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MARKET WISDOM AND EQUITY INVESTING

James Surowiecki writing in *The Wisdom of Crowds* states "under the right circumstances groups are remarkably intelligent, and are often smarter than the smartest people in them." The last several weeks prior to the recent Congressional and Presidential elections saw some of the highest volatility in the recent history of the U.S. equity markets. The crowds involved in those markets had extreme difficulty in predicting the future of American politics.

New York Times writer, Jeff Somner, in a recent column, *So Much for the Wisdom of Financial Markets*, made the point that markets are sometimes flawed in generating market prices. He went on, however, to make what is, at least to us, a much more profound comment:

"Despite these limitations, the ability of markets to generate wealth over the long run makes participation in them worthwhile for people who are not gamblers or professional traders. As the Columbia professor and great value investor Benjamin Graham told students like Warren Buffett: "In the short run, the market is a voting machine but in the long run it is a weighing machine."

Over the long run, asset allocation has been effective: a broadly diversified mix of stocks and bonds, mainly using

low-cost index funds. There are constant calls for fancier approaches. I don't buy them any more than I accept the ability of the stock market to predict the future of American politics."

The pendulum swings and so does the direction of American politics. Unlike a pendulum, however, American politics are not regular in timing or steady in route. Historical equity investment total returns, however, prove that despite volatility, irrational exuberance, booms and busts, savers are usually best served by committing a significant portion of their long-term savings to a diversified portfolio of equity securities (low-cost, tax-efficient index funds are best). For example, the S&P 500 Index over the almost 13-year period January 1, 2008 through November 10, 2020 (12.86 years), which includes two major market declines (the meltdown of 2008 – 2009 and the COVID collapse of February – March 2020) but nonetheless provided a 9.37 percent annual total return to investors who remained fully invested in this diversified equity index. In other words, an investment of \$1,000 at January 1, 2008 grew to a pre-tax accumulation of \$3,163 at November 10, 2020. Because of the tax effectiveness of index funds, the estimated annual rate of return, after current income tax, is approximately 8.75 percent for an accumulation, net of current income tax, of approximately \$2,940.

(Continued on reverse)

Mr. Somner has it right – over the long run, participation in the stock market through low-cost index funds is worthwhile for people who are not

gamblers or professional traders. There is no reason to accept the constant calls for fancier approaches.

IRS FORM 1099-NEC MAKES A COMEBACK

Prior to 1983, nonemployee compensation paid for services of independent contractors, directors, attorneys, etc. were reported by business owners to the recipient and IRS on Form 1099-NEC. After 1982, however, Form 1099-NEC was eliminated, and business owners who paid nonemployee compensation have been required to report those payments annually on Form 1099-MISC. Form 1099-MISC also reports the payment of several other types of income (e.g., rents, royalties, etc.).

The due date for filing Forms 1099-MISC that report nonemployee compensation has been January 31 (both for the recipient and IRS). However, the due date for filing Forms 1099-MISC

with IRS that report other types of income has been February 28 (March 31 if electronically filed). These dual due dates for the same form has been confusing to taxpayers and problematic with computer tax software for both the IRS and businesses.

Accordingly, for 2020, the IRS is resurrecting Form 1099-NEC, which will report only the business payment of nonemployee compensation. For 2020 payments, this “new” form will be due to both the payee and the IRS on February 1, 2021 (January 31 is Sunday). Revised 2020 Forms 1099-MISC (reporting rents, royalties, etc.), as in prior years, will be due to payees by February 1, 2021 and to the IRS by March 1, 2021 (March 31 if electronically filed).

TOTAL FINANCIAL COMPENSATION

The long-term health of most businesses is dependent on finding and keeping good people. Many factors other than financial compensation significantly influence employee retention – that is, people want to work in a pleasant environment, feel appreciated, and feel a part of something significant, of helping others, etc. Nonetheless, most of us do want to feel that we are being dealt with fairly in all aspects of our work including financial compensation. When considering financial compensation, some employees might fail to give their employers credit for the total compensation that they receive – thinking, instead, only of the cash salary or even only of their “take-home pay.” You might want to encourage all employees to understand their total compensation by furnishing to them a schedule of total compensation along with their 2020 Form W-2 due by February 1, 2021. We

have provided a form below that can be adapted for this purpose. This form can also be helpful in compensation reviews to project an employee’s total annual compensation package.

A way to improve your employee’s after-tax compensation is to utilize a “cafeteria plan.” With a cafeteria plan, employees can have a flexible spending account and can elect to have part of their cash compensation redirected to this benefit plan. The cafeteria plan is attractive to both the employee and the employer. The employee’s disposable income increases because the amounts directed into the plan for tax-free fringe benefits are not subject to social security and Medicare taxes or to income taxes. The employer saves any otherwise applicable payroll taxes on the amounts that the employee redirects to tax-free benefits.

