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A blurred background image showing a person's hands writing on a piece of paper with a black pen. The person is wearing a grey long-sleeved shirt. A calculator is visible on the desk in the foreground, partially obscured by a blue overlay.

Construction Update for the New Tax Law for 2018

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.... Tax Reform and What it Means for Contractors

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Construction Tax Agenda 2018

1. Higher limitations on required revenue method changes, equals more deferral options for contractors.
2. Proposed regulations under Internal Revenue Code Section 199A - guidance at last!
3. Other tax law changes effective for 2018.

Small Contractor Exemption

Accounting Method Changes - Long-Term Contracts

- **Pre-Act 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).

Accounting Method Changes - Long-term Contracts (con't.)

- **New Law:** 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 \$25 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 Code Section 481(a) for contracts entered into before January 1, 2018).

... **Changes in Method of Accounting**

- Consent required to change a method of accounting.
- Adopting a method:
 - Permissible Method - first filed return - new taxpayer.
 - Impermissible Method - two consecutive tax returns.
 - Amended return if filed before second return.
 - Revenue Ruling 90-38 - retroactive changes not permitted.

... Changes in Method of Accounting (con't.)

- Method of accounting or treatment of any material item.
 - Involves timing and consistency.
- Change in facts is not a change in method.
 - A bona fide change in business policy or practice.
 - The taxpayer engaging in a new business.
 - The appearance of a new item of income or expense.
 - The development of a more accurate estimation or valuation formula.

... Changes in Method of Accounting (con't.)

- Voluntary.
 - Revenue Procedure 2018-31 automatic consent changes (updates Revenue Procedure 2017-30).
 - IRC 481(a) positive adjustment - four year spread.
 - Generally two years if taxpayer is under examination.
 - IRC 481(a) negative - all in year of change.
 - IRC 460 changes - cut-off basis only.

... Changes in Method of Accounting (con't.)

- Involuntary (service imposed).
 - Revenue Procedure 2002-18.
 - IRC 481(a).
 - No spread.
- Changing from an impermissible method to permissible method without filing Form 3115 is an unauthorized change.

Exempt vs. Non-Exempt Contracts

Tax Year	Average Annual Gross Receipts	Exempt Method	Non-Exempt Method
2016	9 million	CCM	
2017	11 million		PCM
2018	15 million	CCM	
2019	20 million	CCM	
2020	26 million		PCM

...Exempt vs. Non-Exempt Contracts (con't.)

- Filing Form 3115 to change exempt method to PCM without being required to report on PCM changes the exempt method.
- Must continue with this exempt method or secure the Commissioner's consent to change.

... Accounting Method Changes Taxable Year of Inclusion

- **Pre-Act 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 relate 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).

... Accounting Method Changes Taxable Year of Inclusion (con't.)

- **New Law:** 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 Code Section 460).

Accounting Method Changes - Cash Method of Accounting

- **Pre-Act 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).

Accounting Method Changes - Cash Method of Accounting (con't.)

- **New Law.** For tax years beginning after December 31, 2017, the cash method may be used by taxpayers (other than tax shelters) that satisfy a \$25 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 \$25 million (indexed for inflation for tax years beginning after December 31, 2018) for the three prior tax years are allowed to use the cash method.
 - Use of this provision results in a change in the taxpayers' accounting method for purposes of Code Section 481.

... Accounting Method Changes - UNICAP

- **Pre-Act 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.

Accounting Method Changes - UNICAP (con't.)

- **New Law:** For tax years beginning after December 31, 2017, any producer or re-seller that meets the \$25 million gross receipts test is exempted from the application of the Code 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 Code Section 481.

Qualified Business Income Deduction - Section 199A

... **New Section 199A Deduction for Pass-Through Businesses**

- Up to a 20 percent deduction on business income.
- Only available to non-professional businesses.
- Limitations on the amount of the deduction.
- Complex calculation to figure the limitations.
- New Regulations issued.

