

BUSINESS TECHNOLOGY ASSOCIATION

Sept 21, 2018

The New Tax Law & Practical Implications for You & Your Business



TOPICS

- Tax Cuts and Job Act (TCJA)
- Brief State and Local Tax Update
 - Northeast States Respond to TCJA
 - Wayfair Supreme Court Decision – Sales Tax Nexus



Tax Cuts and Job Act (TCJA)

- Basically a Corporate and Pass Through Entity Tax Bill, with some personal income tax benefits, and some considerable detriments, especially for “high income and property tax” state residents



Individuals

Individual Income Tax Rates & Brackets - 2018

- Lowered Highest Tax Bracket from 39.6 % to 37%

Tax Rates	Single	Married Filing Jointly/ Surviving Spouse	Married filing Separately	Head of Household	Estate and Trusts
Bracket Beginning Point					
10%	\$9,525	\$19,050	\$9,525	\$13,600	\$2,550
12%	\$38,700	\$77,400	\$38,700	\$51,800	N/A
22%	\$82,500	\$165,000	\$82,500	\$82,500	N/A
24%	\$157,500	\$315,000	\$157,500	\$157,500	\$9,150
32%	\$200,000	\$400,000	\$200,000	\$200,000	N/A
35%	\$500,000	\$600,000	\$300,000	\$500,000	\$12,500
37%	\$500,000+	\$600,000+	\$300,000+	\$500,000+	\$12,500+

** All provisions for individual taxpayers EXPIRE after 2025*

Highlights of Personal Income Tax Law Changes:

- Personal Exemptions for tax years beginning after December 31, 2017 and before January 1, 2026 **are repealed** (\$0)
- Standard Deduction Increases to:

	<u>New</u>	<u>Old</u>
▪ MFJ	\$24,000	\$12,700
▪ Hoh	\$18,000	\$9,350
▪ Single	\$12,000	\$6,350
- Capital Gains and Qualified Dividend Rates Basically Remains the Same
- Rules for Exclusion of Gain from the Sale of a Principal Residence Unchanged
- Estates and trusts:

▪ Estates -	\$600
▪ Complex trust -	\$100
▪ Simple trust -	\$300
▪ Qualified disability Trust	\$4,150

Material Increase in AMT Exemption and AGI Thresholds

- For 2018 the exemptions are:
 - \$109,400 (up from \$84,500 in 2017) in the case of a joint return or the return of a surviving spouse;
 - \$70,300 (up from \$54,300 in 2017) in the case of an individual who is unmarried and not a surviving spouse;
 - \$54,700 (up from \$39,375 in 2017) in the case of a married individual filing a separate return
- Increases the AMT income limit where the exemptions begin to phase out.
 - The phase out threshold is increased to:
 - \$1,000,000 – married individuals filing jointly and surviving spouses
 - \$500,000 – all other taxpayers, other than estates and trusts
 - The phase out threshold is not increased for estates and trusts.

Affordable Care Act (ACA) and Child Tax Credit

- Repeal of Affordable Care Act (ACA) individual mandate as of January 1, 2019
 - in place for all of 2018 – so penalty will still apply!
- An increase in the Child Tax Credit (“CTC”) to \$2,000 per “qualifying child”
 - Qualifying Child has not reached age 17 during the year.
 - Refundable portion of CTC increased to \$1,400 from \$1,000 and indexed for inflation.
 - CTC modified to provide for \$500 nonrefundable credit for qualifying dependents other than qualifying children.
 - The phase-out threshold amounts raised to \$400,000 for MFJ and \$200,000 for all others. These amounts are not indexed for inflation.
 - The earned income threshold for the refundable CTC is lowered to \$2,500 from \$3,000.

