



clarity
GAINED

Top 8 Federal and State Tax Issues and Strategies for 2018



AGENDA

- 1 QUALIFIED BUSINESS INCOME DEDUCTION
- 2 NEW SALES TAX LANDSCAPE
- 3 DEPRECIATION AND COST RECOVERY
- 4 UNRELATED BUSINESS INCOME
- 5 INTEREST EXPENSE
- 6 SALT AND CHARITY
- 7 OTHER CHANGES FOR BUSINESSES
- 8 STATE TAX CONFORMITY



#1

QUALIFIED BUSINESS INCOME DEDUCTION (QBI)

WHAT IS QBI?

Net amount of qualified income, gain, deductions and losses from a **Qualified Business**

EXCLUDES:

1. Wages/guaranteed payments earned from such entities
2. Certain investment income

QBI DEDUCTION

LESSER OF:

- A. Combined Qualified Business Income of taxpayer, or
- B. 20% of the excess of taxable income over sum of net capital gain

COMBINED QUALIFIED BUSINESS INCOME

- 1. 20% of QBI, or
- 2. GREATER of:
 - a. 50% of allocable share of W-2 wages paid by entity, or
 - b. 25% of allocable share of W-2 wages, PLUS 2.5% of allocable share of unadjusted basis of the entity's assets

NOTE: W-2/ASSET LIMITATIONS IGNORED IF TAXABLE INCOME BEFORE QBI DEDUCTION < \$315,000 (MFJ) OR \$157,500 FOR ALL OTHER FILERS.

WHAT IS A QUALIFIED TRADE OR BUSINESS?

SECTION 199A DEFINES A QUALIFIED TRADE OR BUSINESS BY EXCLUSION

Every trade or business is qualified, other than:

- The trade or business of performing services as an employee; and
- A specified service trade or business (generally)

MUST BE EFFECTIVELY CONNECTED WITH A U.S TRADE OR BUSINESS



Investment
Management

Health

Actuarial Services

Brokerage
Services

QBI DEDUCTION

Specified service businesses prohibited

“Any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners”

Consulting

Law

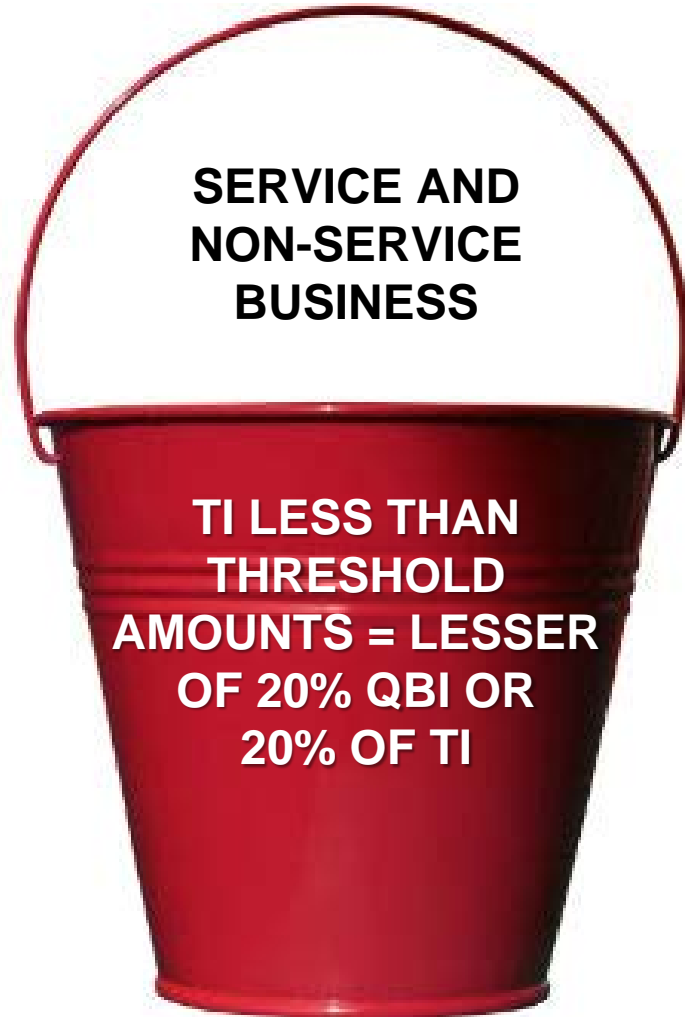
Athletics

Accounting

Performing
Arts

Financial
Services

QUALIFIED BUSINESS INCOME DEDUCTION "BUCKETS"