... **The New Tax Law Enacted in December of 2017 Included Many Noteworthy Provisions**

- Congress created Section 199A so that owners of these entities could deduct a piece of their business income “off the top” before calculating their personal tax.
- Sounds simple enough in theory, but in order to give businesses a break without creating a wealth of opportunities for tax avoidance, certain limitations and special circumstances needed to be addressed.

Clarifying How Section 199A Will Work in Practice

- The Internal Revenue Service released several pieces of Section 199A guidance designed to clarify how the law would apply in practice.
- Operation rules. This Section takes Congress' legislative language and begins to translate it into instructions. It covers the nuts and bolts of how the provision works when there are no special circumstances to address.

... Clarifying How Section 199A Will Work in Practice (con't.)

- For instance, many taxpayers will fall below the income limits (\$315,000 for joint returns or \$157,500 for other filers) that allow them to take the full 20 percent deduction from their pass-through income.
- Those folks may have a relatively uncomplicated calculation to determine their deduction.

... Clarifying How Section 199A Will Work in Practice (con't.)

- Limits based on wages paid. In some situations, the deduction may be limited based on a percentage of the wages a pass-through business pays to employees.
- The guidance includes three possible methods for calculating this limitation.

New Call-to-Action - Lots of Rules

- Limits calculated from basis in acquired property. The regulations offer guidance on limitations based on an owner's basis in different types of property.

What Constitutes “Business Income?”

- Aggregating business income for owners of multiple pass-throughs. Many taxpayers own interests in multiple pass-through entities. The rules allow taxpayers to aggregate multiple entities for purposes of applying the wage and property limitations.

What Constitutes “Business Income?” (con’t.)

- The recent Section 199A guidance covers a lot of ground when it comes to answering questions raised by the 2017 law. However, tax professionals and taxpayers still have lots of questions the guidance didn’t answer, as well as new questions that have arisen as a result of the guidance.



Other Business Provisions

... Increased Section 179 Expensing

- The Act increases the maximum amount a taxpayer may expense under Section 179 to \$1,000,000, (from \$500,000) and increases the phase-out threshold amount to \$2,500,000 (from \$2,000,000).
- Effective property placed in service in taxable years beginning after December 31, 2017.
- The \$1,000,000 and \$2,500,000 amounts, as well as the \$25,000 sport utility vehicle limitation, are indexed for inflation for taxable years beginning after 2018.
- The Act 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.



Increased Section 179 Expensing

- The Act also expands the definition of qualified real property eligible for Section 179 expensing to include any of the following improvements to non-residential real property placed in service after the date such property was first placed in service:
 - Roofs;
 - Heating;
 - Ventilation and air-conditioning property;
 - Fire protection and alarm systems; and
 - Security systems.
- No sunset provision.

... 100 Percent Expensing of Qualified Business Assets (Bonus Depreciation)

- **Pre-Act Law:** An additional first-year depreciation deduction was allowed equal to 50 percent of the adjusted basis of qualified property placed in service before 2020.
- **New Law:** Allows 100 percent 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).

... 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.
- Special rules and shorter depreciable lives did exist for qualified leasehold improvement, qualified restaurant and qualified retail improvement property.
- For property placed in service after December 31, 2017, the separate definitions of qualified leasehold improvement, qualified restaurant and qualified retail improvement property are eliminated, a general 15 year recovery period and straight-line depreciation are provided for **qualified improvement property**.
- Thus, qualified improvement property is now generally depreciable over 15 years using the straight-line method and half-year convention, without regard to whether the improvements are property subject to a lease, placed in service more than three years after the date the building was first placed in service or made to a restaurant building.

Corporate Alternative Minimum Tax Repealed

- The corporate alternative minimum tax (AMT) is repealed.
- AMT credit carryforward.
 - Full realization to offset regular tax.
 - 50 Percent refundable in 2018 - 2021.
 - 100 Percent refundable in 2022.

