WILLIAM JEFFERSON COLE, C.P.A.
BARRY S. SHIPP, C.P.A.
STEVEN W. HEDGEPETH, C.P.A.
STEVEN R. BAYER, C.P.A.
TIMOTHY R. DURR, C.P.A.
BAILEY B. BAYNHAM, C.P.A.
ROBERT A. BUSBY, C.P.A.
ANNE-MARIE COLE, C.P.A.
TIMOTHY W. BORST, C.P.A.
ERIC D. SMITH, C.P.A.
KYLE S. DOBBINS, C.P.A.
MATTHEW R. HAHN, C.P.A.
FAYE D. BARFIELD, C.P.A.
KELLY B. NELSON, C.P.A.
GEORGE D. FAUBER III, C.P.A.

J. AMY HEMMINGS, C.P.A.
LINDA K. BIBLE, C.P.A.
JANA JOHNSTON COX, C.P.A.
R. SCOTT MOORE, C.P.A.
ADAM JEFFERSON CAIN, C.P.A.
MADISON PAIGE LAIRD, C.P.A.
BONNIE C. PESNELL, C.P.A.
JENNIFER RENEE TURNER, C.P.A.
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

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INCOME TAX RETURNS AND PAYMENTS EXTENDED

Louisiana taxpayers now have until June 15, 2021 to file their 2020 federal and Louisiana income tax returns, pay any 2020 balances, and pay the first installment of their 2021 estimated tax. The automatic federal extension of time to file and pay was announced on March 10, 2021 and is a result of the winter storms occurring February 11th through February 19th of 2021. The extension applies to all Louisiana parishes. Texas taxpayers were granted similar federal extensions on February 22, 2021. In other words, Louisiana residents (and Texas residents required to file Louisiana non-resident returns) have until June 15, 2021 to file and pay federal and Louisiana income taxes that would have been due on or after February 8, 2021 and on or before June 15, 2021.

ROTH CONVERSIONS

The accompanying *Tax & Business Alert* contains a discussion of the key differences between a traditional IRA and a Roth IRA. In the final paragraph, it asks the very important question "Do you have money to pay the tax bill?" Those who believe that early payment of taxes is generally a bad idea (that includes us) find it relatively easy to answer no. However, taxpayers who are saving and investing in taxable accounts, who have life expectancies of 20 years or more, and who do not expect to be in a significantly lower income tax bracket during retirement should seriously consider Roth conversion. For such taxpayers, the income tax paid on the conversion might appropriately be considered the "purchase" at a bargain price of an asset, which can grow tax free. For example, for a constant 40 percent bracket taxpayer, $1,000 inside a traditional IRA is, in effect, "owned" by the taxpayer in the amount of $600 and by the taxing authorities $400. A Roth conversion will cause the taxpayer to pay $400 (40 percent of $1,000) in current tax and will result in the entire amount of the IRA now belonging to and compounding for the owner tax-free for the balance of the life of the Roth IRA, which can exceed by 10 years the life of the original owner. By converting to Roth, this owner has "purchased" the taxing authorities "ownership interest" in the traditional IRA for $400. Assuming the owner's tax bracket is constant (to remove the benefit or detriment of any future change in the applicable tax rate), the taxpayer has not from this perspective "paid tax" of $400 but rather has purchased a $400 investment, which is likely worth more than $400 as it compounds tax-free over the balance of the taxpayer's life and, if the taxpayer predeceases a spouse, over the longer life of the spouse plus 10 years. A longer discussion of the decision "To Roth or Not" is included in our paper on our website (*www.cepcpa.com/Resources/Papers/ToRothorNot*).

CREDIT CARD REWARD DOLLARS RULED TAX FREE

A recent Tax Court case, *Anikeev v. Commissioner of Internal Revenue* (Tax Court Memo 2021-23) concerns an unusually large amount of credit card award dollars (approximately $300,000 in total over two years). The case reiterates that such award dollars from the purchase of goods and services are reductions in the cost of the purchase and are not taxable income. The Internal Revenue Service (IRS) was required to follow its rebate rule as set forth in its Publication 17, *Your Federal Income Tax*.

Mr. Anikeev held a Bachelor's degree in physics from the Moscow Institute of Physics & Technology and a Doctorate degree in physics from the Massachusetts Institute of Technology. He noticed that during 2013 and 2014, American Express offered a rewards program, Blue Cash, allowing a five percent rebate on purchases of eligible goods and services above $6,500 per year. To maximize the generation of the five percent reward dollars, Mr. and Mrs. Anikeev, using two American Express cards, would almost daily purchase the maximum Visa gift cards allowed from local grocery stores and pharmacies. They would then use the gift cards to purchase money orders, which they would deposit in their bank account from which they made frequent credit card payments to stay within their credit card balance limit. One thousand dollars in purchases would generate $50 in rebate and, after fees associated with the gift card and related money orders of about $14, would net about 3.6 percent or $36 per $1,000. Almost all of the taxpayer's dollars spent on the American Express cards were for the purchase of the Visa gift cards.

