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Business Tax Update & Key Provisions in the TCJA

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Business Tax Update & Key Provisions in the Tax Cuts and Jobs Act

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Qualified Business Income Deduction (IRC Section 199A)

Overview of Qualified Business Income Deduction

- The new **Qualified Business Income Deduction** is a **pass-through entity tax cut** that gives a non-corporate taxpayer, including a trust or estate, who has qualified business income **(QBI**) a qualified business income deduction **(QBID)** of **up to 20%** of the net QBI.

- Pass-through businesses include:
  - Sole-proprietorships (no entity, Schedule C).
  - Real estate investors (no entity, Schedule E).
  - Disregarded entities (single member LLCs).
  - Multi-member LLCs.
  - Any entity taxed as an S corporation.
  - Trusts and estates, REITs and qualified cooperatives.

Overview of QBI Deduction

- The QBI deduction is not allowed in computing adjusted gross income (AGI), but rather is allowed as a deduction reducing taxable income (similar to the standard deduction).
- The **QBI deduction** is equal to the **lessor of**:
    - 20% of net **QBI** from the taxpayer's businesses or
    - 20% of **taxable income** adjusted for any net capital gains and qualified dividends and without the adjustment for the QBID.
- ***Sunset Provision.*** Effective for years beginning after 1/1/17 and before 1/1/26.
- The QBI deduction **is not** allowable for NYS purposes.

Overview of QBI Deduction - Example

- Bill earns $130,000 of pass-through QBI in a company he operates as an S corporation which is **not an SSB**.
- His **taxable income** on his Form 1040 equals **$150,000**.
- **QBI limit**: $130,000 x 20% = **$26,000**.
- **Taxable income limit**: $150,000 x 20% = **$30,000**.
- He can use the **QBI deduction** in the amount of **$26,000 (the lesser of the two).**

Qualified Business Income Definition

- QBI is the net amount of items of income, gain, deduction, and loss from a ***qualified trade or business*** conducted within the U.S. (including Puerto Rico)
  - The **SE tax deduction**, **SE health insurance deduction** and **retirement plan deduction** are deductions in arriving at QBI.
- **QBI includes** gains and losses on dispositions of assets used in the business if the tax law treats such dispositions as **ordinary income or ordinary losses.**
- **QBI does not include investment income** such as **capital gains and losses, dividends, interest income** (unless properly allocable to a trade or business) **annuities**, and **commodity and foreign currency gains**.
- **Real Estate Rental Income -** Qualifies as QBI if a "trade or business." See safe harbor discussed below.
- ***Section 481 Adjustment***: Taken in account for QBI if Section 481 Adjustment arises in a taxable year ending after 12/31/17.

Qualified Business Income Definition

- Partners treat **ordinary income** or loss recognized under the *IRC* ***Section 751 "hot asset" rules*** as QBI.

- **Previously disallowed losses** or deductions (i.e., under the at-risk, passive activity loss, or basis limitation rules) **are taken into account for computing QBI** on a FIFO basis, **if such losses were incurred after 1/1/18.**

- Generally, an **NOL deduction** under *IRC Section 172* is **not considered for computing QBI**, but **to the extent that the NOL is comprised of amounts disallowed under the new excess business loss rules, it is taken into account**.

Qualified Business Income Definition

- The following items are **specifically excluded from QBI**:
  - **Compensation** paid by the business to the taxpayer.
  - **Guaranteed payments** paid by the business to partners.
  - **Payments to partners** outside their capacity as partners.
- ***Partnerships and S Corporations***: A partner in a partnership or shareholder in an S corporation calculates his or her QBI as his or her **proportional share** of the entity's QBI.
  - Pass-through entities are required to provide partners/shareholders with additional information (i.e., wages and property info) required to calculate limitations at the individual level.

Dealing with Multiple Pass-Through Entities

- If a taxpayer owns several pass-through entities or interests in pass-through entities:
  - The taxpayer **first determines the QBI deductible amount with respect to each qualified trade or business** after application of any entity required limitations (W-2/Property Limitation; SSB Limitation).
  - The taxpayer **then combines the individual QBI deduction** amounts to arrive at the "combined QBI amount."
  - The taxpayer then compares this combined QBI amount to the taxable income limitation to determine the allowable deduction.

Qualified Trade or Business Definition

- A ***qualified trade or business*** is defined as any trade or business **other than**:
  - The business of performing **services as an employee**.
    - The final regs provide for anti-abuse rules to prevent taxpayers from classifying themselves as independent contractors if they are really employees under the normal Federal tax rules.
      - Independent contractor is not treated as an employee if the independent contractor was not an employee during the last three years.
  - A ***specified service business (SSB)***.
    - However, in any year that a taxpayer's taxable income is **at or below the taxable income threshold amount** (explained below), that taxpayer can treat an SSB as a qualified trade or business.

Rental Real Estate – Final Regs.

- QBI includes income from **rental real estate activities** if such activities rise to the level of a **trade or business**.
  - Rental activities are regular and continuous enough to constitute a trade or business.
  - Factors to consider are the taxpayer's intent and involvement with the property (i.e., showing the property for rent, collecting rents, purchasing materials, paying expenses, providing services to the tenants, etc.).
  - There is **no 500-hour safe harbor test** for ***qualified real estate professionals*** like there is under the NIIT regulations.
  - Filing Form 1099s may help.
- ***Self-Rentals:*** The rental or licensing of tangible or intangible property to a commonly controlled **non-C corporation** trade or business is **treated as a trade or business for QBI purposes**.
  - Same person or group of persons owns (directly or indirectly) 50% or more of the rental activity and trade or business activity.
  - Under the attribution rules, an individual is considered to own an interest in a trade or business held by a spouse, child, grandchild or parent.

Rental Real Estate Safe Harbor

- ***Rev. Proc. 2019-38 and IRS Notice 2019-7*** **-** IRS finalized a safe harbor under which a rental real estate enterprise will be treated as a trade or business for the QBI deduction. If safe harbor requirements met, **the rental real estate enterprise will be treated as a single trade or business** for QBI deduction purposes.

- Rental Real estate enterprise may consist of a single property or interests in multiple **similar** properties.

- **Similar properties - Commercial properties** can be only be combined with other commercial properties as a single enterprise and **residential properties** can only be combined with other residential properties. **Mixed-use properties can be bifurcated** between commercial and residential and then combined with the applicable commercial or residential enterprise.

- **Safe Harbor requirements:**

  - Separate books and records must be maintained for each rental enterprise.

  - At least 250 hours of rental service must be performed per year.

  - Contemporaneous records must be maintained.

  - Taxpayer must attach a statement to tax return describing the properties and representing that the safe harbor requirements were met.

Rental Real Estate Safe Harbor

- ***Certain Rental Real Estate Arrangements are Excluded from the Safe Harbor as Follows:***
    - **Residence -** Real estate used by the taxpayer as a residence.
    - **Triple Net Lease -** Lease where tenant pays the taxes, insurance and maintenance.
    - **Self-Rental -** Rental real estate rented to a trade or business conducted by a taxpayer which is commonly controlled.
    - **SSB -** The entire real estate interest if any portion is treated as an SSB.

Qualified Business Income (Net Loss)

- If the combined QBI from all of the trades or businesses of the taxpayer for any taxable year **nets to a loss, no QBI deduction gets calculated** for that year and the loss carries **forward to the next year's QBI calculations**.

- Real estate investors treat the net rental income shown on the Schedule E tax form as QBI.
  - These investors also net rental losses against income, including passive suspended losses.