Individual Alternative Minimum Tax (AMT)

- The alternative minimum tax (AMT) is a tax system separate from the regular tax that is intended to prevent a taxpayer with substantial income from avoiding tax liability by using various exclusions, deductions and credits.
- The Act increases the AMT exemption amounts in 2018 for non-corporate taxpayers, as follows:
 - Married Joint - \$109,400 (*was \$84,500*).
 - Single & HOH - \$70,300 (*was \$54,300*).
 - Married Filing Separately - \$54,700 (*was \$42,250*).
 - Estates and Trusts - \$22,500 (*was \$24,100*).

Individual Alternative Minimum Tax (AMT) (con't.)

- Under the Act, the above exemption amounts are reduced (not below zero) to an amount equal to 25 percent of the amount by which the alternative taxable income of the taxpayer exceeds the phase-out amounts, increased, as follows:
 - Married Joint - \$1 million (*was \$164,000*).
 - All other taxpayers (other than estates and trusts) - \$500,000 (*was \$123,100*).
 - Estates and Trusts - \$75,000 (*was \$75,000; i.e., no change*).
- Sunset provision.
- **NOTE:** With the repeal of dependent exemptions, the \$10,000 limitation on SALT deductions, the disallowance of miscellaneous itemized deductions and the increase in the AMT exemption amounts and thresholds, many taxpayers that were in AMT in prior years will not be going forward.

Year-End Discussions with Contractors

Discussions with Contractors

- Acceleration of revenue???
- C corporations.
 - Historic low rate.
 - 34/35 Percent since 1988.
 - Prior to that, 40-52 percent back to 1950.
 - Go back to 1939 at 19 percent.

Discussions with Contractors (con't.)

- Current rate 21 percent - to return to 34 percent would be a 62 percent increase.
- AMT eliminated.
 - Depletion.
 - Life insurance proceeds.
 - Long-term contracts on PCM.
- Uncertain political future.
 - Vows by Democrats to repeal 2017 tax law.

Discussions with Contractors (con't.)

- Many companies have “set aside” investment monies to pay taxes.
 - Highly appreciated.
 - Take gains (lower rate) and pay now.
 - Perfect Calm/The Reset.

Example

- Smith & Jones Construction has grown quickly, without paying a lot of taxes on very good profits. Revenue deferral, using acceleration of deductions and bonus depreciation it has consistently turned book profits into zero taxes.
- They now have a \$12 million cumulative income deferral and what was a \$4.1 million deferred tax liability. That will be adjusted to \$2.5 million for the new rate. They also have investments, which they used some of the tax savings (\$1 million) which grew to \$3 million in value.

Question - Now what?

Example (con't.)

- We could sell the investments over several months (realizing a \$2 million gain) and adopt a plan to accelerate revenue recognition using the \$3 million to pay all the taxes.

OR

- We can continue business as usual, maybe even increase the deferral, then when taxes go up, AMT comes back, the markets go down and depreciation is straight-line watch as the deferral reverses, and the remaining \$1 million investment pays only a quarter of the bill and operations has to cover the other \$3.1 million.

Pass-Throughs are Less Clear

- Assuming Section 199A treatment current top rate is just under 30 percent. A good reduction from the prior law of 38 percent (42 percent effective rate, less DPAD).
- If old law was restored, that would be a 28 percent increase - not the 62 percent C-corps would endure.

Finance May be a Concern

- Money is available now.
- Growth opportunities have to be weighted.
- Time value of money.
- Trying to time rate reversals.
 - How long will the deferrals take to clear?
- Timing political changes.



Always Good to Have Long Range Discussions

- Possible impact on transitions.
 - Internal/family.
 - External sale.
 - Merger.
- Good problem to have.

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Appendix

199A Proposed Regulations - 1.199A-1

- Key definitions:
 - Aggregated trade or business.
 - Applicable percentage / phase-in-range / reduction amount / threshold amount.
 - Trade or business - means a Section 162 business.
 - All other key definitions are referenced to other Regulations Sections under 199A.

