

# 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

WILLIAM JEFFERSON COLE, C.P.A.  
BARRY S. SHIPP, C.P.A.  
STEVEN W. HEDGEPEETH, 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.

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.  
ADAM JEFFERSON CAIN, C.P.A.  
MADISON PAIGE LAIRD, C.P.A.  
BONNIE C. PESNELL, C.P.A.  
ANDY L. BUI, C.P.A.  
JENNIFER RENEE TURNER, C.P.A.  
JONATHAN B. WEST, C.P.A.  
MANDI ROSE KILLIAN, C.P.A.

JUNE 2020

## THE DEVELOPING PPP

The Paycheck Protection Program (PPP), part of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), continues to evolve as its rules are promulgated by the Treasury and the Small Business Administration (SBA). PPP loans are available (when loan approval is completed by June 30, 2020) to almost all businesses with 500 or less employees and extended within some industries to employers with more than 500 employees.

The program provides SBA guaranteed (and likely to be forgiven) loans in an amount equal to 2 ½ months of the average pre-Covid-19 payroll cost of the borrower. Originally, some or all of a loan was to be forgiven based on the amount of spending during an eight-week period (56 days) on certain payroll costs, rent, utilities, and certain mortgage interest payments, but subject to certain clawback rules. The forgiveness spending period (coverage period) has now been expanded to 24 weeks by the Paycheck Protection Program Flexibility Act of 2020. This change also reduced the requirement that payroll cost must be at least 75 percent of the amount forgiven to 60 percent of the amount forgiven. Because the coverage period for spending “forgivable costs” is now 24 weeks and the loan amount was equivalent to only 10 weeks of payroll cost, it appears likely that most

PPP loans will be fully forgiven despite the clawback rules.

The administrative burden of proving program qualifications has been eased by ruling that any borrower, together with its affiliates, that receives PPP loans in an original principal amount of less than \$2 million will be deemed qualified as to the necessity of the loan.

Currently unresolved is the question of the taxation of the loan forgiveness. The law and congressional leadership indicate that the benefit of loan forgiveness is to be tax-free. The Internal Revenue Service has ruled to the contrary. Senator Grassley, along with several other congressional leaders, has introduced the Small Business Expense Protection Act to clarify that expenses paid with forgiven PPP loan proceeds remain tax-deductible.

In summary, it appears for now that many, if not most, PPP loans are likely to be forgiven in full, loans under \$2 million are “safe-harbored” as being appropriate loans, but the tax deduction status of expenses that formed the basis for loan forgiveness remains disputed as the Internal Revenue Service has ruled them non-deductible, but Senator Grassley and several other congressional leaders assert such expenses are fully deductible.

*(Continued on reverse)*

## TOP COMBINED TAX RATES

The current federal tax rate schedules show the top federal income tax rate for individuals as 37 percent. That is not, however, the top individual federal tax rate because it omits an “add-on” income tax. In addition to the stated top tax bracket of 37 percent, the net investment income tax (for single individuals with adjusted gross income above \$200,000 and married couples with adjusted gross income above \$250,000) is 3.8 percent of net investment income and creates an actual top stated federal rate for these taxpayers of 37 percent plus 3.8 percent or 40.8 percent.

The top Louisiana bracket is six percent. Federal income tax remains deductible in computing Louisiana income tax (its non-deduction was proposed in the 2016 session of the Louisiana Legislature); however, the Louisiana tax deduction in computing federal taxable income tax is now limited to \$10,000. This limited interrelated deduction results in a combined federal (40.8 percent) and Louisiana top rate ( $100.00 - 40.8 \times .06 = 3.55\%$ ) for 2019 of 44.35 percent.

After paying income tax at the top Louisiana and federal brackets, high-income taxpayers are left with 55.65 percent of their marginal, top-bracket investment income. If this after-tax income is saved and is subjected to death tax at the current 40 percent rate, the heirs will receive about 33 percent of the decedent’s marginal income ( $55.65\% \times .6 = 33.4\%$ ), and the federal and Louisiana governments will have received about 67 percent of that income. In other words, without effective lifetime income and estate tax planning, the federal and Louisiana governments will ultimately enjoy about two-thirds of top bracket income, and the heirs will receive about one-third of this top rate, investment (savings) income.

For those with top-bracket investment incomes (especially those with probable taxable estates), understanding the income tax and death tax aspects before making investment and estate planning decisions is important. Those who are paying in the upper income tax brackets might be forgiven for thinking about what is their “fair share” of the cost of government.

## OCCAM’S RAZOR

Complicated situations require complex responses – for example, space travel, rocket science, and neurosurgery. Although nowhere nearly as complicated as the preceding examples, some legal, tax, and financial issues do require complicated responses – for example, intentionally defective trusts, choice between taxable corporations and pass-through entities, and long-term investment planning amid frequently changing tax law. There is, however, at least one area where simplicity and the resulting tax and cost-effectiveness are easily achieved – where complexity is not required – that is, in selecting investments.