QBI Net Combined Net Income Example

- Jim, a real estate investor, owns three rental properties (Schedule E's on his Form 1040).
- **Property A -** $15,000 net rental income.
- **Property B -** $20,000 net rental income.
- **Property C** - $5,000 net rental loss
- The QBI = $30,000 ($15,000 + $20,000 - $5,000).
- The **QBI** deduction = $6,000 ($30,000 x 20%)

QBI Deductible Amount Limitations

- There **<u>are basically two limitations</u>** which must be applied where a taxpayer meets certain **<u>taxable income thresholds</u>**. They are:
  - **W-2 Wage and Property Limitation:**
    - Applies to all taxpayers and all business types where the taxpayer's **<u>taxable income exceeds a threshold amount</u>**.
    - Limitation is **<u>calculated separately for each entity</u>** based on the wages and property specific to that entity.
  - **Specified Service Trade or Business Limitation:**
    - Applies only to taxpayers where QBI is generated in an SSB.
    - Will result in full allowance, partial limitation or total disallowance based on taxable income of taxpayer.

Taxable Income Threshold

- The **taxable income thresholds that apply to both** the **W-2 Wage and Property Limitation** and the **SSB Limitation** are, as follows:
  - $321,400 MFJ (full phase-out at $421,400).
    - Phase-out range of $100,000.
  - $160,700 for other taxpayers (full phase-out at $210,700).
    - Phase-out range of $50,000.

W-2 Wages and Property Limitation

- Applies to all taxpayers with QBI where taxable income exceeds the applicable threshold.
    - Once the taxpayer's **taxable income threshold** is exceeded, the wage and property limitation is imposed.
- For taxpayers with **taxable income above the threshold amount**, **the QBI deduction cannot exceed the lesser of**:
    - 20% of the taxpayer's QBI with respect to the qualified trade or business; or
    - The **greater of**:
        - **50% of the W-2 wages** with respect to the qualified trade or business ("W-2 Wage Limit"); or
        - The **sum of 25% of the W-2 wages** paid with respect to the qualified trade or business plus **2.5% of the Unadjusted Basis Immediately after Acquisition (UBIA) of the business's qualified property**.

Qualified Property Definition

- ***Qualified Property***: Defined as depreciable property held by the qualified business at the end of the year to produce QBI and for which the **depreciable period hasn't ended** before the close of the year.
- The **depreciable period** is the **later of**:
  - 10 years from the placed-in-service date, or
  - The last day of the last full year in the MACRs recovery period.
- Accordingly, the cost of any **fully depreciated** property that was purchased in the prior 10-year period by the taxpayer will be included.

Qualified Property Definition - Final Regs.

- ***Additions to Qualified Property***: Capitalized improvements to an existing property is treated as a new and separate property addition.
- ***Effect of IRC Section 179 and Bonus Depreciation***: The UBIA of qualified property is determined without regard to the *IRC Section 179* deduction or bonus depreciation.
- ***Like-Kind Exchanges***: The UBIA of qualified property received is the UBIA of the relinquished property adjusted for boot received or given.
- ***Partnership Basis Adjustments***: If an *IRC Section 754* election is in effect, ***IRC Section 743(b)*** *(sale or death)* basis step up adjustments **are** treated as qualified property. ***IRC Section 734(b)*** *(redemption)* basis step up adjustments **are not** treated as qualified property.
- ***Anti-abuse Rule***: Property is excluded from qualified property if it is acquired within 60 days of the end of the tax year and disposed of within 120 days of the acquisition date without having been used in the business for at least 45 days.

Application of the W-2 Wage and Property Limitation

- Taxable income becomes an important component when dealing with the W-2 Wage and Property Limitation.
- **If taxable income is less than** $160,700/$321,400, then the 20% **deduction is fully available**.
- **If taxable income is greater than** $160,700/$321,400 but less than $210,700/$421,400 then a full deduction, **partial deduction or no deduction may be available**.
  - Subject to the W-2 Wage/Property Limitation.
- **If taxable income is greater than** $210,700/$421,400 **then a full deduction, partial deduction or no deduction may be available**.

Wage and Property Limitation – Example 1

- Susan has **$500,000** of **taxable income**, **$100,000** of which is from a **non-SSB** she operates. The business has no qualified property and pays **$30,000 in W-2 wages**. As Susan's taxable income exceeds the taxable income threshold, she is subject to the W-2 Wage/Property Limitation.
  - **General QBI deduction**: $100,000 x 20% = **$20,000**.
  - **W-2 Wage limitation**: $30,000 x 50% = **$15,000**.

- Susan is **limited to a QBI deduction of $15,000** from this business.

W-2 Wage and Property Limitation - Example 2

- **QBI deduction calculation for a taxpayer whose taxable income is above the QBI taxable income threshold.**
- Jake, a single individual, has **taxable income of $185,700** and **QBI of $150,000** from a business that owns no depreciable property and pays **$30,000 in W-2 wages.**
- **QBID = $30,000** ($150,000 x 20%).
- **W-2 Wage Limit = $15,000** ($30,000 x 50%).
- Since his **taxable income of $185,700** rests halfway between **$160,700** and **$210,700**, then his **final QBI deduction is $22,500** which is halfway between the **$15,000 W-2 wages limit value** and the **$30,000 20% QBI value.**
- If the Wage and Property Limitation exceeded the 20% QBI calculation, no limit would apply and Jake would get the full **$30,000** QBI deduction.

Aggregation Rules – Final Regs.

- The final regulations provide for aggregation rules that permit taxpayers **to elect to combine** separate trades or businesses if the following requirements are met:
  - The same person or group of persons owns directly or indirectly (i.e., through attribution) 50% or more of each business.
  - The items of each business are reported in returns with the same tax year.
  - **None** of the businesses **are an SSB**.
  - The businesses satisfy **at least two** of the following factors:
    - They provide products, property or services that are the same or customarily offered together.
    - They share facilities, personnel, or other business resources.
    - They operate in coordination with, or reliance upon each other.

Aggregation Rules - Final Regs.

- When aggregation is allowed, the taxpayer has the option to chose which businesses to aggregate (i.e., can be selective as to which businesses to aggregate).
- Aggregation is allowed at the **individual level or the entity level (RPE)**.
- The taxpayer calculates QBI, W-2 wages and the UBIA of qualified property for each business and then combines these amounts to compute QBI and the wage/property limit for the aggregated businesses.
- Failure to aggregate a business in one year does not preclude the taxpayer from including that business in a future year.
- The Taxpayer must consistently report the aggregation on his or her return.
- Additional businesses can be added if they are newly established.
- Change in circumstances will allow taxpayers to change prior aggregation if businesses no longer qualify.

Aggregation Rules – Final Regs.

- ***Planning Opportunity***
- Aggregating businesses can allow an individual with high taxable income to claim a larger QBI deduction when otherwise subject to the wage/property limit.
- For example, aggregating one business with substantial QBI but little or no W-2 wages and another business with minimal QBI but considerable W-2 wages can result in a substantial QBI deduction while keeping them separate could result in a lower QBI deduction or even no QBI deduction.

Aggregation Rules – Final Regs.

- **Netting of negative and positive QBI amounts and carryovers**.
  - Businesses with negative QBI amounts are allocated proportionately to businesses with positive QBI amounts.
  - W-2 wages and the unadjusted basis of qualified property of negative QBI businesses are not taken into account in calculating the aggregate wage/property limit.
  - If a taxpayer has an overall negative QBI for the year, the negative amount is treated as a loss from a qualified business in the following year.
- **Examples of businesses eligible for aggregation**:
  - Restaurant and catering business that use same kitchen and staff.
  - Clothing manufacturer and retail store.
  - A group of hardware stores.