199A Proposed Regulations - 1.199A-1 (con't.)

- Computations - individuals not exceeding threshold amount.
 - Lesser of 20 percent of Qualified Business Income or 20 percent of taxable income.
 - Carryover rules.
 - Total negative QBI - deduction is zero and negative QBI carries to following tax year as a separate trade or business.

199A Proposed Regulations - 1.199A-1 (con't.)

- Computations - individuals exceeding threshold amount.
 - Lesser of QBI component or 20 percent of taxable income.
 - QBI component - SSTB exclusion.
 - Individuals within the phase in range (\$315,000 - \$415,000 MFJ) apply only the applicable percentage of QBI, W-2 wages, and UBIA.
 - Individuals exceeding the range apply none of the QBI, W-2 wages, or UBIA (Unadjusted Basis Immediately after Acquisition).
 - Aggregation - individuals may choose to aggregate to combine QBI, W-2 wages and UBIA for calculation of limitations.

199A Proposed Regulations - 1.199A-1 (con't.)

- Computations - individuals exceeding threshold amount.
 - QBI component determined for each trade or business.
 - Lesser of:
 - (1) 20 Percent of QBI: or
 - (2) 50 Percent of W-2 wages or 25 percent W-2 wages plus 2.5 percent basis in qualified property.

199A Proposed Regulations - 1.199A-1 (con't.)

- Computations - individuals within phase-in range.
 - QBI Component is determined based on the “reduction amount.”
 - Reduction amount is the amount by which (1) above exceeds (2) above multiplied by a percentage determined by:
 - The amount taxable income exceeds the threshold amount divided by \$50,000 (\$100,000 MFJ).

199A Proposed Regulations - 1.199A-1 (con't.)

- Computations - individuals within phase-in range (EXAMPLE).
 - B & C are married with \$375,000 of taxable income.
 - Pass-through QBI from S-corp of \$300,000 and W-2 wages of \$40,000 and zero UBI A.
 - 20 Percent of QBI = \$60,000.
 - 50 Percent W-2 wages = \$20,000.
 - QBI must be reduced by “reduction amount.”

199A Proposed Regulations - 1.199A-1 (con't.)

- Computations - individuals within phase-in range (EXAMPLE).
 - Applicable percentage = 60 percent $(\$375,000 - \$315,000) / \$100,000$.
 - Excess amount = \$40,000 $(\$60,000 \text{ QBI} - \$20,000 \text{ W-2 wage limitation})$.
 - Reduction amount = \$24,000 $(60 \text{ percent} \times \$40,000)$.
 - QBI component = \$36,000 $(\$60,000 \text{ QBI} - \$24,000 \text{ reduction amount})$.

199A Proposed Regulations - 1.199A-1 (con't.)

- Computations - individuals within phase-in range (EXAMPLE SSTB).
 - For SSTB, QBI and W-2 wages must first be limited to the applicable percentage.
 - Applicable percentage = 40 percent.
 - QBI = \$120,000 (\$300,000 x 40 percent).
 - 20 Percent of QBI = \$24,000.
 - W-2 wages = \$16,000 (\$40,000 x 40 percent).
 - 50 Percent W-2 wages = \$8,000.

199A Proposed Regulations - 1.199A-1 (con't.)

- Computations - individuals within phase-in range (EXAMPLE SSTB).
 - Applicable percentage = 60 percent $(\$375,000 - \$315,000) / \$100,000$.
 - Excess amount = \$16,000 $(\$24,000 \text{ QBI} - \$8,000 \text{ W-2 wage limitation})$.
 - Reduction amount = \$9,600 $(60 \text{ percent} \times \$16,000)$.
 - QBI component = \$14,400 $(\$24,000 \text{ QBI} - \$9,600 \text{ reduction amount})$.