The taxpayers did not report the rebates as income, relying on Internal Revenue Service (IRS) publications stating that purchased rebates were not taxable income but rather reductions in the purchase price. The Tax Court agreed and ruled that the credit card reward dollars associated with the Visa gift card purchases were not taxable income. The Tax Court then went on to point out (adding insult to injury?) that the IRS failed to argue what, according to the Tax Court, likely would have been a successful case based on established precedents – that is, the IRS should not have argued that the taxable event was the receipt of the reward dollars, but rather the taxable event was the transformation of the gift cards into cash equivalents that could be deposited into a bank account. Although the Tax Court suggested (and we agree) that the Revenue Service mishandled this case, it is encouraging to see that the Court required the IRS to abide, at least in this case, by its published position.

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

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

Tax & Business Alert

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CONSIDERING A ROTH IRA CONVERSION

Investors have long grappled with the conundrum of whether to opt for a traditional or Roth IRA. One factor that might tip the scales toward a Roth is a downturn in the value of your investments. If you have a traditional IRA, a decline may provide a valuable opportunity to convert your traditional IRA to a Roth IRA at a lower tax cost. Let's review the ins and outs of IRAs and then delve deeper into this strategy.

KEY DIFFERENCES

What makes a traditional IRA different from a Roth IRA? Plenty. Contributions to a traditional IRA may be deductible, depending on your modified adjusted gross income (MAGI) and whether you (or your spouse) participate in a qualified retirement plan, such as a 401(k). Funds in the account grow tax deferred.

On the downside, you generally must pay income tax on withdrawals from a traditional IRA. In addition, you'll face a penalty if you withdraw funds before age 59½ — unless you qualify for a handful of exceptions — and you'll face an even larger penalty if you don't take your required minimum distributions (RMDs) after age 72.

Roth IRA contributions, on the other hand, are never deductible. But withdrawals — including earnings — are tax-free as long as you're age 59½ or older and the account has been open at least five years. In addition, you're allowed to withdraw contributions (not earnings) at any time tax- and penalty-free. You also don't have to begin taking RMDs after you reach age 72.

The ability to contribute to a Roth IRA is subject to limits based on your MAGI. Fortunately, no matter how high your income, you're eligible to convert a traditional IRA to a Roth. The catch? You'll have to pay income tax on the amount converted.

SAVING TAX DOLLARS

This is where the "benefit" of a downturn in the value of investments comes in. If, for example, your traditional IRA is invested in the stock market and has lost value, converting to a Roth now rather than later will minimize your tax hit. Plus, you'll avoid tax on future appreciation when the market goes back up.

It's important to think through the details before you convert. Ask yourself some important questions when deciding whether to make a conversion. First, do you have money to pay the tax bill? If you don't have enough cash on hand to cover the taxes owed on the conversion, you may have to dip into your retirement funds. This will erode your nest egg. The more money you convert and the higher your tax bracket, the bigger the tax hit.

Also, what's your retirement horizon? Your stage of life may affect your decision. Typically, you wouldn't convert a traditional IRA to a Roth IRA if you expected to retire soon and start drawing down on the account right away. Usually, the goal is to allow the funds to grow and compound over time without any tax erosion.

Keep in mind that converting a traditional IRA to a Roth isn't an all-or-nothing deal. You can convert as much or as little of the money from your traditional IRA account as you like. So, you might decide to gradually convert your account to spread out the tax hit over several years.

RIGHT MOVE

Of course, there are more issues that need to be considered before executing a Roth IRA conversion. If this sounds like something you're interested in, contact us to discuss whether it's the right move for you. ■

WORKER CLASSIFICATION IS STILL IMPORTANT

Over the last year, many companies have experienced "workforce fluctuations." If your business has engaged independent contractors to address staffing needs, be careful that these workers are properly classified for federal tax purposes.

TAX OBLIGATIONS

The question of whether a worker is an independent contractor or an employee for federal income and employment tax purposes is a complex one. If a worker is an employee, the company must withhold federal income and payroll taxes, and pay the employer's share of FICA taxes on the wages, plus FUTA tax. Often, a business must also provide the worker with the fringe benefits that it makes available to other employees. And there may be state tax obligations as well.

These obligations don't apply if a worker is an independent contractor. In that case, the business simply sends the contractor a Form 1099-NEC for the year showing the amount paid (if the amount is $600 or more).

NO UNIFORM DEFINITION

The IRS and courts have generally ruled that individuals are employees if the organization they work for has the right to control and direct them in the jobs they're performing. Otherwise, the individuals are generally independent contractors, though other factors are considered.

Some employers that have misclassified workers as independent contractors may get some relief from employment tax liabilities under Internal Revenue Code Section 530. In general, this protection applies only if an employer filed all federal returns consistent with its treatment of a worker as a contractor and treated all similarly situated workers as contractors.

The employer must also have a "reasonable basis" for not treating the worker as an employee. For example, a "reasonable basis" exists if a significant segment of the employer's industry traditionally treats similar workers as contractors. (Note: Sec. 530 doesn't apply to certain types of technical services workers. And some categories of individuals are subject to special rules because of their occupations or identities.)