\$315,000-\$415,000 MFJ, \$157,500-\$207,500 ALL OTHER TAXPAYERS

PROPOSED REGULATIONS ISSUED IN AUGUST

- Clearer definition of specified service trade or business
- De minimis exception for businesses selling both products and services
- Services or property provided to a SSTB – “cracking” prohibited
- Treatment of Employees turned Independent Contractors
- Aggregation of commonly controlled businesses
- Allocation and aggregation of W-2 wages
- Fiscal year businesses

QUESTIONS LEFT UNANSWERED

- Do owners of rental property qualify? (Trade or business “definition”)
- How will carryforward losses be used?
- What exactly goes into QBI?
- Section 1231 gains as QBI?
- S Corporation Reasonable Compensation

STRATEGIES

ENTITY CHOICE AND ELIGIBILITY FOR QBI DEDUCTION

- Distributions vs. Retained earnings
- Application of payroll taxes, SE taxes, 3.8% Medicare surtax
- State income tax deduction limitation

DON'T FORGET TAX CONSEQUENCES OF CONVERSION...AND THE COST TO UNDO A CONVERSION

REASONABLE COMPENSATION

MULTI-YEAR PLANNING



#2

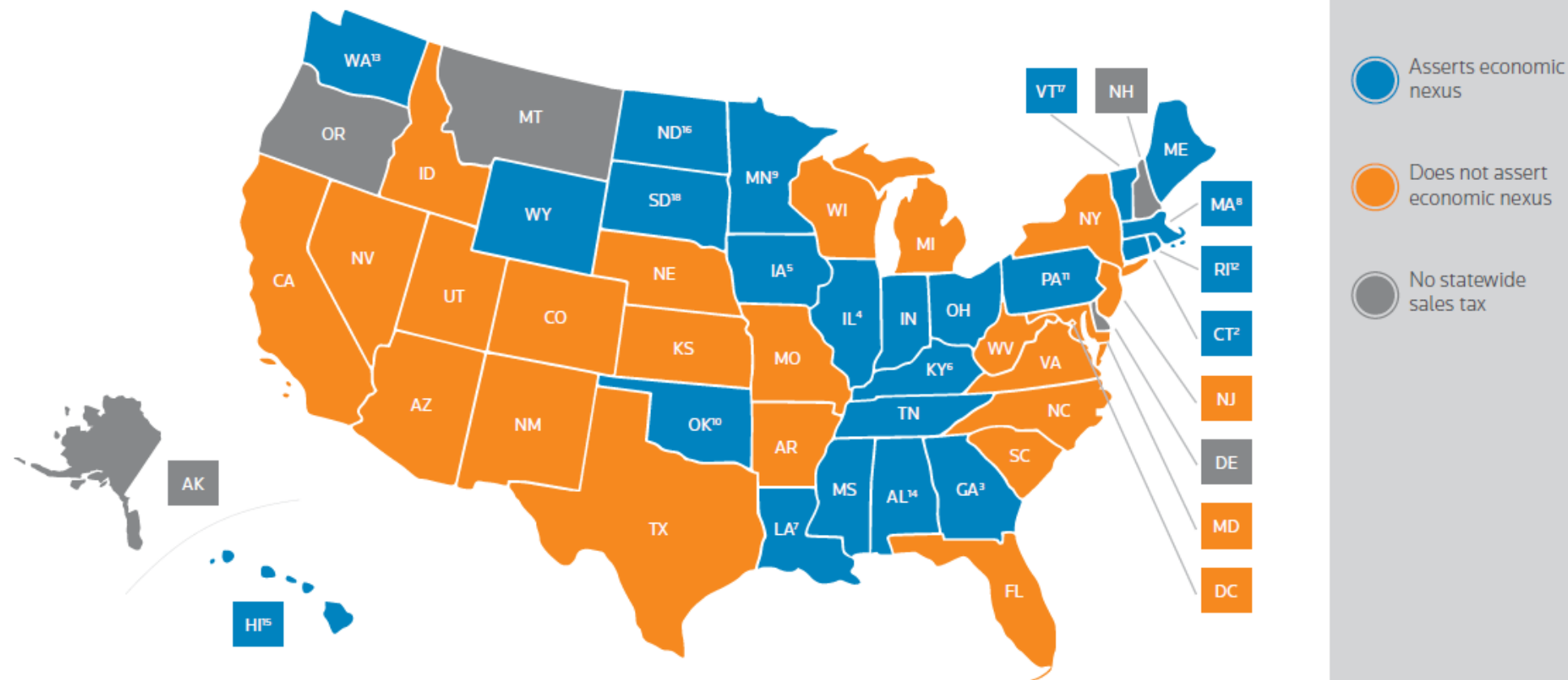
SALES TAX CHANGES

SOUTH DAKOTA V. WAYFAIR

- Decided 6/22/18
- Overrules the decisions of Quill and National Bellas Hess
- Physical presence no longer required for sales tax nexus
- South Dakota law based on economic nexus for sellers with:
 - \$100,000 or more in sales
 - 200 or more transactions
