. ■

ENSURING YOUR LONG-TERM CARE POLICY IS TAX-QUALIFIED

A long-term care insurance policy supplements your traditional health insurance by covering services that assist you or a loved one with one or more activities of daily living. Such activities include eating, bathing, dressing, toileting and transferring (in and out of bed, for example).



Long-term care coverage is relatively expensive, but it may be possible to reduce the cost by purchasing a tax-qualified policy. Generally, benefits paid in accordance

with a policy are tax-free. In addition, if a policy is tax-qualified, your premiums are deductible (as medical expenses) up to a specified limit if you qualify.

To qualify, a policy must:

- Be guaranteed renewable and noncancelable regardless of health,

- Not delay coverage of pre-existing conditions more than six months,
- Not condition eligibility on prior hospitalization,
- Not exclude coverage based on a diagnosis of Alzheimer's disease, dementia, or similar conditions or illnesses, and
- Require a physician's certification that you're either unable to perform at least two of six ADLs or you have a severe cognitive impairment and that this condition has lasted or is expected to last at least 90 days.

It's important to weigh the pros and cons of tax-qualified policies. The primary advantage is the premium deduction. But keep in mind that medical expenses are deductible only if you itemize and only to the extent they exceed 10% of your adjusted gross income for 2019, so some people don't have enough medical expenses to benefit from this advantage. It's also important to weigh any potential tax benefits against the advantages of nonqualified policies, which may have less stringent eligibility requirements. ■