The *Tax Cuts and Jobs Act*: What’s Next?

PLANNING FOR THE OPPORTUNITIES & UNCERTAINTIES THAT EXIST

May 23, 2019
WHAT WE’LL COVER TODAY

1. Legislative update
2. Qualified Business Income Deduction
3. New business interest expense limitation
4. Limited meals & entertainment deductions
WHAT WE’LL COVER TODAY

5. Accounting methods & state considerations
6. Qualified opportunity zones
7. Takeaways from tax season
8. Your questions
Tax Reform 2.0

• Would have made the individual provisions of the *Tax Cuts & Jobs Act* (TCJA) permanent
• Introduced to the House on September 11, 2018
• Passed in the House on September 29, 2018
• Did not advance in the Senate before end of the 115th Congress; must now be reintroduced
• Unlikely under a divided Congress and Democratic control in the House
Technical Corrections

• The TCJA advanced quickly & there were many “errors” because of it, notably:
  • The qualified improvement property glitch
  • NOL glitch
• Rep. Kevin Brady (R) released a draft of technical corrections & extenders bill on January 2, 2019; it did not pass under the 115th Congress and would need to be reintroduced
• Rep. Jimmy Panetta (D) introduced H.R. 1869 proposing a fix to the qualified improvement property glitch, March 26, 2019
• Outlook on any technical corrections is uncertain at this time
Extenders

- Number of temporary provisions that have expired in 2017
  - Energy related provisions
  - Section 179D
  - Deduction of qualified tuition
- Typically they are renewed each year, but tend to take a little work to get the legislation passed
- Sen. Charles Grassley (R) introduced S. 617 to extend those temporary provisions
- Outlook on extenders is uncertain at this time
Kansas

- Senate Bill 25
  - Allow itemizing even if taxpayer does not itemize at a Federal level.
  - Sales tax on food to be reduced from 6.5% to 5.5%
  - Sales tax to adopt rules similar to Wayfair decision
  - Relief or returning foreign income
- A similar bill was vetoed on March 25 by Governor Kelly
IRC Section 199A
Qualified Business Income Deduction
QUALIFIED BUSINESS INCOME DEDUCTION

Effective in 2018; sunsets December 31, 2025

**Deduction**

\[ \text{Deduction} = 20 \% \text{ of excess of taxable income over sum of any net capital gain} \]

Full phaseout:

\[ \text{Full phaseout} = \begin{cases} \$207,500 \text{ (single)} & | \\ \$415,000 \text{ (married filing jointly (MFJ)), indexed} \end{cases} \]

Threshold:

\[ \text{Threshold} = \begin{cases} \$157,500 \text{ (single)} & | \\ \$315,000 \text{ (MFJ), indexed} \end{cases} \]

Visit www.BKD.com/taxreform for PDF & footnotes
Final Regulations (January 18, 2019)

- Relevant Passthrough Entity (RPE) definition: Added common trusts to partnerships and S Corps as qualified RPEs.
- Multiple businesses:
  - At a minimum need separate books
  - Issues with allocation of overhead, needs to be objective
Final Regulations (January 18, 2019)

- Real estate safe harbor
  - Separate books & records to reflect income & expenses for each rental real estate enterprise (RREE)
  - 250 or more hour requirement for rental services performed with respect to the RREE. Can be by owner, employees, agents and/or independent contractors
  - Maintain contemporaneous records (except for 2018)
- Failure to meet the safe harbor does NOT mean it is not a RREE
Specified Service Trade or Business (SSTB)

- Final & Proposed Regulations clarify what is NOT a SSTB. It includes:
  - Real estate brokers
  - Architects
  - Engineers
  - Bankers
- Some of the real winners have been SSTB businesses, since the owner’s taxable income was below the taxable income thresholds.
- Planning point: manage taxable income

PASS-THROUGH BUSINESS DEDUCTION
Sunsets 12/31/2025
QBI Deduction Resources

Articles

• Whitepaper
• Grain Glitch fix
• IRS Releases Highly Anticipated Proposed Regulations Under §199A
• Final & Proposed Guidance Issued