199A Proposed Regulations - 1.199A-2

- Provides guidance on calculating W-2 wages properly allocable to QBI and the UBIA.
- If not properly determined and reported to individual shareholders/partners, W-2 wages and UBIA are presumed to be zero.

199A Proposed Regulations - 1.199A-2 (con't.)

- 3 Step process for determining W-2 wages allocable to QBI.
- (1) Determine total W-2 wages paid for the tax year.
- (2) Allocate W-2 wages between one or more trades or businesses.
- (3) Determine the amount of such wages that are allocable to the QBI of the respective trade or business.

199A Proposed Regulations - 1.199A-2 (con't.)

- (1) Determine total W-2 Wages paid for the tax year.
- Wages include amount of taxable wages plus elective deferrals.
- Wages must be reported on a return filed with the Social Security Administration.
- Employees include officers of and S-corp.
- Can include W-2 wages paid by another person if wages were paid to common law employee of the trade or business.
 - Certified professional employer organizations.

199A Proposed Regulations - 1.199A-2 (con't.)

- (2) Allocate W-2 wages between one or more trades or businesses.
- If an entity conducts more than one trade or business.
- Allocation is determined in the same way expenses are allocated pursuant to Regulation Section 1.199A-3(b)(5) (reasonable method of allocation based on the facts and circumstances).

199A Proposed Regulations - 1.199A-2 (con't.)

- (3) Determine the amount of such wages that are allocable to the QBI of the respective trade or business.
- Wages are allocable to QBI of trade or business if the expense for the wages were taken into account in determining QBI.
- Expense must be allocated and reported to the individual shareholders and partners.
- Duplication of the W-2 wages is prohibited.

199A Proposed Regulations - 1.199A-2 (con't.)

- Qualified property is tangible property subject to the allowance of depreciation:
 - Which is available for use at the end of the year;
 - Which is used for the production of QBI at any point during the year; and
 - The depreciable period has not ended before the end of the year.
 - Depreciable period ends on the later of 10 years or the last day of the applicable recovery period.

199A Proposed Regulations - 1.199A-2 (con't.)

- Improvements to qualified property is treated as separate property on the date the improvement is placed in service.
- Sections 734 and 743 basis adjustments are NOT qualified property.
- Property acquired within 60 days of year-end and disposed within 120 days without being used at least 45 days is NOT qualified property.
- LKE Property - exchanged basis, replacement basis.

199A Proposed Regulations - 1.199A-3

- Provides guidance in determining Qualified Business Income.
- “The net amount of qualified items of income, gain, deduction, or loss with respect to any trade or business of the taxpayer:”
 - Which is effectively connect with the conduct of a trade or business within the United States; and
 - Included or allowed in determining taxable income for the tax year.

199A Proposed Regulations - 1.199A-3 (con't.)

- Section 751 Gain - gain or loss attributable to assets giving rise to ordinary income is included in QBI.
- Guaranteed payments - not included in QBI but deduction from partnership income attributable to QBI.
- Section 481 adjustment - taken into account for QBI if the adjustment arises in a taxable years ending after December 31, 2017.
- Previously disallowed losses allowed in the current year are included in QBI unless loss was disallowed in year ending before January 2018.
- Net operating loss not considered in computing QBI.

199A Proposed Regulations - 1.199A-3 (con't.)

- Income or loss excluded from QBI includes:
 - Capital gain or loss.
 - Dividends.
 - Interest unless properly allocable to a trade or business.
 - Reasonable compensation received by an S-corp shareholder.
 - Guaranteed payments.
 - Payment for services to a partner under 707(a).

199A Proposed Regulations - 1.199A-4

- Provides for guidance in regards to aggregation of separate trades or businesses which must be reported separately unless an election is made.
- Allows taxpayers to treat multiple trades or businesses as a single trade or business for QBI, W-2 wages, and UBIA only.
- Aggregation is allowed based on rules outlined in 1.199A-4, but is not required.
- All aggregated entities must meet the definition of a trade or business under Section 162 (exception for commonly controlled rental of property to a trade or business).

