WILLIAM JEFFERSON COLE, C.P.A.
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STEVEN W. HEDGEPETH, C.P.A.
STEVEN R. BAYER, C.P.A.
TIMOTHY R. DURR, C.P.A.
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KELLY B. NELSON, C.P.A.

J. AMY HEMMINGS, C.P.A.
LINDA K. BIBLE, C.P.A.
JANA JOHNSTON COX, C.P.A.
GEORGE D. FAUBER III, C.P.A.
R. SCOTT MOORE, C.P.A.
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JONATHAN B. WEST, C.P.A.
MANDI ROSE KILLIAN, C.P.A.

COLE, EVANS & PETERSON
CERTIFIED PUBLIC ACCOUNTANTS

FIFTH FLOOR TRAVIS PLACE
624 TRAVIS STREET
SHREVEPORT, LOUISIANA 71101-3013

www.cepcpa.com

PARTNER EMERITUS
M. ALTON EVANS, JR.

OF COUNSEL
CAROL T. BARNES, C.P.A.
AUSTIN G. ROBERTSON, JR., C.P.A.

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

MAILING ADDRESS:
POST OFFICE DRAWER 1768
SHREVEPORT, LOUISIANA 71166-1768

SEPTEMBER 2020

GEORGE D. FAUBER, III IS A PARTNER

We are happy to announce that Trey Fauber is now a partner in the firm. Trey joined the firm in September 2012 after receiving his Bachelor of Science degree from LSUS. Trey successfully completed the CPA exam in September 2012 on his first attempt. Trey and his wife, Morgan, live in Benton and are the parents of three children. Trey currently serves on the board of the Providence House and is a member of Cypress Baptist Church.

PPP LOAN FORGIVENESS

Forms and Rules

As mentioned in our July Newsletter, PPP loan regulations and forms have evolved over the past few months. In June, the Small Business Administration (SBA) released a new simplified form (PPP Loan Forgiveness Application Form 3508 EZ), along with four pages of instructions and a checklist, which will reduce the time required to apply for forgiveness for many borrowers. A discussion of the simplified form and procedure is contained in our July Newsletter *www.cepcpa.com/resources*. On August 11, 2020, the SBA published 11 pages of Frequently Asked Questions (FAQs) on PPP loan forgiveness, also available on our website *www.cepcpa.com/resources*.

Some lenders are beginning to accept applications for PPP loan forgiveness. However, for many, if not most, PPP loan recipients it is probably better to delay filing for forgiveness until 24 weeks after the loan disbursement to ensure the availability of the longer covered period (up to 24 weeks) for computing the expenditures resulting in loan forgiveness. Also, some commentators believe that the banking industry will be successful in further simplification of the application for loan forgiveness for sole proprietors, independent contractors, and self-employed individuals who had no employees at the time of their loan application.

Income Tax Status

While it seems settled that many, if not almost all, PPP loans will qualify for full forgiveness, the income tax consequences of forgiveness remain uncertain. As many may recall, the applicable law (CARES Act, Section 1106, Loan Forgiveness) states "any amount which (but for this subsection) would be includable in gross income of the eligible recipient by reason of forgiveness…shall be excluded from gross income." Nevertheless, the Treasury Department has taken the position

(Continued on reverse)

that forgiveness of the loan results in disallowance of an equal amount of business expenses, which achieves the same results as making the forgiveness amount taxable income. However, several leadership members of Congress, most notably, Senator Grassley, have asserted that benefits of loan forgiveness were to be tax-free. Senator Grassley and several others have introduced the Small Business Expense Protection Act to clarify that all expenses related to forgiven PPP loan proceeds remain fully tax deductible.

Hopefully, the Treasury Department, the SBA, and Congress will resolve their differences and we will have a single, unified interpretation of the law and a straightforward, simple application form for forgiveness.

PAY AS YOU GO

Federal and state income taxes are computed annually after the close of the year, but are generally required to be paid throughout the year as the taxable income is received. The most common mechanism of this “pay-as-you-go” system is the collection of tax through payroll withholdings. The other method is the taxpayer payment of quarterly estimated taxes during the year.

In general, if one waits to pay the tax until the return is filed, the taxpayer has, in the government’s view, taken a loan from the government for the amounts that should have been paid during the year by withholdings and quarterly estimates. The “interest” (called the Estimated Tax Penalty on the income tax return) on this “loan” (the underpayment of estimated tax) is added to the tax return balance due or reduces the overpayment amount. This penalty is equivalent to nondeductible interest at a government-established rate that is determined quarterly. This federal interest/penalty rate during the first six months of 2020 was 5 percent. For the third quarter of 2020, the rate is 3 percent.

Note, however, that if you have overpaid your tax during the year by withholding and/or quarterly estimates, you will have made, in effect, an “interest-free loan” to the government during the year, but you will not receive interest on your overpayment.