- Many states have updated their laws accordingly, or are expected to follow

Economic Nexus

Does the state assert sales/use tax jurisdiction on the basis of economic nexus?¹



1 Current as of June 21, 2018.

2 Beginning December 1, 2018.

3 Beginning January 1, 2019; only as an elective alternative to notice and reporting requirements.

4 Beginning October 1, 2018.

5 Beginning January 1, 2019.

6 Beginning July 1, 2018.

7 Contingent on the outcome in *South Dakota v. Wayfair*. The Louisiana Department of Revenue is studying the decision.

8 Massachusetts Department of Revenue considers cookies and apps to be “physical presence.”

9 Sales via third-party marketplace can create nexus effective July 1, 2019 or, if earlier, a U.S. Supreme Court decision overturning the physical presence requirement.

10 Only as an elective alternative to notice and reporting requirements.

11 Only as an elective alternative to notice and reporting requirements.

12 Only as an elective alternative to notice and reporting requirements.

13 Only as an elective alternative to notice and reporting requirements.

14 Regulation will be enforced only to the extent permitted under *South Dakota v. Wayfair*.

15 Beginning July 1, 2018.

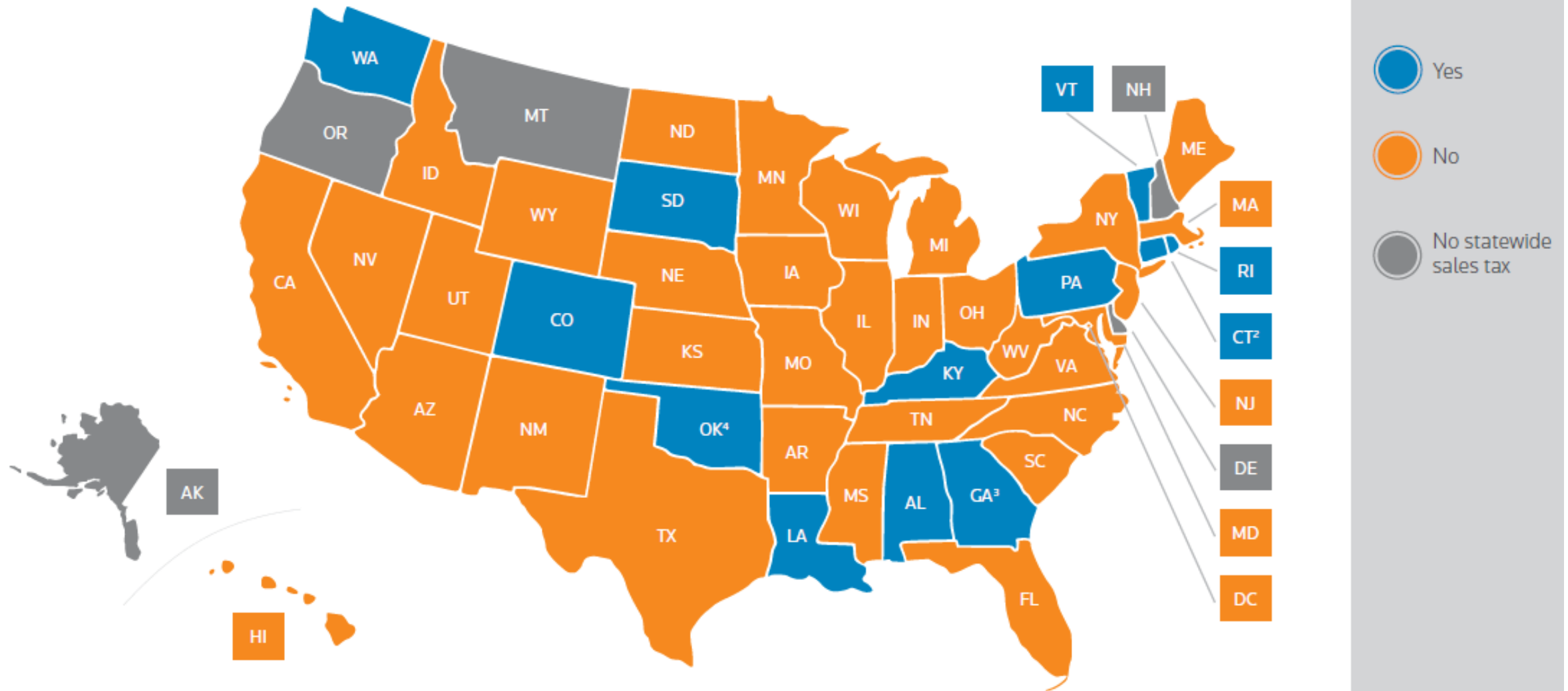
16 Contingent on the outcome of *South Dakota v. Wayfair*. The North Dakota Office of State Tax Commissioner announced that the law took effect on June 21, 2018.

