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JUNE 2016

BUFFETT'S BET
(AND SOME OF HIS RECENT COMMENTS)

As many of you will recall, Warren Buffett, often considered the most successful investor in history, has long recommended that the best way for most of us to own common stocks is through a passive index fund that charges minimal fees. You may also be aware that just over eight years ago, Mr. Buffett made a bet with a team of managers at Protégé Partners, LLC, a New York hedge fund managing over $3,500,000,000 in assets, of a $1,000,000 donation to be made by the loser to a charity to be selected by the winner.

The bet by Mr. Buffett was that for the ten years beginning January 1, 2008 (just prior to the meltdown and the great recession) the Vanguard Index 500 Fund would outperform the hedge fund managers of Protégé Partners, LLC. The Vanguard Index 500 closely tracks the S&P 500 Index.

After the first eight years, the Vanguard 500 Index Fund had a cumulative gain of 65.7 percent while the Hedge Funds gained 21.9 percent. In other words, in the first eight years an investment of $1,000, in the Vanguard Index 500 Fund grew $657 as compared to the Hedge Fund's growth of $219. The Vanguard Index 500 Fund returned precisely three times the return of the hedge fund managers.

The detail results of the first eight years of the wager are as follows:

Total Annual Return

Year	Vanguard Index 500 Fund	Hedge Funds
2008	-37.0%	-23.9%
2009	26.6%	15.9%
2010	15.1%	8.5%
2011	2.1%	-1.9%
2012	16.0%	6.5%
2013	32.3%	11.8%
2014	13.6%	5.6%
2015	1.4%	1.7%
Total Cumulative Return	65.7%	21.9%

Mr. Buffett has long suggested that for long-term investors being fully invested in diversified equities with only token fees and commissions is the most prudent way to invest. In a recent letter to the shareholders (part of the Berkshire Hathaway annual report), he makes the case for a diversified portfolio of equities. He states:

*"The unconventional, but inescapable, conclusion to be drawn from the past fifty years is that it has been **far** safer to invest in a diversified collection of American businesses than to invest in securities – Treasuries, for example – whose values have been tied to American currency. That was also true in the preceding half-*

(Continued on reverse)

century, a period including the Great Depression and two world wars. Investors should heed this history. To one degree or another it is almost certain to be repeated during the next century.

*Stock prices will always be far more **volatile** than cash-equivalent holdings. **Over the long term**, however, currency-denominated instruments are **riskier** investments – **far** riskier investments – than widely-diversified stock portfolios that are bought over time and that are owned in a manner invoking only token fees and commissions. That lesson has not customarily been taught in business schools, where volatility is almost universally used as a proxy for risk. Though this pedagogic assumption makes for easy teaching, it is dead wrong: Volatility is **far** from synonymous with risk. Popular formulas that equate the two terms lead students, investors and CEOs astray."*

Eight years does not win a ten-year bet. Regardless of the outcome of Buffett's bet, the past hundred plus years has shown the wisdom of Mr. Buffett's suggestion that most investors are best served, pre-tax and post-tax, by making their long-term, core investment in a passive stock index fund.

It should be remembered that the returns cited above for the stock index fund and the hedge fund are both pre-tax. After tax computations would result in the passive Vanguard Index 500 outperforming the managed hedge funds even more so as current taxable income is much less on the Vanguard Index 500 (limited to the dividend return of about two percent) than on actively managed hedge funds which are taxed currently on both trading results and dividends. Although Mr. Buffett bet on the Vanguard Index 500, there are many other low-cost, passive stock funds available from other sources which successfully track the S&P 500 index and are currently taxed only on their dividend income.

North Louisiana No. 1

According to the 2016 Competitive Alternatives study by KPMG, LLP a global audit, tax, and advisory firm, Monroe, Louisiana has the lowest cost of doing business of any U.S. city. Shreveport-Bossier was the second most cost competitive city followed by several other Louisiana metropolitan areas.

The study covered 81 U.S. cities and the rankings were reported based on the average cost city being assigned an index of 100. Monroe had an index of 91.3 and Shreveport followed closely at 91.7. In other words, in Monroe, business costs (the study considered 26 cost factors) were 8.7 percent below the U.S. average. In Shreveport, business costs were 8.3 percent less than the national average. The Louisiana average was 92.3. For comparison, Baton Rouge was at 92.8, New Orleans at 93.1, Oklahoma City at 94.6, Atlanta at 95.1, Dallas at 96.2, and Houston 97.6. According to the North Louisiana economic partnership, North Louisiana has been at the top of the most affordable places to do business since 2008. The complete 2016 study is available on-line at https://www.competitivealternatives.com/cities/default.aspx.