Flexible spending account cafeteria plans do have administrative costs that can exceed the employer payroll tax savings and, therefore, might not be cost effective. We suggest that an analysis of the cost effectiveness (tax savings

versus administrative costs) be made before the implementation of any such plan. We will be glad to help you with such an analysis or with any other aspects of your compensation planning.

Summary of Compensation Earned	
Year _____	
Employee _____	
	Compensation Earned
Cash Compensation	\$ _____
Contributions to Retirement Plans	_____
Long-Term Disability Insurance Premiums	_____
Health Insurance Premiums	_____
Life Insurance Premiums	_____
Social Security and Medicare Taxes Paid for You (Employer Portion – Not Withheld)	_____
Other _____	_____
 Total Compensation for the Year	 \$ <u>_____</u>

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Tax & Business Alert

NOVEMBER 2020

ABLE ACCOUNTS HELP THOSE WITH DISABILITIES

There's a tax-advantaged way for people to save for the needs of family members with disabilities — without having them lose eligibility for government benefits to which they're entitled. It can be done through an Achieving a Better Life Experience (ABLE) account, which is a tax-free account that can be used for a variety of expenses.

ELIGIBILITY

ABLE accounts can be created by eligible individuals to support themselves, by family members to support their dependents, or by guardians for the benefit of the individuals for whom they're responsible.

Eligible individuals must be blind or disabled — and must have become so before turning age 26. They also must be entitled to benefits under the Supplemental Security Income (SSI) or Social Security Disability Insurance (SSDI) programs. Alternatively, an individual can become eligible if a disability certificate is filed with the IRS for him or her.

OTHER KEY FACTORS

Distributions from an ABLE account are tax-free if used to pay for expenses that maintain or improve the beneficiary's health, independence or quality of life. These expenses include education, housing, transportation, employment support, health and wellness costs, assistive technology, personal support services and other IRS-approved expenses.

Anyone can contribute to an ABLE account. While contributions aren't tax-deductible, account funds are

invested and grow tax-free. If distributions are used for nonqualified expenses, the portion of the distribution that represents earnings on the account is subject to income tax plus a 10% penalty.



An eligible individual can have only one ABLE account. Contributions up to the annual gift-tax exclusion amount, \$15,000 in 2020, may be made to an ABLE account each year for the benefit of an eligible person. Under a rule that took effect in 2018, if the beneficiary works, the beneficiary can also contribute part or all of their income to the account. (This additional contribution is limited to the federal poverty-line amount for a one-person household for the prior year.)

IMPACT ON SUPPLEMENTAL SECURITY INCOME

Achieving a Better Life Experience (ABLE) accounts have no impact on an individual's Medicaid eligibility. However, ABLE account balances in excess of \$100,000 are counted toward the Supplemental Security Income (SSI) program's \$2,000 individual resource limit.

Thus, an individual's SSI benefits are suspended, but not terminated, if his or her ABLE account balance exceeds \$102,000 (assuming the individual has no other assets). In addition, distributions from an ABLE account to pay housing expenses count toward the SSI income limit.

There is, however, a limit on the total account balance. This limit, which varies from state to state, is equal to the limit imposed by that state on qualified tuition (Section 529) plans. For contributions made before 2026, the designated beneficiary can claim the saver's credit for contributions made to his or her ABLE account.

PLENTY OF OPTIONS

There are many choices. ABLE accounts are established under state programs, but an account may be opened under any state's program if the state allows out-of-state participants. Funds in an account can be invested in a variety of options and the account's investment directions can typically be changed up to twice a year. Contact us if you'd like more details about setting up or maintaining an ABLE account. ■

THE TAX IMPACT OF BUSINESS PROPERTY REMEDIATION

If your company faces the need to “remediate” or clean up environmental contamination, the money you spend can be tax-deductible as ordinary and necessary business expenses. Unfortunately, every type of environmental cleanup expense cannot be currently deducted — some cleanup costs must be capitalized (spread over multiple years for tax purposes).

Of course, to lower your tax bill as much as possible, you want to claim as many immediate income tax benefits as allowed for the expenses you incur. So, it's a good idea to explore the tax impact of business property remediation before you embark on the project. (If you've already done the cleanup, review the costs closely before filing your company's tax return.)



DEDUCT VS. CAPITALIZE

Generally, cleanup costs are currently deductible to the extent they cover “incidental repairs” — for example, encapsulating exposed asbestos insulation. Other deductible expenses may include the actual cleanup costs, as well as expenses for environmental studies, surveys and investigations, fees for consulting and environmental engineering, legal and professional fees, and environmental “audit” and monitoring costs.