17 Contingent on the outcome of *South Dakota v. Wayfair*. The Vermont Department of Taxes announced that the law is effective and will be enforced beginning July 1, 2018.

18 An injunction prevents the state from enforcing the law until the South Dakota Supreme Court rules on the case remanded by the Wayfair Court.

Notice and Reporting Requirements

Does the state impose use tax notice and reporting requirements on remote sellers?¹



¹ Current as of June 21, 2018. Note: registering to collect and remit sales tax typically relieves a seller of use tax notice and reporting obligations.

² Beginning December 1, 2018 applies to "referrers." Connecticut also takes the position that existing state records law allows it to require remote sellers to disclose in-state sales.

³ Beginning January 1, 2019.

⁴ Beginning July 1, 2018.



#3

DEPRECIATION AND COST RECOVERY

EXPENSING OF CAPITAL INVESTMENTS

BONUS DEPRECIATION

Applies to new and used property

PERIOD	APPLICABLE PERCENTAGE
9/27/2017 – 2022	100%
2023	80%
2024	60%
2025	40%
2026	20%
2027 - FORWARD	0%

EXPENSING OF CAPITAL INVESTMENTS

SECTION 179

- Limitation increased to \$1 million max with \$2.5 million additions phase out
- Qualified Improvement Property qualifies for Section 179 (roofs, HVAC, security systems)

LUXURY AUTO DEPRECIATION

Limits increased

EXPENSING OF CAPITAL INVESTMENTS

QUALIFIED IMPROVEMENT PROPERTY

Any improvement to interior portion of a building that is nonresidential real property

Must be placed in service after the date the building was first placed in service

Currently 39 year recovery period *

Eligible for section 179 but not bonus depreciation *

Excluding:

1. Enlargement
2. Elevator/escalators
3. Internal structural framework



#4

UNRELATED BUSINESS INCOME



UBI: UNDER THE NEW RULES

- Unrelated business income (UBI) – track and report each trade or business on a separate basis
- Net Operating Losses (NOLs) cannot offset income derived from another activity
- Guidance needed regarding how broadly a line of business will be defined and what to do with investment and other UBI amounts



NOTICE 2018-67

RELIANCE – UNTIL PROPOSED REGULATIONS ARE ISSUED, PUBLIC COMMENTS BEING GATHERED

Separate trade or business – use reasonable, good-faith interpretation of sections 511-514

- NAICS 6-digit code
- Fragmentation principle under section 513(c)
- Comments requested for debt-financed and controlled entity UBI

UBI: UNDER THE NEW RULES

POST-2017 NOLS:

- Only 80% of NOL carryover can offset income
- Maintain separately for each UBI activity
- NOLs carry forward indefinitely

PRE-2018 NOLS:

- Deduction not limited to the activity that created it
- Not limited to 80%
- Can only be carried forward 20 years