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Tax & Business Alert

JUNE 2016

ORGANIZING YOUR FINANCIAL RECORDS FOR BEST RESULTS

With tax time long over and midyear officially here, it's a great time to organize your financial records. And the key word here is indeed "organize." Throwing all your important documents into a drawer won't help much when an emergency occurs and you (or a family member) need to find a certain piece of paper.

MAKE A LIST

Of course, emergencies aren't the only reason to organize your records. For example, you may need to be able to access relevant personal records if you're ever audited or a victim of theft. Or your home could be damaged in a storm or fire. Or you may need proof to cash in investments or claim insurance benefits.

To get started, make a list of important records. These include items related to:

- Bank and investment accounts,
- Real estate and homeownership,
- Insurance policies,
- Credit card accounts,
- Health care benefits and medical history, and
- Marriage and your estate.

Grouping the items into broad categories such as these will make them easier to file and find later.

ESTABLISH YOUR APPROACH

With your list in hand, it's time to start organizing and storing your records. Here are some tips for streamlining the process:

Create a central filing system. The ideal storage medium for personal documents is a fire-, water- and impact-resistant security cabinet or safe. Create a master list of the cabinet contents and provide a copy of the key to your executor or a trusted family member.

Designate a second storage location. Maintain a duplicate set of the records in another location, such as a bank safety deposit box, and provide access to a trusted individual (preferably not the same individual with access to the original documents). Consider keeping originals of your important legal documents, such as your will, with your attorney.

Back up records electronically. It also makes sense to store copies of records electronically.

CREATE AN EMERGENCY CHECKLIST TO COPE WITH CALAMITY

Having an emergency checklist of important personal records handy is essential in the event you must evacuate your home. In a crisis, you'll likely be able to take only what you can easily carry with you. That means storing the bare essentials in a portable container. Include these items:

- Driver's license, passport and Social Security card,
- Credit cards,
- Vital medical condition and medication information,
- Health insurance cards, and
- Emergency family and physician contacts.

Also set up an "In Case of Emergency" (ICE) directory in your cell phone. In your phone directory, simply type in "ICE" before each contact (ICE-1 Jane Smith, ICE-2 Dr. John Smith, etc.). Also consider storing and carrying electronic copies of key personal records on a USB flash drive.

Simply scan your documents and save them to a trustworthy external storage device. If opting for a cloud-based backup system, choose your provider carefully to ensure its security measures are as stringent as possible.

FOLLOW THE RITUAL

Make organizing your records an annual ritual and not just a one-time event. Need assistance? We can help you identify the specific documents pertinent to your situation and organize them appropriately. ■

BEWARE THE TRANSFER-FOR-VALUE RULE WHEN DEALING WITH LIFE INSURANCE

Life insurance typically is a key component of an estate plan. To keep the value of a life insurance policy you already own out of your taxable estate, or to achieve other planning goals, it may make sense to transfer the policy. But income tax traps exist. One is the transfer-for-value rule. So before making a transfer, it pays to become familiar with this rule.

CONCEPT AND EXCEPTIONS

Normally, life insurance proceeds payable by reason of death (that is, death benefits) are not subject to income tax. However, when the transfer-for-value rule applies, the transferee — the person receiving the policy — will be subject to ordinary income taxes on the policy's death proceeds, excluding the consideration paid for the policy and any premiums or other charges he or she pays after the transfer.

The transfer-for-value rule is intended to discourage speculation in insurance policies by people who lack an insurable interest. An insurable interest is a legitimate reason for someone to be insured against your death — typically, this means the person would suffer a financial hardship. Examples of people with an insurable interest on you could include your spouse, child and business partner.

Unfortunately, the rule's design doesn't necessarily jibe with its underlying rationale. For example, though the rule contains several exceptions, there isn't one for transfers to children or other family members who typically *do* have an insurable interest.

So what are the exceptions? One is when the transfer is made to the insured, a partner of the insured, a partnership in which the insured is a partner, or a corporation in which the insured is a shareholder or officer. Be aware that this exception doesn't apply in reverse, when the transfer is to an officer or shareholder.