Income Tax Withholdings. Often a dilemma for employed taxpayers is the determination of the appropriate salary income tax withholdings when the taxpayer or married couple has multiple sources of taxable income. The employee completes a Form W-4 for the employer to calculate (based on IRS or state tables) the amount of income tax to withhold and remit each pay period. Later, when the individual or married couple files the tax return, often there is distress to discover that additional tax is owed, in spite of completing all Forms W-4 according to the appropriate filing status.

The problem has been that, in the past, Forms W-4 and withholding tables did not make it easy to adequately consider whether or not the employee had other taxable income (e.g., a second job or investment income) or if both spouses worked. An individual’s withholdings generally were determined by the IRS tables, assuming that wage was the only taxable income to be reported on the tax return. For 2020, however, Form W-4 was revised with a new worksheet and instructions to make it easier for employees to adjust their withholdings based on the taxpayer’s other taxable income. The IRS also has an online tax withholding estimator tool to assist with this.

If your tax return will include multiple sources of income (e.g., a spouse’s earnings, investment income, etc.), and you have not already done so, you might want to consider completing a new Form W-4 for your income tax withholdings.

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

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

Tax & Business Alert

SEPTEMBER 2020

AMT LESS "TOOTHY" BUT MAY STILL TAKE A BITE

For many years, the alternative minimum tax (AMT) posed a risk to many taxpayers in the middle- to upper-income brackets. The Tax Cuts and Jobs Act (TCJA) took much of the "teeth" out of the AMT by raising the inflation-adjusted exemption. As a result, middle-income earners have had less to worry about, but those whose income has substantially increased (or remains high) should still watch out for its bite.

BASIC RULES

The AMT was established to ensure that high-income individuals pay at least a minimum tax, even if they have many large deductions that significantly reduce their "regular" income tax. If your AMT liability is greater than your regular income tax liability, you must pay the difference as AMT — in addition to the regular tax.

As mentioned, the TCJA substantially increased the AMT exemption for 2018 through 2025. If your income (calculated for AMT purposes) falls at or below the exemption, you won't have to pay the AMT. The 2020 exemption amounts are $72,900 (for single filers), $113,400 (for married joint filers) and $56,700 (for married separate filers).

If you do get caught by the AMT, applicable rates begin at 26% and rise to 28% at higher income levels. That top rate is lower than the maximum regular income tax rate of 37%, but far fewer deductions are allowed for the AMT. For example, you can't deduct state and local income or sales taxes, property taxes and certain other expenses.

ITEMIZED DEDUCTIONS

The AMT exemption phases out when your AMT income surpasses the applicable threshold, so high-income earners remain susceptible. However, even some taxpayers who consider themselves middle-income earners may trigger the AMT by exercising incentive stock options or incurring large capital gains.

Also, if you typically claim many itemized deductions for expenses that aren't deductible for AMT purposes, you might find yourself falling into the AMT net. These include state and local income taxes and property taxes.

If you're on the threshold of AMT liability this year, you might want to consider delaying state tax payments — as long as the late-payment penalty won't exceed the tax savings from staying under the AMT threshold.

INVESTORS BEWARE: CAPITAL GAINS COULD TRIGGER AMT

Many higher-income individuals and couples are active investors. Because the alternative minimum tax (AMT) exemption phases out based on income, realizing substantial capital gains could cause you to lose part or all of that exemption and, thus, subject you to AMT liability.

If it looks like you could get hit by the AMT this year, you might want to delay sales of highly appreciated assets until next year (if you don't expect to be subject to the AMT then) or use an installment sale to spread the gains (and potential AMT liability) over multiple years. Contact us to discuss further.

APPROPRIATE STRATEGIES

Since passage of the TCJA, the AMT may have become an afterthought for many people. However, it's still worth a look to see whether it could create undesirable tax consequences for you. Please contact us for help assessing your exposure to the AMT and, if necessary, implementing appropriate strategies for your tax situation. ■

REVIEW YOUR ESTATE PLAN FOLLOWING A MAJOR SHOCK

Generally, it's recommended that you review your estate plan at year's end. This is a logical time to note important life events that have taken place over the past 12 months or so that may affect your plan.

However, with a life shock as monumental as the COVID-19 pandemic occurring in 2020, you might want to get an earlier start on reviewing your estate planning documents to ensure that they're up to date — especially if you haven't looked closely at them in a number of years.

POTENTIAL REVISIONS

There are a wide variety of life changes that typically trigger the need to revise an estate plan. A few that come to mind in light of this year's crisis include the illness or disability of you, your spouse or another family member; or the death of a spouse or another family member. On a happier note, the birth or adoption of a child, grandchild or great-grandchild may necessitate changes. A child or grandchild reaching the age of majority is another common event.