Specified Service Business (SSB) Definition

- An SSB is defined as any trade or business:
  - Involved in the performance **of services** in the fields of **health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services**, or any business where the principal asset is the **reputation or skill** of one or more of its owners or employees.
    - **Engineering and architecture are specifically excluded.**
    - The **final regulations** clarify that the income from **facilities in the field of health** where all health and medical services are billed separately and the facility doesn't employ any health care professionals **is not an SSB.**
      - Example – A **specialty surgical center** or **senior residential facility** that only charges a facility fee and does not hire health care professionals or can demonstrate that the health care services are de minimus or a separate trade or business.

SSB Definition - Final Regs.

- Any business that participates in investing and investment management, trading, or dealing in securities, partnerships, or commodities.
    - Dealing in commodities is limited to dealing with financial instruments in commodities not the physical commodities.
    - Does not include businesses taking deposits or making loans (i.e., banks).
    - Hedging transactions in the ordinary course of a business is not SSB income.
- Brokerage services **includes securities brokers** but **does not include insurance agents or brokers and real estate agents or brokers**.

SSB Definition - Final Regs.

- Only the following activities constitute a business whose **principal asset is the reputation or skill of one or more of its owners or employees**:
  - Receiving fees, compensation, or other income for endorsing products or services.
  - Licensing or receiving fees, compensation, or other income for the use of an individual's image, name, signature, etc.
  - Receiving fees, compensation, or other income for appearing at an event or on radio, television, or other media format.
- ***De Minimis Rule:*** A business that **sells both products and performs services is not an SSB** if gross receipts attributable to specified services are **less than**:
  - 10% of total gross receipts (gross receipts are $25MM or less).
  - 5% of total gross receipts (gross receipts are more than $25MM).

SSB Definition - Final Regs.

- **Separate Lines of Business** - A Business can have separate lines of businesses - SSBs and non SSBs without meeting the de minimis rules.
  - Example - A veterinary practice that as a separate line of business that sell pet food with a set of separate books and records.
- **SSB Anti-abuse Provision**: **Curtails the ability to divide a business** into separate entities.
  - Situations where one entity would provide services in an SSB and the other entities would lease property or provide administrative services to the SSB.
  - An SSB includes any business with 50% or more common ownership (including through attribution) that provides some of its property or services to an SSB.
  - **The portion** of the property or services **not provided to the SSB is eligible for the QBI deduction**.

Limitations Based on an SSB

- Where the income is generated in an ***SSB***, the **SSB** begins phasing out in the case of a taxpayer whose taxable income exceeds $321,400 for married individuals filing jointly ($160,700 for other individuals).

- The benefit of the QBI deduction for income generated in an SSB is **phased out** over the next $100,000 of taxable income for joint filers ($50,000 for other individuals).

Limitations Based on SSB

- The taxable income becomes a more important component when dealing with income from an **SSB**.
- If taxable income is **less than** $160,700/$321,400, then the **20% deduction is fully available**.
- If taxable income is **greater than** $160,700/$321,400, **but less than** $210,700/$421,400, then **a partial or no deduction is available**.
  - Subject to the Applicable Percentage and W-2/Property Limitations.
- If taxable income is **greater than** $210,700/$421,400, **then no deduction is available**.

Limitations Based on an SSB

- For taxpayers with **SSB** income and taxable income between the upper and lower thresholds, the phase-out of the deduction is more aggressive than the phase-out applicable to income from a non-SSB.
  - Applicable Percentage Limitation under *IRC Section 199A(d)(3)* applied first.
  - W-2/Property Limitation under *IRC Section 199A(b)* applied next.

Limitations Based on SSB - Example 1

- Don, a single taxpayer, **earns $100,000 as an actor**, which falls into the **SSB** category.
- His **taxable income equals $160,700** due to other investment income.
- He pays **$0 wages and owns no property**.
- As his taxable income does not exceed the lower threshold, his **QBI deduction equals $20,000** ($100,000 x 20%).
    - If Don's taxable income was $185,700: The **QBI deduction would be $5,000**.
    - If Don's taxable income was $203,200: The **QBI deduction would be $450**.

Limitations Based on SSB - Example 2

- Mary files joint with her husband.
  - She earned **$200,000 from an SSB - QBID = $40,000**
  - Her share of **W-2 wages** paid by the SSB is **$60,000 – QBID =$30,000**
  - Their **taxable income** is **$371,400**.
- As their taxable income falls between the $321,400 bottom phase-out limit and the $421,400 full phase-out threshold, Mary's QBI deduction is subject to the phase-out rules, as follows:
- Mary's **QBI deduction** calculates to **$17,500** under the phase-outs applicable to SSB income.
- Had Mary's income been **from a non-SSB**, her **QBI deduction** would have been **$35,000**.

Limitations Based on SSB - Example 3

- John and Karen, married taxpayers filing jointly, together earn **$200,000** as owners of a law firm **(an SSB).**
- Their allocable share of **W-2 wages** is **$300,000.**
- Their **taxable income** is **$500,000.**
- John and Karen **do not get the QBI deduction** as their taxable income exceeds the upper threshold of $421,400.
- If the $200,000 was from a **non-SSB**, the **QBI deduction would have been $40,000** ($200,000 x 20%).

Impact on Self-Employment Tax, NITT and AMT

- ***Self Employment Tax***: Self-employment taxes will still be calculated on the net business income **before** the QBI deduction since the deduction is taken "below the line" on Form 1040.
  - A taxpayer could earn $100,000 and deduct $20,000 under *Section 199A*, but still pay self-employment taxes on $100,000.
- ***Net Investment Income Tax (NIIT):*** The QBI deduction **does not** reduce net investment income for NIIT purposes.
- The QBI deduction is also allowable in calculating the **Alternative Minimum Taxable Income** and is not added back.

Planning Under Section 199A

- **Entity Change – Incorporate Sole Proprietorship as an S Corporation**

Example

- If Tom operates as a sole proprietor with no employees in a non-SSB and earns $500,000, **his QBI deduction is zero** - the **lessor of:** 50% of the W-2 wages ($0 in this example) or 20% of the $500,000.

- He may want to incorporate as an S corporation and pay-out W-2 wages to himself to maximize his QBI deduction.

- If he paid out **$200,000 in wages** to himself and had **$300,000 in net business income**, his **QBI deduction** would be the **lessor of**: **$100,000** (50% of $200,000) or **$60,000** (20% of $300,000).

- Therefore, his **QBI deduction would be $60,000**.

Planning Under Section 199A

- **Planning for the Wage and Property Limitations**
  - **W-2 Wage Limitation**
    - Increase owner wages.
    - Convert independent contractors to employees.
  - **Depreciable Property Limitation**
    - Purchase or capital lease vs. equipment rental.
    - Pay for improvements in operating company vs. real estate entity.

Planning Under Section 199A

- **Consider Adjusting the Guaranteed Payments from a Partnership/LLC**
  - Guaranteed payments to a partner are not considered to be QBI.
  - Accordingly, the classification of income between ordinary income and guaranteed payments will have an impact of the 20% QBI deduction.