CORPORATE TAX RATE CHANGED TO FLAT 21%



COMPENSATION AND BENEFITS

BENEFITS TREATED AS UNRELATED BUSINESS TAXABLE INCOME

- Qualified transportation fringe (e.g., transit passes/qualified parking)
 - Employee pre-tax deferral still permitted
 - Tax on full amount paid by employer and pre-tax by employee
- Most on-premise athletic facilities will not be subject to tax
- Notice 2018-67 advises this UBI does not fall under “silo-ing” rules

BENEFITS TREATED AS TAXABLE INCOME TO EMPLOYEES

- Employee achievement awards – “tangible personal property”
- Qualified moving expenses (2018-2025)

POTENTIAL TAX CREDIT AVAILABLE TO BOTH FOR PROFIT AND NOT-FOR-PROFIT ENTITIES (2018-2019)

Paid family and medical leave if pay at least 50% of regular wages

- Must exceed state requirements
- Must be separate from normal vacation, sick and paid-time off



#5

INTEREST EXPENSE



BUSINESS INTEREST DEDUCTION:

**INTEREST EXPENSE >30% OF “ADJUSTED TAXABLE INCOME”
DISALLOWED**

Tested on an entity-by entity basis

**BUSINESSES WITH AVERAGE GROSS RECEIPTS THAT DO NOT EXCEED
\$25MM ARE EXEMPT**

Tested on an affiliated group basis

EXCEPTION FOR CERTAIN TRADES OR BUSINESSES

Real Property Trade or Business

ANY INTEREST DISSALLOWED IS CARRIED FORWARD INDEFINITELY



ADJUSTED TAXABLE INCOME

COMPUTED WITHOUT REGARD TO:

- Business interest expense or business interest income
- NOL deduction
- 199A pass-thru deduction
- Depreciation, amortization or depletion **before 2022**

PASS-THROUGH ENTITIES

PARTNERSHIPS

- Applied at the partnership level
- Certain allocations made to each partner
 - Excess Taxable Income (ETI)
 - Excess Business Interest (EBI)
- Basis adjustments
 - EBI reduces basis at the time allocated
- Carryforwards
 - EBI carries forward at the partner level

S CORPORATIONS

Applied at the corporate level

ELECTING REAL PROPERTY TRADE OR BUSINESS

Any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business

Asset Category	APPLYING INTEREST LIMITATION		ELECTING OUT OF INTEREST LIMITATION	
	Depreciable life (years)	Eligible for bonus?	Depreciable life (years)	Eligible for bonus?
Nonresidential real property	39	No	40	No
Residential rental property	27.5	No	30	No
Qualified improvement property – under tax reform	39	No	40	No
Qualified improvement property – if Congress passes a technical corrections bill	15	Yes	20	No
Most other tangible property	5 to 15	Yes	5 to 15	Yes

STRATEGIES

AFFILIATED BORROWERS – BE CAREFUL OF SEPARATE ENTITIES

ENTITY RESTRUCTURING

- Consolidated structure
- Disregarded entities

GROSS RECEIPT STRUCTURING

Applied at the corporate level

ACCOUNTING METHOD PLANNING

ALTERNATIVES TO DEBT



#6

SALT AND CHARITABLE GIVING

INCREASED STANDARD DEDUCTION

Roughly doubles 2017 amounts

\$24,000

MARRIED TAXPAYERS FILING JOINTLY
(CURRENTLY \$12,700)

\$12,000

SINGLE FILERS
(CURRENTLY \$6,350)

**SCHEDULE A
(Form 1040)**

Itemized Deductions

OMB No. 1545-0047

► Go to www.irs.gov/soi/individual for instructions and the latest information.

► Attach to Form 1040.



Department of the Treasury
Internal Revenue Service (IRS)
OMB No. 1545-0047

Caution: If you are claiming a net-qualified disaster loss on Form 1040, see the instructions for line 20.