Lowlights of Personal Income Tax Law Changes:

- State and Local Tax Deduction CAPPED at \$10,000/year, \$5,000 for MFS
 - This includes BOTH state income and property taxes
 - Extremely Punitive
- Limits Mortgage Interest Deduction up to \$750K of Mortgage Debt (\$375K for MFS) – Older Mortgages Grandfather in
 - Home Equity Lines of Credit – Interest No Longer Deductible! (No grandfather)
- Repeal of Deduction for Alimony Paid after Dec 31, 2018
 - Income also EXCLUDED for recipient spouse

Lowlights of Personal Income Tax Law Changes continued...

- Medical Expense Deduction
 - For tax years beginning after December 31, 2016 and ending before January 1, 2019, the threshold on medical expense deductions is reduced to 7.5% for all taxpayers, regardless of age.
 - For tax years beginning after December 31, 2016 and ending before January 1, 2019, the rule limiting the medical expense deduction for AMT purposes to 10% of AGI does not apply.
- Repeals the Misc. Itemized Deductions Subject to 2% Floor
 - Tax Prep, Legal Fees, etc.
- Personal casualty and theft losses -TCJA temporarily modifies the deduction such that a taxpayer may claim a personal casualty loss only if such loss was attributable to a disaster area declared by the President.

Flow Through Income Tax Law Changes:

Flow Through §199A 20% Deduction

- Section 199A Qualified Business Income deduction is a deduction from adjusted gross income to arrive at taxable income
- **DETERMINATION OF DEDUCTIBLE AMOUNT FOR EACH TRADE OR BUSINESS.**
 - The amount determined under this paragraph with respect to any qualified trade or business is the **lesser of:**
 - (A) 20 percent of the taxpayer's qualified business income with respect to the qualified trade or business, or
 - (B) the greater of-
 - (i) 50 percent of the W-2 wages with respect to the qualified trade or business, or
 - (ii) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.

199A Qualified Business Income deduction continued...

- The 199A Pass Through Deduction is the LESSER OF:
 - 20% OF THE TAXPAYERS "QUALIFIED BUSINESS INCOME", OR
 - THE GREATOR OF:
 - 50 % OF WAGES WITH RESPECT TO THE BUSINESS, OR
 - 25% OF WAGES WITH RESPECT TO THE BUSINESS, PLUS 2.5% OF UNADJUSTED BASIS OF ALL QUALIFIED PROPERTY
- There are income limits on getting the 20% deduction Specified Service Business (SSB):
 - Single \$157,500 - \$207,500 of AGI
 - MFJ - \$315,000 - \$415,000 of AGI
 - **The upper limit is a hard cap**

199A Qualified Business Income deduction continued...

- Specified Service Business (SSB) is defined as-
 - Traditional service professions such as doctors, attorneys, accountants, actuaries and consultants. (Engineers and Architects are SPECIFICALLY excluded)
 - Performing artists who perform on stage or in a studio.
 - Paid athletes.
 - Anyone who works in the financial services or brokerage industry.
 - "Any trade or business where the principal asset is the reputation or skill" of the owner

199A Qualified Business Income deduction continued...

Specified Service Business (SSB)

- “Any trade or business where the principal asset is the reputation or skill” of the owner
 - What does this mean?
 - It is beyond broad, it’s a catch all, it can be very dangerous
- What is consulting? Beyond broad, very dangerous

199A Qualified Business Income deduction continued...

Specified Service Business (SSB)

- So if you have a trade or business where the principal asset is the reputation or skill” of the owner OR a “CONSULTING” business, what do you do?
- Rename? Rebrand?
 - Serious \$\$ on the line, the SSB classification is patently unfair, arbitrary, capricious and can be quite costly
 - Since there is no guidance, now is the time to establish your position

199A Qualified Business Income deduction continued...