Individual Retirement Account (IRA) owners and 401(k) plan participants, etc. are almost always best served by limiting their choices of investments to mutual funds (passive or actively managed), publicly traded securities (usually buy and hold) and money market accounts. Other investments are available, but some have significant disadvantages when held in tax-favored accounts. For example, limited partnerships with unrelated business income

can require the filing of Form 990T and current payment of income tax even by a Roth IRA account. Loans from a 401(k) to the participant are burdened with complex rules and contain traps for the unwary. Mutual funds holding marketable securities (stocks and fixed income) are usually the best choice for IRAs, 401(k)s, etc.

For investors in taxable accounts, investing in publicly traded limited partnerships frequently results in delayed receipt of Schedules K-1 and more complex and expensive tax return preparation.

In life, simplicity is, of course, not always available and, if available, might not be the best or most interesting option. Nonetheless, in investment selection, when available, simplicity is almost always the best choice. The principle of parsimony (Occam’s Razor) dictates that in choosing between competing explanations of a phenomenon, the simplest should be chosen. We would assert that when choosing between competing investments of similar risks/reward ratios, the simplest should be chosen.

# Cole, Evans & Peterson, CPAs

www.cepcpa.com

624 Travis Street

Shreveport, Louisiana 71101

(318) 222-8367



## Tax & Business Alert

JUNE 2020

### **DON'T FORGET ABOUT YOUR 2019 TAX RETURN**

Earlier this year, in response to the novel coronavirus (COVID-19) crisis, the IRS postponed numerous federal tax filing and payment deadlines. If you took advantage of the extra time, it's important not to forget about your return or lose sight of any important details.

#### **RECAPPING THE RELIEF**

For taxpayers with a 2019 federal income tax return or payment that had been due on April 15, 2020, the due date for filing and paying has been automatically postponed to July 15, 2020, regardless of the size of any payment owed. The taxpayer doesn't have to file Form 4868, which allows automatic extensions for individuals, or Form 7004, which should be used for certain business income tax, information and other returns.

The relief also applies to estimated income tax payments (including tax payments on self-employment income) previously due on April 15, 2020, and June 15, 2020, for the taxpayer's 2020 tax year. The IRS has clarified that the postponed deadline also applies to numerous other federal tax filing and payment deadlines that had been on or after April 1, 2020, and before July 15, 2020, including gift and generation-skipping transfer tax filings and payments.

As a result of the return filing and tax payment postponements, the period from April 1, 2020, through July 15, 2020, is disregarded in calculating any interest, penalty or addition to tax for failure to file the postponed income tax returns or pay the postponed income taxes.

#### **FILING AN EXTENSION BEYOND JULY 15**

It's possible that, before July 15, deadlines could be postponed again or new extension relief could be made available. Otherwise, if you can't file by July 15, as an individual, you can request an automatic extension until October 15, 2020.

As of this writing, you must request the automatic extension by July 15, 2020. To minimize interest and penalties when filing for an extension, you must properly estimate any 2019 tax liability due and pay that liability by July 15, 2020.

#### **CONTRIBUTING TO ACCOUNTS**

The COVID-19 relief also applies to 2019 IRA contributions, so you can still make those



## RELIEF DOESN'T APPLY TO 2019 ESTIMATED TAX PAYMENTS

If you're a gig worker or independent contractor, be advised that the tax relief related to the novel coronavirus (COVID-19) outbreak doesn't apply to 2019 estimated tax payments or penalties for failure to timely make 2019 estimated tax payments. In other words, if you failed to make the required installments of estimated tax in the required amounts, the COVID-19-related relief doesn't apply. However, you may seek relief under the normal rules by filing Form 2210, "Underpayment of Estimated Tax by Individuals, Estates, and Trusts," or Form 2220, "Underpayment of Estimated Tax by Corporations."

contributions through July 15, 2020. Similarly, you can make a 2019 contribution to a Health Savings Account or Archer Medical Savings Account through July 15, 2020, as well.

### GETTING THE OPTIMAL BENEFIT

The COVID-19 crisis put unprecedented pressure on U.S. taxpayers. We can help ensure you get the relief offered by the federal government, as you're eligible. ■

## KEEPING UP WITH THE NET OPERATING LOSS RULES

When a trade or business's deductible expenses exceed its income, a net operating loss (NOL) generally occurs. When filing your 2019 income tax return, you might find that your business has an NOL — and you may be able to turn it to your tax advantage. But the rules applying to NOLs have changed and changed again. Let's review.

### PRE-TCJA

Before 2017's Tax Cuts and Jobs Act (TCJA), when a business incurred an NOL, the loss could be carried back up to two years. Any remaining amount could then be carried forward up to 20 years.

A carryback generates an immediate tax refund, boosting cash flow. A carryforward allows the company

to apply the NOL to future years when its tax rate may be higher.

### POST-TCJA

The changes made under the TCJA to the tax treatment of NOLs generally weren't favorable to taxpayers. According to those rules, for NOLs arising in tax years ending after December 31, 2017, most businesses couldn't carry back a qualifying NOL.