Your social security number

Medical and Dental Expenses	<p>Caution: Do not include expenses reimbursed or paid by others.</p> <p>1 Medical and dental expenses (see instructions)</p> <p>2 Enter amount from Form 1040, line 28 <input type="text" value="2"/></p> <p>3 Multiply line 2 by 7.5% (0.075)</p> <p>4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-</p>				4
Taxes You Paid	<p>5 State and local (check only one box):</p> <p>a. <input type="checkbox"/> Income taxes, or</p> <p>b. <input type="checkbox"/> General sales taxes</p> <p>6 Real estate taxes (see instructions)</p> <p>7 Personal property taxes</p> <p>8 Other taxes. List type and amount: ▶</p> <p>9 Add lines 5 through 8</p>				9
Interest You Paid	<p>10 Home mortgage interest and points reported to you on Form 1098</p> <p>11 Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address ▶</p> <p>Note: Your mortgage interest deduction may be limited—see instructions.</p> <p>12 Points not reported to you on Form 1098. See instructions for special rules</p> <p>13 Reserved for future use</p> <p>14 Investment interest. Attach Form 8082 if required. See instructions</p> <p>15 Add lines 10 through 14</p>				15
Gifts to Charity	<p>16 Gifts by cash or check. If you made any gift of \$250 or more, see instructions</p> <p>17 Other than by cash or check. If any gift of \$250 or more, see instructions. You must attach Form 8320 if over \$500</p> <p>18 Carryover from prior year</p> <p>19 Add lines 16 through 18</p>				19
Casualty and Theft Losses	<p>20 Casualty or theft losses other than net-qualified disaster losses. Attach Form 1040 and enter the amount from line 10 of that form. See instructions</p>				20
Job Expenses and Certain Miscellaneous Deductions	<p>21 Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2136 or 2136-02 if required. See instructions. ▶</p> <p>22 Tax preparation fees</p> <p>23 Other expenses—investment, safe deposit box, etc. List type and amount: ▶</p> <p>24 Add lines 21 through 23</p> <p>25 Enter amount from Form 1040, line 28 <input type="text" value="25"/></p> <p>26 Multiply line 25 by 2% (0.02)</p> <p>27 Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-</p>				27
Other Miscellaneous Deductions	<p>28 Other—from list in instructions. List type and amount: ▶</p>				28
Total Itemized Deductions	<p>29 Is Form 1040, line 28, over \$158,000?</p> <p><input type="checkbox"/> No. Your deduction is not limited. Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40.</p> <p><input type="checkbox"/> Yes. Your deduction may be limited. See the Itemized Deductions Worksheet in the instructions to figure the amount to enter.</p> <p>30 If you elect to itemize deductions even though they are less than your standard deduction, check here <input type="checkbox"/></p>				29

IMPACT ON CHARITABLE GIVING

Tax reform reduces incentive for charitable giving by:



GIVING TRENDS

HISTORICALLY, MISSION AND IMPACT DRIVE CHARITABLE GIVING

According to the 2016 U.S. Trust Study of High Net Worth Philanthropy, high net worth donors reported they would **always** give for the following reasons:



Despite the focus on the tax law and its implications, **tax benefits and financial relief** consistently rank at the bottom of the list of why people give.

STRATEGIES

- Educate staff, volunteers, and donors on basic elements of tax reform
- Reinforce mission and update the case for support – clearly define priorities!
- Update your major gift strategies to take advantage of the new tax legislation
- Communicate your organization's impact to donors on an even more regular basis, especially over the next 12 months
- Gifts of appreciated property
- Qualified charitable distributions



#7

OTHER CHANGES FOR BUSINESSES

BUSINESS DEDUCTIONS AND CREDITS

- Like Kind Exchanges
- Excess Business Losses
- Accounting Methods
- DPAD repealed
- Research and experimentation expenditures
- Deduction for fringe benefit expenses limited
- Meals & Entertainment
- Credit for employer-paid family medical leave