Note: *Many partnerships and LLC's report all income as ordinary income with no allocation to guaranteed payments. Should they now, based on the type of business, make a reasonable allocation to guaranteed payments?*

Planning Under Section 199A

- **Partnership Guaranteed Payment Example**
  - Partnership **A** classifies all of Partner **X's $100,000** share of the partnership's income as a **guaranteed payment** and **$0 as ordinary income**.
  - As guaranteed payments are excluded from the definition of QBI, Partner **X's QBI deduction is zero** from income passing through from Partnership **A**.
  - If Partnership **A** were to classify **$30,000** of Partner **X's** allocable share to **guaranteed payments** (reasonable allocation based on value of services provided to the Partnership) and **$70,000 to ordinary income**, Partner **X** would be entitled to a **QBI deduction** of up to **$14,000** ($70,000 x 20%).

C Corporations

Reduction in C Corporation Tax Rate

- **Prior Law -** C corporations were subject to graduated tax rates of 15% (for taxable income of $0 - $50,000), 25% (for taxable income of $50,001 - $75,000), 34% (for taxable income of $75,001 - $10,000,000), and 35% (for taxable income over $10,000,000).
  - Personal service corporations pay tax on their entire taxable income at the rate of 35%.

- **TCJA -** For tax years beginning after December 31, 2017, the corporate tax rate is a **<u>flat 21% rate</u>**, including personal service corporations.
  - No sunset - permanent.
  - **Note:** This rate will also apply to the S corporations who have recognized built-in-gains in years beginning after December 31, 2017.

Corporate Alternative Minimum Tax Repealed

- The corporate alternative minimum tax (AMT) is repealed.
- **Note:** Under TCJA Law, one of the possible disadvantages of having corporate owned life insurance to fund an entity-purchase buy-sell agreement was the potential taxation of the proceeds under the AMT. This is no longer the case with the repeal of the corporate AMT.

Should an S Corporation Convert to a C Corporation?

- Since C corporations are now at 21%, does it make sense for S corporations to terminate their S corporation elections?
- Although a detailed analysis should be done, the answer in most cases is probably be no.
- Although at a 21% corporate tax rate, wages paid out are still taxed as ordinary income tax rates (and are not eligible for the 20% QBI deduction).
- Dividends paid out of the after-tax income of the corporation are subject to capital gains rates as the corporation does not receive a deduction for the dividends that income will be subject to double taxation with Federal tax rates approaching 37%.
    - 21% Corp Tax + (79% x 23.8%) Dividend Tax = 39.80% Total Tax.
    - Top Tax Rate with QBID (37% x 80%) = 29.60% (ignores state tax).
    - Even after considering state taxes the difference is still about 10%.

Depreciation

Expanded Section 179 Deduction

- The TCJA **permanently** increases the maximum amount a taxpayer may expense under **Section 179.**
- **Increased To $1,020,000** in 2019, ($1,000,000 - 2018; $510,000 - 2017).
- The phase-out threshold amount increased to $2,550,000 in 2019 ($2,500,000 - 2018; $2,030,000 - 2017).
  - If eligible Section 179 asset acquisitions exceed the phase-out threshold, then the maximum Section 179 deduction amount is reduced dollar-for-dollar by the excess over the threshold.
- The $1,020,000 and $2,550,000 amounts, as well as the $25,500 sport utility vehicle limitation, are indexed for inflation.
- **No sunset provision** for the Section 179 deduction.

Expanded Section 179 Deduction

- The TCJA expands the definition of Section 179 property to include certain depreciable ***tangible personal property used predominantly to furnish lodging*** or in connection with furnishing lodging.
  - Applies to residential rental properties, hotels, etc.
  - Furniture, appliances, etc.
- Under the TCJA, ***qualified real property*** eligible for the Section 179 deduction includes any improvement to the **interior portion** of a **nonresidential building** after the building was placed in service.

Expanded Section 179 Deduction

- ***Qualified real property* <u>**does**</u> <u>**not**</u>** include any improvement attributable to the following:
  - The enlargement of the building.
  - Any elevator or escalator.
  - The internal structural framework of the building.

- Under the TCJA, the definition ***qualified real property now*** includes:
  - Roofs
  - HVAC property
  - Fire protection and alarm systems
  - Security systems

Expanded Section 179 Deduction

- **Maximum $25,500 Section 179 deduction for Heavy SUVs in 2019**
  - The Section 179 limit is $25,500 for heavy SUVs with a Gross Vehicle Weight Rating (GVWR) over 6,000 lbs. and less than 14,000 lbs.
  - This $25,500 limit does not apply to heavy non-SUVs which include the following:
    - Vehicles designed to seat more than nine passengers behind the driver's seat (i.e., shuttle vans).
    - Vehicles equipped with a cargo area not readily accessible from the passenger compartment that is at least six feet in length (i.e., many pickups with full-size cargo beds will qualify).
    - Other vehicles meeting other requirements including no seating behind the driver's seat such as most delivery vans.
  - Vehicles with GVWRs above 6,000 lbs. that fall under the above non-SUV exceptions remain eligible for the full Section 179 deduction.

100% Bonus Depreciation

- **Prior Law -** An additional first-year depreciation deduction was allowed equal to 50% of the adjusted basis of qualified property placed in service before 2020.
- **TCJA -** Allows 100% expensing for qualified property (generally, depreciable assets other than buildings) that are acquired and **placed in service after September 27, 2017** and before 2023 (before 2024 for "longer production period" property and certain aircraft).
    - ***Sunset Provision*** - A 20% per year phase-down of full expensing will apply for property placed in service after 2022 and before 2027 (2023 – 80%, 2024 – 60%, 2025 – 40%, 2026 – 20%).
    - **The provision now applies to purchases of used, as well as new items.**
    - To prevent abuses, the first-year bonus depreciation deduction applies only to property purchased in an arm's-length transaction.

100% Bonus Depreciation

- To be eligible for bonus depreciation, the property must meet one of the following definitions:
  - Property with a cost recovery period of 20 years or less.
  - Purchased computer software not amortizable under IRC Section 197.
  - ***Qualified improvement property*** placed in service after 2017 **(only if a legislative error is fixed as explained below).**
  - Qualified water utility property.
  - Qualified film, television or theatrical production property.

100% Bonus Depreciation

- For ***qualified improvement property*** placed in service after 2017, the TCJA was supposed allow such property to qualify for the 100% bonus depreciation.
    - This provision was in the legislative committee reports.
    - However, the law as enacted does not reflect this legislative intent.
    - It was expected that a Technical Corrections bill will fix this drafting error.
    - Until this problem is fixed, ***qualified improvement property*** will not be eligible for the 100% bonus depreciation.
- The IRS has issued final bonus depreciation regulations in 2019.
    - The final regulations issued on 9/23/19 clarify that **qualified improvement property** placed in service after 2017 isn't eligible for bonus depreciation unless a legislative change is made.

Section 179 Deduction & 100% Bonus Depreciation Cautions

- Claiming the Section 179 deduction or the 100% bonus depreciation on **real property** has a **downside**.
  - If the property is later sold for a taxable gain, the gain up to the amount of the Section 179 deduction and/or the bonus depreciation will be treated as depreciation recapture that is taxed at higher ordinary income tax rates (up to 37% plus another 3.8% NIIT, if applicable) .
  - However, if the real property is depreciated under the normal 39- year (commercial) or 27.5-year (residential) periods, then the maximum Federal tax rate attributable to the cumulative depreciation claimed is only 25% (plus the 3.8% NIIT, if applicable).
- Claiming the Section 179 deduction or the 100% bonus depreciation has a **downside** on the **20% QBI Deduction** as well.
  - Since QBI and taxable income is reduced from these accelerated deductions, the 20% QBI Deduction is also reduced.