199A Proposed Regulations - 1.199A-4 (con't.)

- General rule - trades or businesses may only be aggregated if an individual can demonstrate:
 - The same person or group of persons, directly or indirectly, owns 50 percent or more of each trade or business to be aggregated (family attribution for lineal descendants).
 - The ownership must exist for a majority of the tax year.
 - All items for each trade or business are reported on returns with the same tax year.
 - None of the aggregated businesses are SSTB; and

199A Proposed Regulations - 1.199A-4 (con't.)

- General rule - trades or businesses may only be aggregated if an individual can demonstrate:
 - The trades or businesses satisfy AT LEAST TWO of the following:
 - The businesses provide products and services that are the same or customarily offered together.
 - The businesses share facilities or share significant centralized business elements, such as personnel, accounting, legal, etc.
 - The businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group.

199A Proposed Regulations - 1.199A-4 (con't.)

- Taxpayers must consistently report the aggregation.
- 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.
- Individual disclosure is required by attaching a statement to the tax return.
- Failure to disclose may result in Commissioner disaggregating.

199A Proposed Regulations - 1.199A-4 (con't.)

- Examples of businesses eligible for aggregation.
 - Restaurant and catering business that used the same kitchen/staff.
 - Clothing manufacturer and retail store.
 - A group of hardware stores.

199A Proposed Regulations - 1.199A-4 (con't.)

- Computations - benefits of aggregation (EXAMPLE).
 - F is an unmarried individual with \$2,722,000 of taxable income.
 - Business X - \$1,000,000 QBI and \$500,000 wages.
 - Business Y - \$1,000,000 QBI and zero wages.
 - Business Z - \$2,000 QBI and \$500,000 wages.
 - Aggregated total - \$2,002,000 QBI and \$1,000,000 wages.
 - Limitations in determining QBI component applied on business by business basis unless aggregation election is made.

199A Proposed Regulations - 1.199A-4 (con't.)

- Computations - benefits of aggregation (EXAMPLE) - QBI component on separate basis.
 - Business X - \$200,000 QBI or \$250,000 wages.
 - Business Y - \$200,000 QBI or \$0 wages.
 - Business Z - \$400 QBI or \$250,000 wages.
 - QBI Component = \$200,400 (\$200,000 + \$0 + \$400).

199A Proposed Regulations - 1.199A-4 (con't.)

- Computations - benefits of aggregation (EXAMPLE) - QBI component on aggregated basis.
 - Total QBI limit = \$400,400 (20 percent x \$2,002,000 total QBI).
 - Total wage limit = \$500,000 (50 percent x \$1,000,000 wages).
 - QBI component = \$400,400.
 - Additional deduction due to aggregation = \$200,000 (\$400,400 - \$200,400).

199A Proposed Regulations - 1.199A-4 (con't.)

- What constitutes a “trade or business?”
- For 199A purposes, a trade or business eligible for QBID means a Section 162 trade or business other than the trade or business of performing services as an employee.
- Code and regs never define the term “trade or business.”
 - Must be involved with continuity and regularity.
 - Primary purpose for engaging in the activity must be profit.
- Facts and circumstances and case law.

199A Proposed Regulations - 1.199A-4 (con't.)

- Landmark case - Groetzinger vs. Commissioner.
 - Sporadic activity, a hobby, or an amusement diversion does not qualify.
 - Gambler who spent 60 to 80 hours per week and depended on gambling for his livelihood was held to be in the trade or business of gambling similar to a trader of securities.
 - Pursued full-time, in good faith, and with regularity.
 - Skill was required and applied.

199A Proposed Regulations - 1.199A-4 (con't.)