Specified Service Business (SSB)

- Removing your name and/or the word consulting from your business name might be something to be considered
- Keep in mind your Business Activity Code on your return could and most likely will be used to classify your business as an SSB or not an SSB

QUALIFIED BUSINESS INCOME (QBI)

- QBI is defined in Section 199A(c) as the "ordinary" income -- less ordinary deductions -- you earn from a sole-proprietorship, S corporation, or partnership.
- QBI does not include, however, any wages you earn as an employee, nor does it include:
 - short-term capital gain or loss;
 - long-term capital gain or loss;
 - dividend income; or
 - interest income
- QBI is determined **on a per business, not a per taxpayer, basis**

QUALIFIED BUSINESS INCOME (QBI)...continued

- Therefore, If you are a shareholder or a partner in a flow-through business, it is important to note that QBI also **doesn't include any wages or guaranteed payments received from the business.**
- So, if you own 30% of an S corporation:
 - that pays you \$40,000 of wages and
 - allocates you \$80,000 of income , and
 - Has ZERO BASIS
 - your QBI from the S corporation is ONLY the \$80,000 of income; the \$40,000 of wages do not count.

QUALIFIED BUSINESS INCOME (QBI)...continued

- You are only entitled to deduct 20% of QBI up to a limit (W-2 limitations)
- That limit is the GREATER OF:
 - 50% of your allocable share of the "W-2 wages" paid by the business, or
 - 25% of your allocable share of the "W-2 wages" paid by the business PLUS 2.5% of your allocable share of the "unadjusted basis" immediately after acquisition of all "qualified property".
- So If in our example, the deduction is the LESSER OF:
 - 20% of \$80,000, which **\$16,000**
 - or the GREATER OF:
 - 50% of W-2 wages (\$40,000), or **\$20,000**, or
 - 25% of W-2 wages, or **\$10,000**, plus 2.5% of the unadjusted basis of the S Corps assets, or \$0, for a total of **\$10,000**
 - **So the 199A Deduction is \$16,000**

Allocable Share of the W-2 wages Paid by the Business

- W-2 wages are exactly that:
 - wages paid to an employee, INCLUDING any elective deferrals into a Section 401(k)-type vehicle or other deferred compensation.
 - W-2 wages do NOT INCLUDE, however, things like payments to an independent contractor or management fees
 - Section 199A(f)(1) tells us that a partner's share of a partnership's W-2 wages is, determined in the same manner as his share of the partnership's wage deduction.
 - Example:
 - If you own a 20% capital stake in a partnership, but under the terms of the agreement you are allocated 80% of any depreciation but only 30% of Schedule K-1, Line 1 ordinary income, then because you are being allocated 30% of the partnership's wage deduction via your Line 1 allocation, you are stuck being allocated only 30% of the partnership's W-2 wage expense for the purposes of these limitations

Unadjusted Basis Immediately after Acquisition of all Qualified Property

- "Qualified property" is defined in Section 199A(b)(6)(A)
 - Any tangible property, subject to depreciation (meaning inventory doesn't count), which is held by the business at the end of the year and is used -- at ANY point in the year -- in the production of QBI.
- If you're going to count the basis towards your limitation, the "depreciable period" of the period could not have ended prior to the last day of the year for which you are trying to take the deduction.
 - The "depreciable period," for 199A purposes starts on the date the property is placed in service and ends on the LATER OF:
 - 10 years, or
 - the last day of the last full year in the asset's "regular" (not ADS) depreciation period.
- IMPORTANT NOTES
 - The basis taken into consideration is "unadjusted basis," meaning it is NOT reduced by any depreciation deductions. Section 199A(b)(2)(B)(ii) requires that you take into consideration the basis of the property "immediately after acquisition."
 - Any asset that was fully depreciated prior to 2018, unless it was placed in service after 2008, will not count towards basis.

20% 199A Deduction Example

- Facts:

- A is a 30% owner of ABC, LLC. The LLC produced total ordinary income of \$3,000,000. The LLC paid total W-2 wages of \$1,000,000, and the total unadjusted basis of property held by ABC, LLC is \$100,000. A is allocated 30% of all items of the partnership.