Recovery Period for Real Property Shortened

- The cost recovery periods for most real property are 39 years for non-residential real property and 27.5 years for residential rental property.

- For ***qualified improvement property*** placed in service after 2017, the TCJA was supposed to permanently install a 15-year cost recovery period .
  - This provision was in the legislative committee reports.
  - However, the law as enacted does not reflect this legislative intent.
  - It was expected that a Technical Corrections bill will fix this drafting error.
  - Unless this problem is fixed, qualified improvement property will still be subject to a 39-year cost recovery period.

Luxury Automobile Depreciation Limits Increased

- **TCJA** - For passenger vehicles placed in service in 2019, the maximum amount of allowable depreciation is increased to:
  - $10,100 (was $3,160 in 2017) for the year in which the vehicle is placed in service,
  - $16,100 (was $5,100 in 2017) for the second year,
  - $9,700 (was $3,050 in 2017) for the third year, and
  - $5,760 (was $1,875 in 2017) for the fourth and later years in the recovery period.
- These dollar limits will be indexed for inflation.
- For **passenger vehicles eligible for first-year bonus depreciation**, the maximum first year bonus depreciation allowance remains at $8,000 which when combined with the above depreciation limitation will allow a first-year deduction of $18,100.
- **Definition of Listed Property**: The TCJA also **removes computer or peripheral equipment** from the definition of listed property.
  - Therefore, this property is no longer subject to the heightened substantiation requirements that apply to listed property.

Limitation on Business Interest Deduction

Limitation on Interest Deductions for Businesses

- **Prior Law -** Businesses were allowed to deduct 100 percent of their business interest expense.

- **TCJA -** Interest deductions for businesses with **average annual gross receipts over $26 million** for the 3 prior years generally are **limited to 30%** of the corporation's **adjusted taxable income**.
  - ***Adjusted Taxable Income*:** Defined as the taxpayer's taxable income, computed without regard to:
    - Any item of income, gain, deduction or loss that is not properly allocable to a trade or business;
    - Any business interest expense or business interest income;
    - The amount of any net operating loss (NOL) deduction under Code Section 172;
    - The amount of any QBI deduction allowed under Code Section 199A; and
    - For tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization or depletion.
  - Disallowed interest can be carried forward indefinitely.
  - Special reporting rules apply to partnerships and S corporations.
  - **No sunset provision**

Limitation on Interest Deductions for Businesses

Example:

- XYZ Corp has **net income of $90,000** after the following deductions, **depreciation and amortization - $60,000**, **business interest expense $100,000**.

- XYZ's **average annual gross receipts** for the past three years was **$30 million**.

- XYZ Corp's business **interest deduction is limited to $75,000**, calculated as follows:
  - Adjusted taxable income = $250,000 ($90,000 + $60,000 + $100,000).
  - Limitation: $75,000 ($250,000 x 30%).
  - Allowable interest deduction: $75,000.
  - Disallowed interest deduction: $25,000.
  - Carryover of $25,000 subject to indefinite carryforward.

- After 2021, the business interest limitation would be $57,000 ($190,000 x 30%)
  - No addback for depreciation and amortization.

Limitation on Interest Deductions for Businesses

Exceptions:

- **Employee**
  - The performance of services as an employee isn't a trade or business for the business interest limitation.
  - Thus, an employee's wages are not counted in the taxpayer's ***adjusted taxable income*** for purposes of determining the limitation.

- **Floor plan financing interest** is fully deductible.
  - Applies to debt used to finance motor vehicles, boats and farm machinery for sale or lease.
  - However, such businesses **cannot utilize the 100% bonus depreciation** expensing provision if the floor plan interest was "taken into account" to determine the interest expense deduction.
    - Proposed regulations issued on September 13, 2019 provide that if the floor plan interest was not needed to deduct all the interest expense, including floor plan interest, bonus depreciation can be taken.

Limitation on Interest Deductions for Businesses

Exceptions:

- A **regulated public utility will not** be subject to the limitation.
    - However, such businesses cannot utilize the 100% bonus depreciation expensing provision.

- An electing **real property trade or business** or electing **farming business will not** be subject to the limitation.
    - However, such businesses must use the Alternative Depreciation System (which doesn't allow for bonus depreciation) to depreciate:
        - Nonresidential real property, residential rental property and qualified improvement property for real property trades or businesses.
        - Property with a recovery period of 10 years or more for farming businesses.

Excess Business Losses (Non-corporate Taxpayers) IRC Section 461 & NOLS

Overview of Excess Business Losses

- The TCJA provided for rules relating to an "excess business loss" for **tax years beginning after December 31, 2017 and before January 1, 2026**.
- Provides for a disallowance of "excess business loss" for noncorporate (non-C corporation) taxpayers.
- Disallowed excess business losses are treated as a "net operating loss" (NOL) carryover, subject to the NOL rules under *IRC Section 172*.
- Wages were originally thought to be excluded from the calculation; however all wages have been specifically added to the calculation on the 2018 issued Form 461.

Excess Business Losses - Defined

- Excess business losses are determined at the individual (partner/shareholder/sole proprietor) level.
- An "excess business loss" is the **excess** of:
  - The taxpayer's aggregate deduction for the tax year attributable to trades or businesses of the taxpayer (determined without regard to the Section 461 excess business loss limitation), over
  - The sum of:
    - The taxpayer's aggregate gross income or gain for the tax year which is attributable to those trades or businesses, plus
    - **$250,000 threshold (single)** or **$500,000 threshold (married filing joint).**
      - *Rev. Proc. 2018-57* provided inflation increases to these limits in 2019 to $255,000 (single) and $510,000 (married filing joint).

Excess Business Loss - Example #1

Income Calculation (Single taxpayer)

Investment Income	15,000
Business Income (Sch C)	
Gross Receipts	100,000
Expenses	(450,000)
Net Income (Loss)	(350,000)
Excess Business Loss Adj.	**100,000**
Adjusted Gross Income	(235,000)
Standard Deduction	(12,000)
Taxable Income	-

Excess Business Loss Calculation

Business #1	(350,000)
Net Business Income (Loss)	(350,000)
Section 461 Limitation (Single)	250,000
Excess Business Loss	**100,000**

Excess Business Loss - Example #2

Income Calculation (Single taxpayer)

Investment Income	15,000
Business #1	
Gross Receipts	1,000,000
Expenses	(375,000)
Net Income (Loss)	625,000
Business #2	
Gross Receipts	100,000
Expenses	(450,000)
Net Income (Loss)	(350,000)
Excess Business Loss Adj.	**-**
Adjusted Gross Income	290,000
Standard Deduction	(12,000)
Taxable Income	278,000

Excess Business Loss

Business #1	625,000
Business #2	(350,000)
Net Business Income (Loss)	275,000
Section 461 Limitation (Single)	250,000
Excess Business Loss	**-**

Excess Business Loss - Example #3

Income Calculation (Single taxpayer)

Investment Income	15,000
Business #1	
Gross Receipts	1,000,000
Expenses	(375,000)
Net Income (Loss)	625,000
Business #2	
Gross Receipts	1,000,000
Expenses	(2,000,000)
Net Income (Loss)	(1,000,000)
Excess Business Loss Adj.	**125,000**
Adjusted Gross Income	(235,000)
Standard Deduction	(12,000)
Taxable Income	(247,000)