POTENTIAL PITFALLS

One reason the transfer-for-value rule is so dangerous is that the term "transfer" goes well beyond an outright sale or physical transfer of a policy. A transfer can occur, for example, when you name a beneficiary or assign someone an interest in the policy.

A transfer won't cause the death benefits to become subject to income taxes unless the transferee provides "valuable consideration," but this aspect of the rule can be treacherous as well. Valuable consideration isn't limited to money. It can be virtually anything of value to the transferor — the person transferring the policy or interest.

It's logical to assume that the transfer-for-value rule won't apply to a gift of a policy or of an interest in a policy. In most cases, that's true, but even gift transfers should be examined closely to avoid the transfer-for-value trap.

PLENTY OF THOUGHT

If you want to transfer a policy, give it plenty of thought. The transfer-for-value rule is a tax trap to which many individuals fall prey. We can help you decide whether a policy transfer is really a good idea and, if so, how to prepare for the tax impact. ■

BUSINESS OWNERS, IS IT TIME FOR SECTION 199?

The Section 199 tax deduction was first introduced with the American Jobs Creation Act of 2004. It was intended to primarily benefit America's manufacturing industry. Indeed, sometimes the tax break is called the "manufacturers' deduction" or the "domestic production activities deduction." But, helpfully, eligibility for the break is broad enough to include many other types of businesses.

Among the primary requirements for the deduction is that your company regularly perform "qualified production activities." These are generally defined as tasks related to manufacturing, producing, constructing, growing or extracting property "in significant part" within the United States. If any of that sounds familiar, it may be time for you to check out Sec. 199.

IDENTIFYING AND GATHERING

To get started, you'll need to identify and document your qualified production activities, and then determine how much income you've derived from them. Doing so will require gathering gross receipts from the lease, rental, exchange or other transfer of qualifying production property minus out-of-pocket expenses, such as materials costs. Eligible items include tangible personal property, computer software and sound recordings used in qualified production activities.

Having done all of this, you may then be able to claim a deduction equal to 9% of the lesser of either your net income derived from your qualified production activities or your entire taxable income for the year. There is, however, an important caveat: The deduction can't exceed 50% of the W-2 wages paid to employees during the calendar year that are allocable to domestic production gross receipts.

CRUNCHING THE NUMBERS

Let's take a hypothetical look at the Sec. 199 deduction and how it might benefit a business. Say your company nets $800,000 in taxable income on $4 million in gross receipts in 2016, entirely from qualified production activities. Assuming your W-2 wages paid are adequately substantial, the deduction at the 9% rate will be $72,000, for a federal tax savings of over $25,000 based on a 35% rate. That would presumably be a nice cash flow boost.

Perhaps the biggest challenge of the Sec. 199 deduction, and one that many companies underestimate, is the administrative burden that may be associated with claiming it. You'll need to meticulously track and maintain documentation for your business's qualifying production activities.

GETTING EVERYTHING IN ORDER

If you're intrigued by the Sec. 199 deduction, please call us. Not only are the administrative requirements challenging, but the calculations involved often get complex as well. ■

SUMMER CAMP COSTS MAY BRIGHTEN YOUR TAX RETURN

The coming and going of Memorial Day marks the beginning of summer in the minds of many Americans. Although the kids might still be in school for another week or two, summer day camp is rapidly approaching for many families. If yours is among them, did you know that sending your child to day camp might make you eligible for a tax break?

Day camp *is* a qualified expense under the child and dependent care credit. This tax break is worth 20% of qualifying expenses, subject to a cap — and could be worth even more if your adjusted gross income is less than $43,000. For 2016, the maximum expenses allowed for the credit are $3,000 for one qualifying child and $6,000 for two or more.

Be aware, however, that *overnight* camp costs don't qualify for the credit, nor do expenses related to summer school tutoring. In addition, certain types of child care are ineligible. These include care provided by a spouse and care provided by a child who's under age 19 at the end of the year.

A variety of additional rules may apply. For example, eligible costs for care must be work-related. In other words, parents need to pay for the care so that they can work (or look for work). If you think you might qualify for the child and dependent care credit, please contact us. We can help you determine whether you're eligible and then properly claim this potentially valuable tax break. ■