	Total	A's Allocable Share	20% Deduction
QBI	\$3,000,000	\$900,000	\$180,000
And the Greater of:			50% Limitation
W-2 Wages	\$1,000,000	\$300,000	\$150,000
Or the TOTAL of:	Total	A's Allocable Share	25% Limitation 2.5% Limitation
W-2 Wages	\$1,000,000	\$300,000	\$75,000 \$750
Unadjusted Basis of Prop	\$100,000	\$30,000	
TOTAL			\$75,750

20% 199A Deduction Example

- Thus, A is entitled to a deduction of **\$150,000**,

Which is the lesser of:

- \$180,000, or

- the greater of:

- **\$150,000** or
- \$ 75,750.

20% 199A Deduction Example

Allocable W-2 Limitation is the Key

- 40% PARTNER
- \$20M QBI
- \$6M WAGES
- \$20M BASIS,
- LESSER OF:
 - $QBI = (\$20M * 40\% * 20\%) = \$1.6M$
- GREATER OF:
 - $W-2 = (\$6M * 40\% * 50\%) = \$1.2M$
 - $W-2 \text{ \& BASIS} = (\$6M * 40\% * 25\% = \$600K + \$200K (2.5\% \text{ BASIS})$
- **So \$1.2M is the 199A deduction**

Higher QBI/Lower Wages

- 40% PARTNER
- \$22M QBI
- \$4M WAGES
- \$20M BASIS,
- LESSER OF:
 - $QBI = (\$22M * 40\% * 20\%) = \$1.76M$
- GREATER OF:
 - $W-2 = (\$4M * 40\% * 50\%) = \$800K$
 - $W-2 \text{ \& BASIS} = (\$4M * 40\% * 25\% = \$400K + \$200K (2.5\% \text{ BASIS})$
- **So \$800K is the 199A deduction**

20% 199A Deduction Examples

Higher QBI/Lower Wages

- 40% PARTNER
- \$22M QBI
- \$4M WAGES
- \$20M BASIS,
- LESSER OF:
 - $QBI = (\$22M * 40\% * 20\%) = \$1.76M$
- GREATER OF:
 - $W-2 = (\$4M * 40\% * 50\%) = \$800K$
 - $W-2 \text{ \& BASIS} = (\$4M * 40\% * 25\% = \$400K + \$200K (2.5\% \text{ BASIS})$
- **So \$800K is the 199A deduction**

Lower QBI/Higher Wages

- 40% PARTNER
- \$16M QBI
- \$10M WAGES
- \$20M BASIS,
- LESSER OF:
 - $QBI = (\$16M * 40\% * 20\%) = \$1.28M$
- GREATER OF:
 - $W-2 = (\$10M * 40\% * 50\%) = \$2M$
 - $W-2 \text{ \& BASIS} = (\$10M * 40\% * 25\% = \$1M + \$200K (2.5\% \text{ BASIS})$
- **So \$1.28 M is the 199A deduction**

Corporate (& Flow Through) Income Tax Law Changes:

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Corporate (& Flow Through) Income Tax Law Changes:

- Lowers C-Corporation Rate to 21% from 35%, no longer graduated rates.
- Repeals Corporate AMT
- 100% Bonus Depreciation
- Significant Foreign Income Tax Changes
 - Foreign Profits Taxation
 - Repatriation of Foreign Earnings
- Like Kind Exchange Eliminated, **Yet Remains for Real Estate**

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Corporate (& Flow Through) Income Tax Law Changes:

- Meals and Entertainment Deduction – 50%
 - **Now only Meals are Deductible**
 - **Entertainment Deduction is GONE**
 - This includes all:
 - Sporting events,
 - Shows,
 - Charitable(golf) events, etc.
 - Some may try to now categorize this as a “Marketing Expense”
- Miscellaneous Fringe Benefits
 - Parking and Transit Passes for Employees are no Longer Deductible
 - Only 50% of Employee meals (was 100%) – after 2025, no longer deductible