Excess Business Loss

Business #1	625,000
Business #2	(1,000,000)
Net Business Income (Loss)	(375,000)
Section 461 Limitation (Single)	250,000
Excess Business Loss	**125,000**

Excess Business Loss - Example #4

Income Calculation (Single taxpayer)

Wages (S Corporation #1)	100,000
Investment Income	400,000
S Corporation #1	200,000
S Corporation #2	(1,000,000)
Excess Business Loss Adj.	**450,000**
Adjusted Gross Income	150,000
Standard Deduction	(12,000)
Taxable Income	138,000

Excess Business Loss

Wages	100,000
S Corporation #1	200,000
S Corporation #2	(1,000,000)
Net Business Income (Loss)	(700,000)
Section 461 Limitation (Single)	250,000
Excess Business Loss	**450,000**

Excess Business Loss - Example #5

Income Calculation (Single taxpayer)

Wages (S Corporation #1)	1,000,000
Investment Income	250,000
S Corporation #1	(1,000,000)
Excess Business Loss Adj.	**-**
Adjusted Gross Income	250,000
Standard Deduction	(12,000)
Taxable Income	238,000

Excess Business Loss

Wages	1,000,000
S Corporation #1	(1,000,000)
Net Business Income (Loss)	1,000,000
Section 461 Limitation (Single)	250,000
Excess Business Loss	**-**

Excess Business Losses - Other Information

- The disallowed excess business losses are converted to a net operating loss carryover.
- Under the NOL carryover rules (for NOL's generated after 2017), *IRC Section 172* limits the use of NOL's to 80 percent of taxable income (calculated without regard to any NOL deduction).
- Planning for the excess business loss rules are extremely important when bonus depreciation or any potential state level adjustment may require an addition to income, as it may result in paying state tax when a Federal loss is completely disallowed.

Change in Treatment of Net Operating Losses

- **Prior Law -** Generally, with some exceptions, a net operating loss (NOL) could be **carried back 2 years and carried over 20 years** to offset taxable income in such years.

- **TCJA -** For NOLs arising in tax years ended after December 31, 2017, the **2-year carryback** and the special carryback provisions **are repealed.**
  - A 2-year carryback continues to apply in the case of certain losses incurred in the trade or business of farming.
  - For losses arising in tax years beginning after December 31, 2017, the **NOL deduction** is **limited to 80 percent of taxable income** (determined without regard to the deduction).
  - Carryovers to other years are adjusted to take account of this limitation and **NOLs can be carried forward indefinitely.**
  - **Exception:** NOLs of **property and casualty insurance companies** can be carried back 2 years and carried over 20 years to offset 100 percent of taxable income in such years.

Accounting Method Changes

Accounting Method Changes Taxable Year of Inclusion

- **Prior Law -** In general, for a cash basis taxpayer, an amount is included in income when actually or constructively received.
    - For an accrual basis taxpayer, an amount is included in income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy (i.e., when the "all events test" is met), unless an exception permits deferral or exclusion.
    - A number of exceptions that exist to permit deferral of income related to advance payments.
        - An advance payment is when a taxpayer receives payment before the taxpayer provides goods or services to its customer.
        - The exceptions often allow tax deferral to mirror financial accounting deferral (e.g., income is recognized as the goods are provided or the services are performed).
- **TCJA -** Generally, for tax years beginning after December 31, 2017, a taxpayer is required to recognize income **no later than the tax year in which such income is taken into account as income on an applicable financial statement (AFS**) or another financial statement under rules specified by IRS (subject to an exception for long-term contract income under *IRC Code Section 460*).

Accounting Method Changes - Cash Method

- **Prior Law -** A corporation, or a partnership with a corporate partner, may generally only use the **cash method** of accounting if the corporation or partnership met a gross receipts test (i.e., the average annual gross receipts of the entity for the three tax year period ending with the earlier tax year **does not exceed $5 million).**

- **TCJA -** The cash method may be used by taxpayers (other than tax shelters) that satisfy a $26 million gross receipts test, regardless of whether the purchase, production or sale of merchandise is an income-producing factor.
  - Under the gross receipts test, taxpayers with annual average gross receipts that do not exceed $26 million (indexed for inflation) for the three prior tax years are allowed to use the cash method.
  - Use of this provision results is a change in the taxpayer's accounting method for purposes of *IRC Section 481*.

Accounting Method Changes - Inventories

- **Prior Law -** Businesses that are required to use an inventory method must generally use the accrual accounting method.
  - However, the cash method can be used for certain small businesses that meet a gross receipt test with average gross receipts of not more than $1 million ($10 million businesses in certain industries).
  - These businesses account for inventory as non-incidental materials and supplies.
- **TCJA -** Taxpayers that meet the $26 million gross receipts test are not required to account for inventories under *IRC Section 471*, but rather may use an accounting method for inventories that either:
  - Treats inventories as non-incidental materials and supplies, or
  - Conforms to the taxpayer's financial accounting treatment of inventories.

  Use of this provisions results is a change in the taxpayer's accounting method for purposes of *IRC Section 481*.

Accounting Method Changes - UNICAP

- **Prior Law -** The uniform capitalization (UNICAP) rules generally require certain direct and indirect costs associated with real or tangible personal property manufactured by a business to be included in either inventory or capitalized into the basis of such property.
  - ***Exception:*** Under pre-Act Law, a business with average annual gross receipts of $10 million or less in the preceding three years is not subject to the UNICAP rules for personal property acquired for resale.

- **TCJA** - **<u>Any producer or re-seller</u>** that meets the $26 million gross receipts test is exempted from the application of the *IRC Section 263A* UNICAP rules.
  - The exemptions from the UNICAP rules that are not based on a taxpayer's gross receipts are retained.
  - Use of this provision results in a change in the taxpayer's accounting method for purposes of *IRC Section 481*.

Accounting Method Changes – Long-term Contracts

- **Prior Law -** An exception from the requirement to use the percentage-of-completion method (PCM) for long-term contracts was provided for construction companies with **average annual gross receipts of $10 million or less** in the preceding three years (i.e. they are allowed use other methods such as the completed contract method or an accrual method).

- **TCJA -** For contracts entered into after December 31, 2017, in tax years ending after that date, the exception for small construction contracts from the requirement to use the PCM is expanded to apply to contracts for the construction or improvement of real property if the contract: (1) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer that (for the tax year in which the contract was entered into) meets the $26 million gross receipts test.
  - Use of this PCM exception for small construction contracts is applied on a cutoff basis for all similarly classified contracts (so there is no adjustment under *IRC Section 481(a)* for contracts entered into before January 1, 2018).

Meals & Entertainment Expenses

Meals and Entertainment Expenses

- **Prior Law -** Taxpayers could generally deduct 50% of business-related meal and entertainment expenses incurred before 1/1/18.
    - Taxpayer had to establish that the expenses were directly related to or associated with the business.

- **TCJA -** No deduction will be allowed for expenses of a trade or business related to entertainment, amusement or recreation activities or for membership dues to any club organized for business, pleasure, recreation or other social purposes.
    - Some examples include:
        - Tickets to sporting events.
        - Private boxes or license fees for seating rights at sporting events.
        - Theater tickets.
        - Golf club dues.
        - Golf, hunting, fishing, sailing outings, etc. for customers.