You may also be able to currently claim tax deductions for cleaning up contamination that your business caused on your own property (for example, removing soil contaminated by dumping wastes from your own manufacturing processes and replacing it with clean soil) — if you acquired that property in an uncontaminated state.

On the other hand, remediation costs generally must be capitalized if the remediation:

- Adds significantly to the value of the cleaned-up property,
- Prolongs the useful life of the property, or
- Adapts the property to a new or different use.

In addition, you'll likely need to capitalize the costs if the remediation makes up for depreciation, amortization or depletion that's been claimed for tax purposes, or if it creates a separate capital asset that's useful beyond the current tax year.

However, parts of these types of remediation costs may qualify for a current deduction. It depends on the facts and circumstances of your situation. For instance, in one case, the IRS required a taxpayer to capitalize the costs of surveying for contamination various sites that

proved to be contaminated, but the agency allowed a current deduction for the costs of surveying the sites that proved to be uncontaminated.

COMPLEX TREATMENT

Along with federal tax deductions, state or local tax incentives may be available for cleaning up contaminated property. The tax treatment for the expenses can be complex. If you have environmental cleanup expenses, we can help plan your efforts to maximize the deductions available. ■

CATCHING UP ON CATCH-UP CONTRIBUTIONS

When it comes to retirement planning, many people tend to focus on two things: opening a retirement savings account and then eventually drawing funds from it. However, there are other important aspects to truly doing everything you can to grow your nest egg.

One of them is celebrating your 50th birthday. This is because those age 50 or older on December 31 of any given year can start making "catch-up" contributions to their employer-sponsored retirement plans by that date (assuming the plan allows them). These are additional contributions to certain accounts beyond the regular annual limits.

Maybe you haven't yet saved as much for retirement as you'd like to. Or perhaps you'd just like to make the most of tax-advantaged savings opportunities. Whatever the case may be, now is a good time to get caught up on the latest catch-up contribution amounts.

401(K)s AND SIMPLEs

Under 401(k) limits for 2020, if you're age 50 or older, you can contribute an extra \$6,500 after you've reached the \$19,500 maximum limit for all employees. That's a total of \$26,000. If your employer offers a Savings Incentive Match Plan for Employees (SIMPLE) instead, your regular contribution maxes out at \$13,500 in 2020. If you're 50 or older, you're allowed to contribute an additional \$3,000 — or \$16,500 in total for the year. (Be sure to check with your employer because, while most 401(k) plans and SIMPLEs offer catch-up contributions, not all do.)

SELF-EMPLOYED PLANS

If you're self-employed, retirement plans such as an individual 401(k) — or solo 401(k) — also allow catch-up contributions. A solo 401(k) is a plan for



those with no other employees. You can defer 100% of your self-employment income or compensation, up to the regular yearly aggregate deferral limit of \$19,500, plus a \$6,500 catch-up contribution in 2020. But that's just the employee salary deferral portion of the contribution.

You can also make an "employer" contribution of up to 20% of self-employment income or 25% of compensation. The total combined employee-employer contribution is limited to \$57,000, plus the \$6,500 catch-up contribution.

IRAs, TOO

Catch-up contributions to non-Roth accounts can not only enlarge your retirement nest egg, but also reduce your 2020 tax liability. And keep in mind that catch-up contributions are available for IRAs, too.

However, the deadline for 2020 contributions is April 15, 2021, and deductible contributions may be limited or unavailable based on your income and whether you're covered by a retirement plan at work. Please contact us for more information. ■

DO YOU KNOW THE “HIDDEN” ADVANTAGE OF HSAs? _____

A Health Savings Account (HSA) coupled with a high-deductible health plan can be a powerful tool for funding medical expenses on a tax-advantaged basis. For 2020, individuals with self-only coverage can make up to \$3,550 in tax-deductible contributions to an HSA, while those with family coverage can contribute up to \$7,100. These limits are increased by \$1,000 for individuals 55 or older.



Funds may be withdrawn tax-free to pay qualified medical expenses. Once you reach age 65, you can withdraw funds penalty-free for any purpose (subject to tax if not used for qualified medical expenses).

But there’s also a “hidden” advantage of HSAs, or at least one that many people overlook: These accounts can play a helpful role in your estate plan. HSAs have an advantage over traditional IRAs and 401(k) plans in that they’re not subject to required minimum distributions at age 72. This means, to the extent you don’t use the account for medical expenses, the account can continue growing on a tax-deferred basis indefinitely — providing valuable benefits for your loved ones.

If your spouse inherits the account, it will be treated as his or her own HSA. If someone else inherits it, the HSA will terminate and the recipient will be taxed on its value, less any qualified medical expenses of the decedent paid by the transferee within one year after the date of death. ■