Corporate Tax Update

- **Net Operating Losses – 80% Limitation**
 - Effective for NOLs generated in tax years ending after December 31, 2017
 - The NOL deduction allowed for a tax year is limited to the lesser of:
 - The aggregate of NOL carryovers and NOL carrybacks to that year; or
 - 80% of the taxpayer’s taxable income.
 - Repeals the general two year NOL carryback and other special carryback provisions.
 - NOLs may be carried forward indefinitely
 - NOLs that arose in tax years ending before January 1, 2018 will be subject to the old rules and limitations

Net Business Interest Deduction

Old

- Paying deductible interest to a related person subject to no U.S. taxes on the income is earnings stripping.
 - To prevent earnings stripping, a corporation's interest deduction for "disqualified interest" was denied to the extent of the corporation's excess interest expense in any year that the corporation had a debt-to-equity ratio greater than 1.5 to 1.

New

- Replaces earnings stripping rules with a business interest deduction limitation.
- The business interest deduction for a tax year cannot exceed:
 - The taxpayer's business interest income for the tax year; plus
 - **30% of the taxpayer's adjusted taxable income for the tax year which cannot be less than zero; plus**
 - The taxpayer's floor plan financing interest for the tax year.
- Limitation applies at the taxpayer level and partnerships at the partnership level.
- Unused business interest may be carried forward indefinitely, subject to restrictions applicable to partnerships.
- Does not apply to small businesses that meet the \$25 million gross receipts test for any tax year.
- As of 2022 will only be for up to 30% of EBIT

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Net Business Interest Deduction – continued

Example:

- In 2018, Corporation A has \$120,000 of adjusted taxable income, \$5,000 of business interest income and \$12,000 of business interest expense. It has no floor on financing interest.
- Corporation A may deduct all \$12,000 of its business interest expenses because this amount is less than the sum of its business interest income (\$5,000) plus 30% of its adjusted taxable income ($30\% \times \$120,000 = \$36,000$).

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Qualified Transportation Fringe Benefits

Old Law

- Employers could deduct expenses for providing qualified transportation fringe benefits or other transportation/commuting benefits to employees.
- A qualified transportation fringe:
 - Transportation in a commuter highway vehicle travel;
 - Transit passes;
 - Qualified parking; or
 - Qualified bicycle commuting reimbursement (suspended for tax years beginning after December 31, 2017 and before January 1, 2026).

New Law

- **Employer denied deduction.**
- **Employee** still able to exclude benefit from income under I.R.C. Section 132.
- Applies to amounts incurred or paid after December 31, 2017.

Family & Medical Leave

- **Old Law** - There was no employer tax credit for paid family and medical leave under the Internal Revenue Code.
- **New Law** –
 - Provides a credit to certain employers for paid family and medical leave.
 - The credit is a component of the general business credit and can be used to reduce a taxpayer's AMT and won't apply to wages paid in tax years beginning after December 31, 2019.
- The credit is equal to the applicable percentage of the amount of wages paid to a qualifying employee during any period in which that employee is on family and medical leave.
 - Applicable percentage is 12.5% increased (but not above 25%) by 0.25 percentage points for each percentage point by which the rate of payment exceeds 50%.
 - Effective for wages paid in tax years beginning after December 31, 2017 and before January 1, 2020

Family & Medical Leave – continued

Example:

- Employer pays \$12,000 of wages to qualifying employee while employee is on family and medical leave.
- This amount is 60% off the wages normally paid to the employee.
- The applicable percentage of 12.5% is increased since 60% exceeds 50% by 10%. The Employer's credit is increased by 10 times 0.25%, or 2.5%.
- Employer can deduct 15% of the \$12,000 paid, or \$1,800.
- Taxpayer may not take the credit and also deduct the employee's wages paid.