Meals and Entertainment Expenses

- This eliminates the subjective determination of whether such expenses were sufficiently business related.
- **<u>The 50% limitation on deductions for meals continues to apply</u>** and is expanded to include meals provided through an in-house cafeteria or otherwise on the premises of the employer.
  - Business meetings meals.
  - Customer business meals.
  - Business travel meals.
- Effective for amounts paid or incurred after 12/31/17.

Meals and Entertainment Expenses

De minimis Meals

- **Prior Law** – Employer could deduct 100% of meal expenses that were excluded from the recipient employee's income as a *de minimis* fringe benefit. Examples include:
  - Meals or meal money provided to employees on an occasional basis.
  - Meals or meal money provided to employees working overtime.
- **TCJA** – De minimis meals are no longer 100% deductible.
  - The new law **still allows a 50% deduction** for de minimis meals.

Meals and Entertainment Expenses

Convenience of Employer Meals and Lodging

- **Prior Law** – Employer could deduct 100% of meal or lodging expenses provided to an employee (including his or her spouse and dependents) for the convenience of the employer and such expenses were excluded from employee's income if the following requirements were met:
  - ***Business Premises***. The meals or lodging must be furnished on the employer's business premises.
  - ***Convenience of the Employer***. The meals or lodging must be furnished for the convenience of the employer
  - ***Condition of Employment***. In the case of lodging (but not meals), the employee must be required to accept such lodging as a condition of employment.
- **TCJA** – Convenience of employer meals are **now only 50% deductible**.
  - After 2025, no deductions for such meals will be allowable.

Meals and Entertainment Expenses

Employer-Operated Eating Facility

- **Prior Law** – Employer could deduct 100% of the cost (including facility costs) of providing meals to employees at a qualifying employer-operated eating facility (i.e., company cafeteria). To qualify, the facility had to meet the following requirements:
  - Be owned or leased by the employer.
  - Be operated by the employer (can be through a vendor).
  - Be on or near the employer's business premises.
  - Revenue from the facility must equal or exceed the cost of operating the facility.
  - Meals are served during or immediately before or after working hours.
  - The facility is generally available to all employees.
- **TCJA** – Employer-operated eating facility costs are **now only 50% deductible**.
  - After 2025, no deductions for such costs will be allowable.

Meals and Entertainment Expenses

Employee Events

- **Prior Law** – Employer could deduct 100% of food, beverages and entertainment expenses incurred for recreational, social, or similar activities primarily for the benefit of employees. Examples include:
  - Company holiday parties or picnics.
- **TCJA** – Same as prior law - **100% deductible**.
  - Covers applicable entertainment expenses as well.

Meals and Entertainment Expenses

General Public Events

- **Prior Law** – Employer could deduct 100% of food, beverages and entertainment expenses made available to the general public. Examples include:
  - Free snacks at a business showroom.
  - Free food and entertainment at an event open to the public.
- **TCJA** – Same as prior law - **100% deductible**.
  - Covers applicable entertainment expenses as well.

Meals and Entertainment Expenses

Compensation Meals

- **Prior Law** – Employer could deduct 100% of meal and entertainment expenses that were reported as taxable compensation to recipient employees.
- **TCJA** – Same as prior law - **100% deductible**.
  - Still applies to entertainment expenses as well.

Meals and Entertainment Expenses

Nonemployee Recipients

- **Prior Law** – Taxpayers could deduct 100% of meals and entertainment expenses that were reported to a nonemployee recipient on a Form 1099. Example includes:
  - Customer or independent contractor wins a trip or entertainment package at a sales event.
- **TCJA** – Same as prior law - **100% deductible**.
  - Covers applicable entertainment expenses as well.

Meals and Entertainment Expenses

Sold to Customers

- **Prior Law** – Taxpayers could deduct 100% of food, beverages and entertainment expenses sold to customers at full value.
- **TCJA** – Same as prior law - **100% deductible**.
  - Covers applicable entertainment expenses as well.

Meals and Entertainment Expenses

Fundraising Charitable Sporting Events

- **Prior Law** – Taxpayers could deduct 100% of the cost of tickets to fundraising charitable sporting events if all of the following requirements were met:
  - The event was organized for the benefit of a qualifying charitable organization.
  - 100% of the net proceeds were contributed to the charity.
  - Volunteers did substantially all the work in staging the event.
- **TCJA** – Such expenses are **no longer deductible**.

Meals and Entertainment Expenses

- IRS clarified in ***IRS Notice 2018-76*** *(10-3-18)* when ***entertainment business meals*** are deductible.

- Per ***IRS Notice 2018-76***, businesses can deduct 50% of otherwise allowable business meal expenses (food and beverages) if the following requirements are met:
  - The expense is an ordinary and necessary business expense under ***IRC Sec. 162(a).***
  - The expense is not lavish or extravagant under the circumstances.
  - The taxpayer, or an employee of the taxpayer, is present at the meal.
  - The meals are provided to a current or potential business customer, client, consultant, or similar business contact.
  - The cost of the meals are purchased separately or stated separately on the bill from the cost of the entertainment.
    - This identification provision is a new requirement.

Meals and Entertainment Expenses

- Although not specifically discussed in ***IRS Notice 2018-76***, to be an *otherwise allowable* business meal expense:
  - Business must be conducted immediately before, during, or immediately after the event, and
  - The normal substantiation requirements must be met.
- ***IRS Notice 2018-76*** represents interim guidance until IRS issues proposed regulations.

Other Business Provisions

Fringe Benefits

Transportation Fringe Benefits

- The deductions for employee transportation fringe benefits **(e.g., parking and mass transit)** are **no longer allowed**.
    - Transportation in a commuter highway vehicle for travel between the employee's residence and place of employment.
    - Transit passes.
    - Qualified parking.
    - Qualified bicycle commuting reimbursement.
- However, the **exclusion from income** for such benefits received by an employee **is retained**.
    - Qualified bicycle commuting reimbursements are taxable to employees under the TCJA.
        - This provision is effective for tax years beginning after 1/1/17 and before 1/1/26.
- Effective for amounts paid or incurred after 12/31/17.

Like-Kind Exchange Limited to Real Property

- **Prior Law -** Like-kind exchanges (LKE's) are permitted for property held for use in a trade or business or for investment.
  - LKE's were permitted for both real property and personal property.

- **TCJA -** Like-kind treatment **will be limited to real property only.**

- **Note:** With the increased Section 179 expensing and the 100% bonus depreciation expensing provisions, the inability to defer the gain recognized on a trade-in will have limited impact as the increased basis of the property acquired can most likely be expensed in full.

Five Year Write-Off of Specified R&E Expenses

- **Prior Law -** Taxpayers can elect to deduct currently the amount of certain reasonable research or experimentation (R&E) expenses paid or incurred in connection with a trade or business.
  - Alternatively, taxpayers may forgo a current deduction, capitalize their research expenses, and recover them ratably over the useful life of the research, but in no case over a period of less than 60 months.

- **TCJA -** For amounts paid or incurred in tax years beginning after December 31, 2021, "specified R&E expenses" **must be capitalized and amortized ratably over a 5-year period** (15 years if conducted outside of the U.S.), beginning with the midpoint of the tax year in which the specified R&E expenses were paid or incurred.
  - Specified R&E expenses subject to capitalization include expenses for software development, but not expenses for land or for depreciable or depletable property used in connection with the research or experimentation (but do include the depreciation and depletion allowances of such property).
  - Also excluded are exploration expenses incurred for ore or other minerals (including oil and gas).
  - In the case of retired, abandoned or disposed property with respect to which specified R&E expenses are paid or incurred, any remaining basis may not be recovered in the year of retirement, abandonment or disposal, but instead must continue to be amortized over the remaining amortization period.