ASKING FOR A DETERMINATION

Under certain circumstances, you may want to ask the IRS (on Form SS-8) to rule on whether a worker is an independent contractor or employee. However, be aware that the IRS has a history of classifying workers as employees rather than independent contractors.

Consult a CPA before filing Form SS-8 because doing so may alert the IRS that your company has worker classification issues — and inadvertently trigger an employment tax audit. It may be better to properly treat a worker as an independent contractor so that the relationship complies with the tax rules.

LATEST DEVELOPMENTS

In January 2021, the Trump Administration published a final rule revising the Fair Labor Standards Act's employee classification provision. The rule change was considered favorable to employers. However, as of this writing, the Biden Administration has delayed the effective date of the final rule change. Stay tuned for the latest developments and contact us for any help you may need with employee classification. ■

BE PREPARED FOR TAXES ON SOCIAL SECURITY BENEFITS

Whether you've filed your 2020 tax return or soon will, you probably don't want any surprises. One thing that takes many older people off-guard is getting taxed on their Social Security benefits.

Will you be taxed and how much will you have to pay? That depends on your other income. If you're taxed, between 50% and 85% of your payments will be hit with federal income tax. (There could also be state tax.) This doesn't mean you'll *pay* 50% to 85% of your benefits back to the government. It means you may have to *include* 50% to 85% of them in your income subject to regular tax rates.

CALCULATE PROVISIONAL INCOME

To determine how much of your benefits are taxed, you must calculate your "provisional income." Doing so involves adding certain amounts (for example, tax-exempt interest from municipal bonds) to the adjusted gross income on your tax return.

If you file jointly, you'll need to add your spouse's income, and then further add half of the Social Security benefits that you and your spouse received during the year. The result is your joint provisional income.

If you file a joint tax return and your provisional income, plus half your benefits, isn't above $32,000 ($25,000 for single taxpayers), none of your Social Security benefits are taxed. If your provisional income is between $32,001 and $44,000, and you file jointly, you must report up to 50% of your Social Security benefits as income. If your provisional income is more than $44,000, and you file jointly, you need to report up to 85% of your Social Security benefits as income on Form 1040.

For single taxpayers, if your provisional income is between $25,001 and $34,000, you must report up to 50% of your Social Security benefits as income. And if your provisional income is more than $34,000, the general rule is that you need to report up to 85% of your Social Security benefits as income.

SIDESTEP A SURPRISE

If you aren't paying tax on your Social Security benefits now because your income is below the floor, or you're paying tax on only 50% of those benefits, an unplanned increase in your income can have a significant tax cost. You'll have to pay tax on the additional income, you'll also have to pay tax on (or on more of) your Social Security benefits, and you may get pushed into a higher tax bracket.

Contact us for help in accurately calculating your provisional income. We can also assist you with other aspects of tax planning before and during retirement. ■

TAX CALENDAR

April 15
Along with being the last day to file (or extend) your 2020 personal return and pay any tax that's due, first quarter 2021 estimated tax payments for individuals, trusts and calendar-year corporations are due today. Also due are 2020 returns for trusts and calendar-year estates and C corporations. FinCEN Form 114 ("Report of Foreign Bank and Financial Accounts") is due, though an automatic extension applies to October 15. Plus, any final contribution you plan to make to an IRA or Education Savings Account for 2020 is due on this day. SEP and profit-sharing plan contributions are also due if your return isn't being extended.

April 30
Employers must file Form 941 for the first quarter (or on 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 17
Calendar-year exempt organizations must file (or extend) their 2020 Form 990, 990-EZ or 990PF returns.

June 15
Second quarter 2021 estimated tax payments are due for individuals, calendar-year corporations, estates and trusts.

HOW THE CAA AFFECTS EDUCATION FUNDING

The Consolidated Appropriations Act (CAA), signed into law late last year, contains a multitude of provisions that may affect individuals. For example, if you're planning to fund a college education or in the midst of paying for one, the CAA covers two important areas:

1. Student loans. The CARES Act temporarily halted collections on defaulted loans, suspended loan payments and reduced the interest rate to zero through September 30, 2020. Subsequent executive branch actions extended this relief through January 31, 2021. The CAA leaves in place that expiration date.

Also under the CARES Act, employers can provide up to $5,250 annually toward employee student loan payments on a tax-free basis before January 1, 2021. The payment can be made to the employee or the lender. The CAA extends the exclusion through 2025. The longer term may make employers more willing to offer this benefit.

2. Tax credits. Qualified taxpayers generally can claim an education tax break with the American Opportunity Tax Credit (AOTC) and the Lifetime Learning Credit (LLC). Previously, though, the two credits were subject to different income phaseout rules, with the AOTC available at a greater modified adjusted gross income than the LLC. In addition, before the new law, there was a "higher education expense deduction" for qualified tuition and related expenses that taxpayers could opt to claim instead of the credits.

The CAA adopts a single phaseout for both the AOTC and the LLC, effective for tax years beginning after December 31, 2020. The credits will phase out beginning at $80,000 for single filers and ending at $90,000. For joint filers, they will begin to phase out at $160,000 and disappear at $180,000. The new law also repeals the higher education expense deduction. Instead, taxpayers can claim the LLC credit. ■