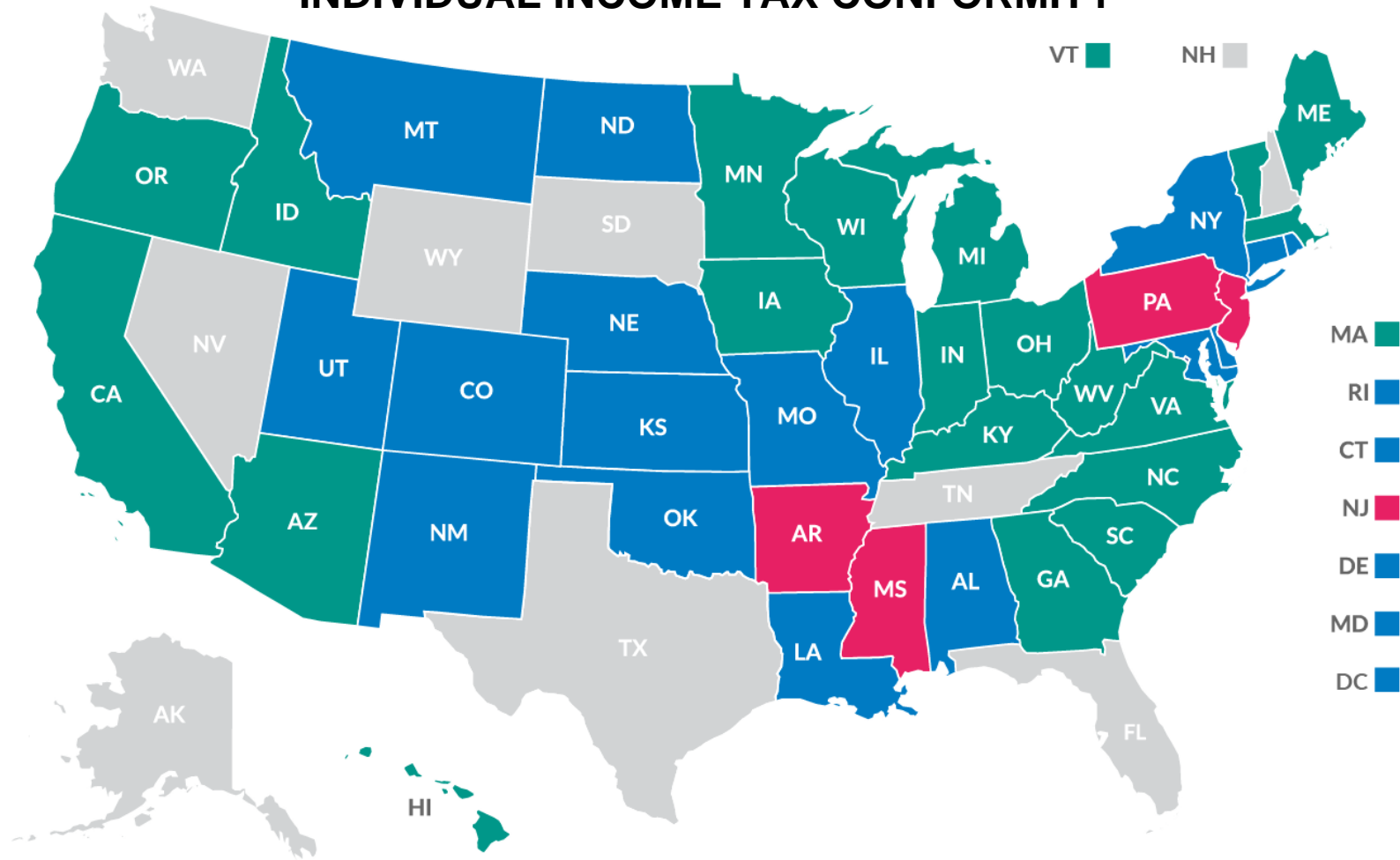


#8

STATE TAX CONFORMITY

STATE CONFORMITY WITH THE INTERNAL REVENUE CODE

INDIVIDUAL INCOME TAX CONFORMITY

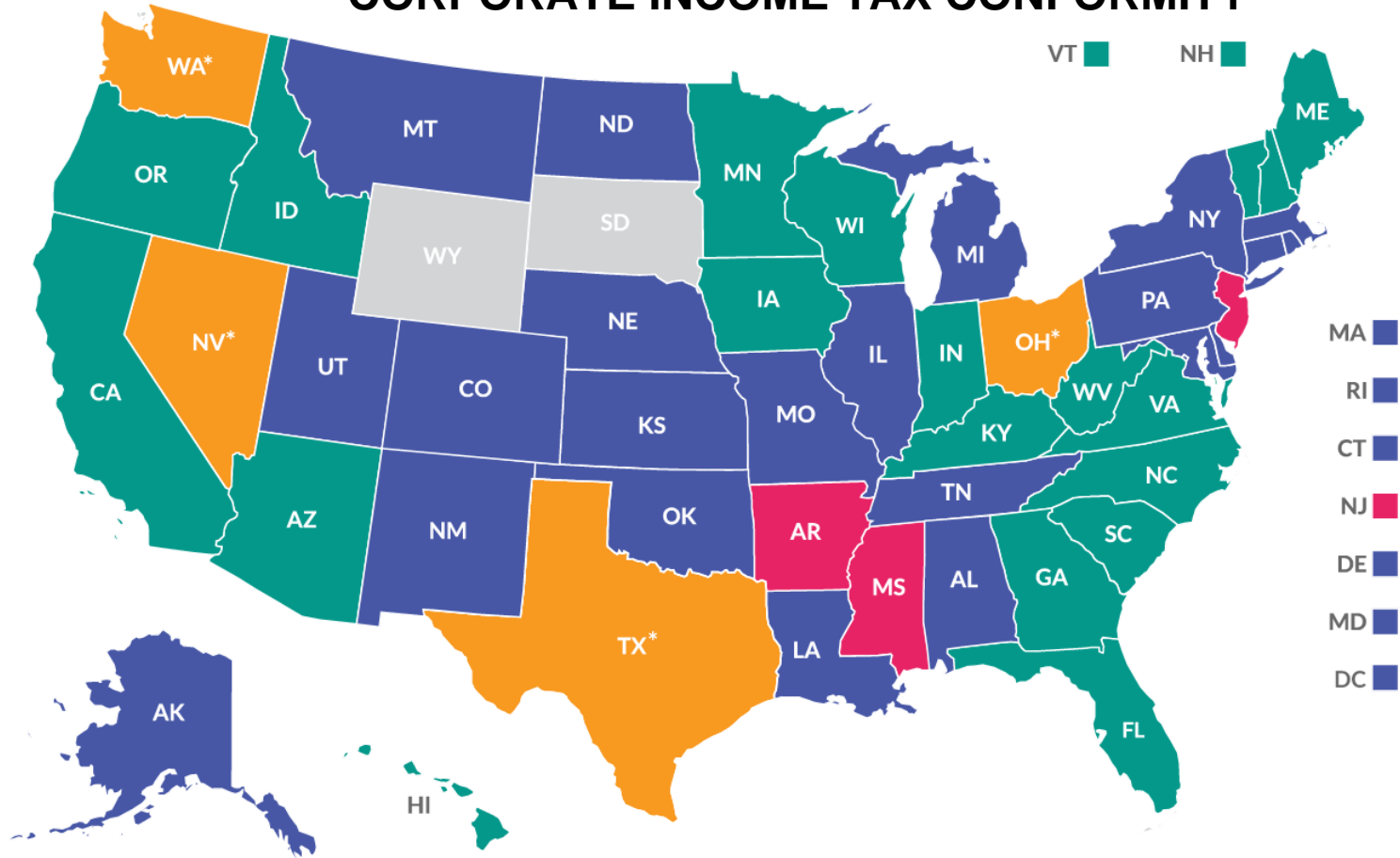


Note: States conform to the federal tax code on either a static or rolling basis. Static conformity means conforming to the Internal Revenue Code (IRC) as of a specific date, such as January 1, 2016. Rolling conformity means adopting IRC changes as they occur.
Source: Bloomberg BNA

- Rolling Conformity
- Static Conformity
- No Conformity (State Calculation)
- No Individual Income Tax

STATE CONFORMITY WITH THE INTERNAL REVENUE CODE

CORPORATE INCOME TAX CONFORMITY



Note: States conform to the federal tax code on either a static or rolling basis. Static conformity means conforming to the Internal Revenue Code (IRC) as of a specific date, such as January 1, 2016. Rolling conformity means adopting IRC changes as they occur.

*Gross receipts taxes are not comparable to corporate income taxes.

Michigan taxpayers have the choice of rolling conformity or the tax code as of January 1, 2012.

Maryland has rolling conformity unless the Comptroller finds a revenue impact of greater than \$5 million.

Source: Bloomberg BNA

- Rolling Conformity
- Static Conformity
- No Conformity (State Calculation)
- State Levies Gross Receipts Tax*
- No Corporate Income Tax

STATE CONFORMITY

EXPENSING OF CAPITAL INVESTMENTS

As of 9/12/18:

	BONUS DEPRECIATION	SECTION 179
Maine	No*	Same as Federal
Massachusetts	No	Same as Federal
New Hampshire	No	\$500,000 max / \$2M additions phase out
Vermont	No	\$500,000 max / \$2M additions phase out

*On 9/12/18, a tax conformity bill became law. Maine still decouples from federal bonus depreciation, but the Capital Investment Credit is still available in lieu of future depreciation recapture.



QUESTIONS?



Sno Barry

sbarry@berrydunn.com



Jon Ireland

jireland@berrydunn.com