- Rental activities as a trade or business.
 - Thomason vs. Commissioner - sporadic condo activities did not constitute a trade or business despite clear profit motive.
 - Jafarpour vs. Commissioner - Rental activity did not rise to the level of a trade or business. Taxpayers did not spend enough time due to the property locations in Alabama and Louisiana with taxpayers residing in California. Activities with California rental property were not used in determining whether rental of properties in Alabama/Louisiana constituted a trade or business.

199A Proposed Regulations - 1.199A-5

- Clarifications regarding the definitions of specified service businesses.
- Code Section 199A definition:
 - “...any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees.”

199A Proposed Regulations - 1.199A-5 (con't.)

- QBI Deduction for SSTB.
 - Below \$157,500 (\$315,000 MFJ) - full 20 percent deduction.
 - Between \$157,500 - \$207,500 (\$315,000 - \$415,000 MFJ) - limited deduction.
 - Over \$207,500 (\$415,000 MFJ) - no deduction.

199A Proposed Regulations - 1.199A-5 (con't.)

- Definition of business where the principal asset is the reputation or skill of one or more employees:
 - Person received fees, compensation, or income for endorsing products of services.
 - Person licenses or receives fees, compensation for the use of an individual's image, likeness, name, signature, voice, trademark or any other symbol associated with an individual's identity.
 - Receiving fees for appearing at an event or on radio, television.

199A Proposed Regulations - 1.199A-5 (con't.)

- Services or property provided to SSTB.
 - A trade or business that provides 80 percent or more of its property or services to a SSTB with 50 percent or more common ownership is considered a SSTB.
 - If less than 80 percent is provided - a pro-rated portion of the QBI is treated as income from a SSTB.
 - Example is rental of an office building to a law firm. QBI of the rental trade or business would be SSTB.

199A Proposed Regulations - 1.199A-5 (con't.)

- Incidental to SSTB.
 - A separate trade or business that has common ownership and shared expenses.
 - Separate trade or business would not otherwise be SSTB.
 - Treated as SSTB if separate trade or business represents less than 5 percent of the total combined gross revenues.
 - Example used is a dermatologist that sells skin care products.

199A Proposed Regulations - 1.199A-5 (con't.)

- Trade or business of performing services as an employee.
 - Not a qualified trade or business.
 - Refers to compensation for services as an employer (i.e. wages).
 - Presumption that former employees are still employees.
 - An employee prior to the enactment of 199A that is performing “substantially the same services” is considered to be in the trade or business of being an employee for 199A purposes.
- The individual must show under Federal tax law, regulations, and principles that the performance of services is in a capacity other than as an employee.

199A Proposed Regulations - 1.199A-6

- Relevant pass-through entities.
- Four computational rules:
 - (1) Determine the existence of 1 or more trades or businesses.
 - (2) Determine QBI for each trade or business.
 - (3) Determine W-2 wages and UBIA allocable to each trade or business.
 - (4) Determine any qualified REIT dividends or PTP income.
- Two reporting rules:
 - (1) Separately identify and issue K-1 each owner's allocable share of QBI, W-2 wages, and UBIA.
 - (2) Indicate whether trade or business is SSTB.

199A Proposed Regulations - 1.199A-6 (con't.)

- Application to estates and trusts.
 - QBI, W-2 wages and UBIA are determined by the trust.
 - Trust determines deduction based amounts allocable to trust income.
 - Beneficiaries reporting trust income would calculate QBID based on allocable QBI, W-2 wages, and UBIA.
 - Trust is RPE to the extent it allocates QBI, W-2 wages, and UBIA to beneficiaries.
 - Trust is an individual to the extent it retains QBI, W-2 wages, and UBIA.

199A Proposed Regulations - Planning Points

- Run the Numbers!
- Determine any need to shift wages and property to maximize deduction.
- Pay bonuses at year-end to increase wages.
- Make the aggregation election.
- Purchase fixed assets.
- Does it make sense to elect S Status for LLCs filing as partnerships?
- Reduce/limit guaranteed payments.