Rehabilitation Credit Limited

- **<u>The 10% credit</u>** for qualified rehabilitation expenditures with respect to a pre-'36 building **<u>is repealed</u>**.
- **<u>The 20% Certified Historic Structure tax credit</u>** must now be claimed **<u>ratably over a 5-year period</u>** beginning with the year the qualified rehabilitated building is placed into service.

New Credit for Employer-paid Family and Medical Leave

- Under the TCJA, **for tax years beginning after 12/31/17 and before 1/1/20**, businesses can claim a **tax credit equal to 12.5%** of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave if the rate of payment is 50% of the wages normally paid to the employee.

- The credit is increased by .25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%.

- The amount of family and medical leave that may be taken into account with respect to any employee in determining the credit for any tax year can't exceed 12 weeks.

- The taxpayer's wage deduction must be reduced by the total amount of family and medical leave credits claimed.

- All qualifying full-time employees have to be given at least two weeks of annual paid family and medical leave.

Other Miscellaneous Business Provisions Under the TCJA

- **No deductions for amounts paid for sexual harassment subject to nondisclosure agreement.**
- **Deduction for local lobbying expenses eliminated.**
- **Changes to the limitation on excessive employee compensation** - The exceptions to the $1 million deduction limitation for commissions and performance-based compensation are repealed.
- **Domestic production activities deduction repealed.**
- **Repeal of rollover of publicly traded securities gain into specialized SBICs.**
- **Orphan drug credit modified** - Credit rate reduced from 50% to 25%.
- **New tax incentives for investments in qualified opportunity zones.**

Other Business Updates

IRS Issues FAQ Guidance on Negative Tax Basis Capital Account Reporting for Partnerships

- The IRS has issued guidance in the form of an FAQ on the new **negative tax basis capital account** reporting requirement added to the 2018 Form 1065 instructions.

- The instructions require partnerships to report partners' tax basis capital accounts on Line 20 of Schedule K-1 if those amounts are negative at either the beginning or ending of the year.

- ***Notice 2019-20*** provides penalty relief for some partnerships that fail to report the amounts.

- The FAQ defines a partner's tax basis capital account, explains how it is calculated with examples, and provides a safe harbor that allows partnerships to calculate a partner's tax basis capital account by subtracting the partner's share of partnership liabilities under ***IRC Sec. 752*** from the partner's outside basis.

New Guidance Issued for Centralized Partnership Audit Regime

- The IRS has issued a memo that provides interim guidance for IRS Appeals employees on new case procedures for different phases of the centralized partnership audit regime enacted by the Bipartisan Budget Act of 2015 (BBA) ***(Memorandum AP-08-1019-0013)***.

- The new partnership audit regime generally provides that adjustment, assessment, and collection of tax due to **audit adjustments will occur at the partnership level**. Previously, adjustments were passed through to partners with ensuing tax, penalty and interest adjustments.

  - However, **a partnership may elect** to ***"push out"*** any audit adjustments to those who were partners during the reviewed year.

- The guidance is effective October 18, 2019, and addresses several phases including: (1) early election into BBA, (2) Administrative Adjustment Request (AAR), (3) Notice of Proposed Partnership Adjustment (NOPPA), (4) modification disputes, and (5) Notice of Final Partnership Adjustment (FPA).

IRS Expands List of Permitted Preventive Care Benefits under an HDHP

- The IRS has **expanded the list of preventive care benefits** permitted to be **provided by a High Deductible Health Plan** (HDHP) without a deductible, or with a deductible below the applicable minimum deductible (self-only or family) for an HDHP.

- The updated list includes medical care services and other items (such as prescription drugs) for **certain chronic conditions**.

- However, these additional services and items are treated as preventive only when prescribed to treat an individual diagnosed with the specified chronic condition, and only when prescribed for preventing the exacerbation of the chronic condition or the development of a secondary condition.

- The IRS will review the list every five to ten years to determine whether services or items should be added or removed. The updated list of benefits is effective 7/17/19. (*Notice 2019-45*).

The IRS has issued Final Regulations on Hardship Distributions from 401(k) Plans

- The IRS has issued final regulations on hardship distributions from 401(k) plans.
- Among other things, the final regulations eliminate any requirement that an employee be prohibited from making elective contributions after receiving a hardship distribution, or that an employee must first take plan loans before receiving a hardship distribution.
- The regulations also eliminate the facts and circumstances determination of whether a distribution is necessary to satisfy a financial need.
- Under the final rules, a hardship distribution may not exceed the amount of an employee's need, and the employee must represent having insufficient cash or other liquid assets to satisfy the need.

IRS Offers Settlement for Microcaptive Insurance Schemes

- The IRS is presenting a time-limited settlement offer to certain taxpayers under audit who participated in abusive microcaptive insurance transactions. Those eligible for this offer will be notified by letter with the applicable terms.

- The settlement requires substantial concession of the income tax benefits claimed by the taxpayer, along with appropriate penalties (unless good faith, reasonable reliance is shown).

- Taxpayers who receive letters, but choose not to participate, will continue to be audited by the IRS under its normal procedures. In addition, they will not be eligible for any potential future settlement initiatives.

- Currently, settlement procedures are limited to taxpayers with at least one open year under exam; however, the IRS will continue to assess whether the program should be expanded to others **(News Release IR 2019-157).**

Denial of Deductions for Marijuana Business is Constitutional

- The Tax Court has held that it is constitutional for the IRS to deny all deductions to a medical marijuana dispensary under ***IRC Sec. 280E***, even though the dispensary operated legally under state law ***(Northern California Small Business Assistants*** **Inc., (2019)** ***153 TC No. 4).***

- No deduction or credit is allowed for any amount paid or incurred during the tax year in carrying on any trade or business if the trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted ***(IRC Sec. 280E).***

- Marijuana is a Schedule I controlled substance within the meaning of the Controlled Substance Act. But the sale of marijuana is legal (but regulated) in CA.

- Consistent with the Federal designation under the Controlled Substances Act, the Tax Court has held that the limitations imposed by ***IRC Sec. 280E*** are applicable to marijuana businesses operating legally under state law ***(Olive, (2012) 139 TC No. 19).***

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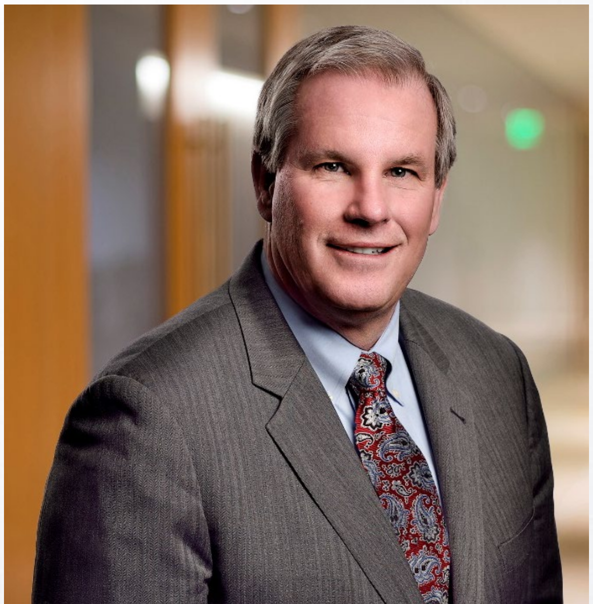

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