Corporate Dividends Received Deduction

Old

- Deduction equal to 70% of dividends received from a domestic corporation.
- Deduction rate is 80% if the corporate dividend recipient owns at least 20% of the stock of the distributing corporation (vote and value).
- 100% deduction for dividends from a domestic corporation in the same affiliated group as the taxpayer (i.e., 80% vote and value ownership).

New

- Reduces 70% deduction to 50%.
- Reduces 80% deduction to 65%.
- 100% deduction for affiliated groups unchanged.
- Effective for tax years beginning after December 31, 2017.

Expensing, Depreciation and Capitalization Provisions

- Increased Code 179 Expensing
 - Election to expense the cost of qualifying property rather than depreciation
 - The \$25,000 per-SUV limit is indexed for inflation after 2018

	Old	New
Maximum annual deduction	\$510,000	\$1,000,000
Claw-back threshold	\$2,070,000	\$2,500,000

Luxury automobiles

- Additional first-year bonus depreciation.

	Yr1	Yr2	Yr3	Yr4+
Old Law*	\$3,160	\$5,100	\$3,050	\$1,875
New Law	\$10,000	\$16,000	\$9,600	\$5,760

- For passenger autos eligible for bonus first-year depreciation, the maximum first-year depreciation allowance remains at \$8,000
 - Old law phase down of \$1,600 per year beginning in 2018 is repealed
 - Computer or peripheral equipment is removed from the definition of listed property

** Continues to apply to passenger automobiles acquired before September 28, 2017, and placed in service by the taxpayer after September 27, 2017*

Brief State and Local Sales Tax Update

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STATE RESPONSES TO FEDERAL LAW

The Northeast State have officially passed their response to Federal Law.

The SALT CAP of \$10,000 is the Major issue

- Connecticut, Maryland, New Jersey, and New York filed a lawsuit in federal court to strike down the cap on SALT deductions under the new tax law
- Connecticut, New York and New Jersey signed legislation allowing local governments to set up charitable organizations to accept property tax payments as “charitable contributions”
- IRS has pushed back with proposed regulations to disallow the workaround

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STATE RESPONSES TO FEDERAL LAW

- Connecticut - char deduction is fully deductible
- New York – 90 % of char deduction is deductible
- New Jersey – 85 % of char deduction is deductible
- IRS has responded in a proposed regulation and said you could only get 10% of this “charitable deduction” on your Federal return

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STATE RESPONSES TO FEDERAL LAW

- New York also passed the Employer Compensation Expense Tax (ECET) as a ‘work around’ to deal with the limitation on the deductibility of state and local taxes – See TSB-M-18(1) ECEP
 - The ECET is an optional tax beginning Jan. 1, 2019, for employers paying annual wages in excess of \$40,000 for each employee who elect to participate.
 - If an employer elects to pay this tax, a credit will be available to the employee, reducing the employee’s New York personal income tax, thereby mitigating the effect of the federal SALT limitation.

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Wayfair - U.S. Supreme Court Sales Tax Case

US Supreme Court Upheld a South Dakota sales tax law that requires out-of-state retailers to collect South Dakota sales tax if the retailer:

- had annual gross revenue of more than \$100,000 from sales in South Dakota; or
- completed more than 200 sales annually in South Dakota.
- This removes the physical presence standard
- States must pass laws to now follow this standard, AND MOST HAVE DONE JUST THAT

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Wayfair U.S. Supreme Court Case

- Current Wayfair States (30 so far):
 - AL (\$250K), CO, CT(\$250k and 200), GA (\$250k or 200, eff 1/1/19), HI, ID, IL, IN, IA, KY, LA(1/1/19), ME, MI, MN, MS, NE, NJ, NY(\$300K or 100), NC, ND, OH(\$500K), ~~OK(\$10K), PA (\$10K)~~, RI, S UT(1/1/19), VT, WA, WI

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QUESTIONS?



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