This was especially detrimental to trades or businesses that had been operating for only a few years. They tend to generate NOLs in those early years and greatly benefit from the cash-flow boost of a carryback. On the plus side, the TCJA allowed NOLs to be carried forward indefinitely, as opposed to the previous 20-year limit.

For NOLs arising in tax years beginning after December 31, 2017, the TCJA also stipulated that an NOL carryforward generally can't be used to shelter more than 80% of taxable income in the carryforward year. (Under previous law, generally up to 100% could be sheltered.)

### COVID-19 RESPONSE

In response to the novel coronavirus (COVID-19) pandemic, the NOL rules were changed yet again under the Coronavirus Aid, Relief, and Economic Security (CARES) Act. For NOLs arising in tax years beginning in 2018 through 2020, taxpayers are now eligible to carry back the NOLs to the previous five tax years. You may be able to file amended returns for carryback years to receive a tax refund now.





The CARES Act also modifies the treatment of NOL carryforwards. For tax years beginning *before* 2021, taxpayers can now potentially claim an NOL deduction equal to 100% of taxable income (rather than the 80% limitation under the TCJA) for prior-year NOLs carried forward into those years. For tax years beginning *after* 2020, taxpayers may be eligible for a 100% deduction for carryforwards of NOLs arising in tax years before 2018 *plus* a deduction equal to the lesser of 1) 100% of NOL carryforwards

from post-2017 tax years, or 2) 80% of remaining taxable income (if any) after deducting NOL carryforwards from pre-2018 tax years.

### COMPLICATED RULES

The NOL rules have always been complicated and multiple law changes have complicated them further. It's also possible there could be more tax law changes this year affecting NOLs. Please contact us for further clarification and more information. ■

## SHOULD YOU DIGITIZE YOUR TAX AND FINANCIAL RECORDS?

Traditionally, important tax and financial records have been stored as hardcopies in desk drawers, filing cabinets and safe deposit boxes. Nowadays, it's become increasingly popular and easy to digitize documents and store them electronically. Is this the right move for you?

### PLUSES OF ELECTRONIC STORAGE

Perhaps the biggest advantage of digital documents is a drastic reduction in the amount of paper that you must sort, organize and store. Also, digital documents are generally more protected from damage than paper files — assuming they're stored properly.

In addition, electronic documents can be digitally date-stamped, which helps ensure that you're accessing the most recent versions. You can track edits to electronic files, monitor who's been viewing them and restrict access to sensitive documents, too.

### SELF-HOST OR THE CLOUD

To digitize paper documents, you need only a scanner, which can be rented if you don't have one and don't wish to purchase one. You can shred many paper files after digitization, though you may need to retain paper versions of some legal documents. (Consult an attorney about which ones.)

When it comes to storage, you essentially have two options:

**1. A self-hosted system.** Here, you buy a dedicated hard drive (or several high-quality thumb drives) to store your digital records. It's best not to keep these files on your home computer because, if it crashes or gets hacked or stolen, your sensitive data may be lost permanently or exposed. Hackers can't get to self-hosted files because they're not on the Internet,



and you can limit your drive's exposure to natural disasters, accidental damage and theft risk by keeping it in a fire-proof safe.

**2. The cloud.** You've likely heard of, and may even use, Internet-based storage for photos or other items. You can do this for tax and financial records as well, but you've got to be careful. Choose a reputable and stable provider that encrypts everything. The upside is you'll have instant access to your files anywhere in the world — as long as you have a secure Internet connection. The downside: you'll lose access during Internet outages and no cloud system is 100% guaranteed secure.

### ORGANIZED AND SAFE

For many people, the right approach might be "both." Retain paper files of certain documents for a recommended period and digitize everything else. Our firm can help you find the best way to keep your tax and financial records organized and safe. ■

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## THE MARRIAGE PENALTY STILL EXISTS UNDER THE TCJA

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One byproduct of the Internal Revenue Code is that the tax liability of married couples who file jointly may be more than their combined tax liabilities would be as single filers. This is “the marriage penalty.”

Unfortunately, this hasn’t gone away under the Tax Cuts and Jobs Act (TCJA). For example, through 2025, the TCJA imposes a \$10,000 limit on itemized deductions for state and local taxes. The limit is the same for joint filers and single filers. That means unmarried couples can deduct \$10,000 each, for a total of \$20,000, while married couples can deduct only \$10,000. (There have been proposals in Congress to eliminate the limit.)

There’s a similar marriage penalty on mortgage interest deductions. Through 2025, the TCJA reduced the amount of home acquisition debt that’s eligible for interest deductions from \$1 million to \$750,000 for debt incurred after Dec. 15, 2017. Again, the limit is the same for joint filers and singles filers, so while married couples may be able to deduct interest on



only \$750,000 in home acquisition debt, unmarried couples may be able to deduct interest on up to a combined \$1.5 million.

If you’re getting married, we can help you crunch the numbers and see how your union will affect your tax bill. No one would suggest that a potential marriage penalty should influence your decision to tie the knot, but knowing the impact can help you make informed financial planning decisions. ■