If you married, divorced or remarried, you might need to revise your estate plan. The sale or purchase of a principal residence or second home could also necessitate action. Other oft-cited examples include your or your spouse's retirement, receipt of a large gift or inheritance, or any sizable changes in the value of assets. It's also important to review your estate plan when there've been changes in federal or state income tax or estate tax laws.

WILL AND POWERS OF ATTORNEY

As part of your estate plan review, closely examine your will, powers of attorney and health care directives. If you have minor children, your will should designate a guardian to care for them should you die prematurely, as well as make certain other provisions, such as creating trusts to benefit your children until they reach the age of majority, or perhaps even longer.

A durable power of attorney authorizes someone to handle your financial affairs if you're disabled or otherwise unable to act. Likewise, a medical durable power of attorney authorizes someone to handle your medical decision making if you're disabled or unable to act. The powers of attorney expire upon your death.

Typically, these powers of attorney are coordinated with a living will and other health care directives. A living will spells out your wishes concerning life-sustaining measures in the event of a terminal illness. It says what measures should be used, withheld or withdrawn. Changes in your family or your personal circumstances might cause you to want to change beneficiaries, guardians or power-of-attorney agents you've previously named.

PEACE OF MIND

In response to the COVID-19 crisis, many people's thoughts have turned to the importance of family and economic security. Updating and revising your estate plan today can provide peace of mind. We can help you determine whether any revisions are needed. ■

COLLEGE SAVINGS SHOWDOWN: 529s VS. ROTH IRAs

Many people assume that a 529 plan is the ideal college savings tool, but other vehicles can help parents save for college expenses, too. Take the Roth IRA, for example. Whether you should use one or the other (or both) depends on several factors, including how much you intend to contribute and how you'll use the earnings.

PLAN SNAPSHOTS

A 529 plan allows participants to make substantial nondeductible contributions — up to hundreds of thousands of dollars, depending on the plan and state limits. The funds grow tax-free, and there's no tax on withdrawals, provided they're used for "qualified higher education expenses" such as tuition, fees, books, computers, and room and board. If you use the funds for other purposes, you'll generally be subject to income taxes and a 10% penalty on the earnings portion. Some 529 plans are also eligible for state tax breaks.

Roth IRA contributions also are nondeductible and grow tax-free. And you can withdraw those contributions anytime, tax- and penalty-free, for any purpose. Qualified distributions of earnings — generally, after age 59½ and more than five years after your first contribution — are also tax- and penalty-free.

ADVANTAGES AND DRAWBACKS

The main advantages of 529 plans are generous contribution limits and the ability to accept contributions from relatives or friends. Roth IRAs, on the other hand, are subject to annual contribution limits of currently \$6,000 (\$7,000 if you're 50 or older). So, even if you and your spouse each set up Roth IRAs when your child is born, the most you'll be able to contribute over 18 years is \$216,000. Another drawback is that you must have earned income at least equal to the contribution, and you can't contribute to a Roth IRA if your adjusted gross income exceeds certain limits.

Funds in a 529 plan that aren't used for qualified education expenses will eventually trigger taxes and penalties when they're withdrawn. However, with a Roth IRA, you can use contributions, as well as qualified distributions of earnings, for any purpose without triggering taxes or penalties. This includes items that wouldn't be qualified expenses under a 529 plan, such as a car or off-campus housing expenses that exceed the college's room and board allowance. Plus, if you don't need all your Roth IRA funds for college expenses, you can leave them in the account indefinitely.

CONSIDER GOALS

Before selecting a plan, consider your overall financial, retirement and estate planning goals. Our firm can help. ■

REPORTING A DISASTER'S EFFECTS ON YOUR FINANCIAL STATEMENTS

The COVID-19 pandemic has provided many lessons for business owners. One is how to report the impact of a disaster on a company's financial statements. Under U.S. Generally Accepted Accounting Principles (GAAP), disasters such as this year's crisis are referred to as "subsequent events," of which there are two types:

1. Recognized subsequent events. These events provide additional evidence about conditions, such as bankruptcy or pending litigation, that existed at the balance sheet date. The effects of these events generally need to be recorded directly in the financial statements.

2. Nonrecognized subsequent events. These provide evidence about conditions, such as a natural disaster, that didn't exist at the balance sheet date. Rather, they arose after that date but before the financial statements were issued (or available to be issued). Such events should be disclosed in the footnotes to prevent the financial statements from being misleading. Disclosures should include the nature of the event and an estimate of its financial effect (or disclosure that such an estimate can't be made).

So, for example, the World Health Organization didn't declare the COVID-19 outbreak a public health emergency until January 30, 2020. However, events that caused the outbreak had occurred before the end of 2019. So, the risk was present in China on December 31, 2019. Accordingly, calendar-year entities may have needed to recognize the effects in their financial statements for 2019 and, if applicable, the first quarter of 2020. Contact our firm for help with your financial statements. ■