Summaries

• Flowchart
• SSTBs
• Aggregation rules
QBI Deduction Resources

Podcast Episodes

• The Proposed §199A Regs
• Answers to §199A Questions
• The Hearing on the Proposed §199A Regs
• Section 199A Confusionosis
• Putting the Final §199A Pieces Together

Webinars

• Insights & Planning Points From The Proposed Regulations
• The QBI Deduction: Insights on the Latest Guidance
IRC Section 163(j)
Business Interest Expense Limitation
Interest Expense Deduction

- Deduction limited to sum of
  - Business interest income
  - Floor plan financing interest
  - 30 percent of entity’s adjusted taxable income

<table>
<thead>
<tr>
<th>Taxable income</th>
</tr>
</thead>
<tbody>
<tr>
<td>+/- Items of income, gain, deduction or loss not properly allocable to trade/business</td>
</tr>
<tr>
<td>+ Business interest expense</td>
</tr>
<tr>
<td>- Business interest income</td>
</tr>
<tr>
<td>+ Net operating loss</td>
</tr>
<tr>
<td>+ Pass-through business deduction</td>
</tr>
<tr>
<td>+ Depletion, depreciation &amp; amortization (taxable years beginning before January 1, 2022 only)</td>
</tr>
</tbody>
</table>
Interest Expense Deduction (cont’d)

- Excess carried forward indefinitely
- Limit does *not* apply to
  - Businesses with average annual gross receipts ≤ $25 million
  - Regulated public utility business (including electric cooperatives)
  - Following businesses may elect not to be subject to limitation provided they use ADS method for depreciation
    - Real property businesses
    - Farming businesses (including agricultural & horticultural cooperatives)
Interest Expense Deduction (cont’d)

- Applies to the individual level as well
- A taxpayer could have no RPEs that meet the 25M threshold, and still be subject to 163j
- 163j does NOT apply to investment interest
Need for Guidance

• Notice 2018-28 provides some guidance; promises additional guidance in form of proposed regulations
• First round of proposed regulations issued November 26, 2018
  • General guidance
  • Definitions & rules for consolidated groups
  • Guidance for pass-through entities
  • Interplay with international provisions
• Final regulations & further guidance expected
IRC Section 163(j) Resources

• Summary: IRC §163(j) - Limitation on Business Interest Deduction as Amended by the TCJA

• Articles:
  • IRS Releases Additional Guidance on the Business Interest Expense Limitation Under §163(j)
  • Proposed §163(j) Regulations Address Reporting CFCs
IRC Section 274
Meals & Entertainment
MEALS & ENTERTAINMENT DEDUCTION AFTER THE TAX CUTS AND JOBS ACT

Ordinary(1) & Necessary(2)

- No Deduction
- 100% Deduction

ANY OF FOLLOWING?(3)
- Directly related to business meetings for employees, stockholders, agents or directors
- Directly related to attendance of business meeting/ convention of tax-exempt organization(9)

ANY OF FOLLOWING?(3)
- Furnished on business premises primarily for employees & considered de minimis fringe benefit(6)(4)
- Certain other de minimis fringe benefits(8)
- Client business meals(5)
- Business meals during travel(9)
- Directly related to business meetings for employees, stockholders, agents or directors(5)
- Directly related to attendance of business meeting/ convention of tax-exempt organization(5)(9)

Entertainment?(3)

ANY OF FOLLOWING?
- Included in employee compensation
- Reimbursed under agreement
- Provided for recreational, social or similar activities primarily for benefit of employees(3)(4)
- Provided to general public
- Sold to customers
- Includable in income of persons who aren’t employees(6)

ANY OF FOLLOWING?
- Consumed while away from home by individuals subject to Federal Hours of Service?(3)(7)

Food or beverage?

ANY OF FOLLOWING?
- Provided to employees for convenience of employer at employer’s business
- Provided at an on-premises, employer-operated eating facility & considered de minimis fringe benefit(6)

Lavish or extravagant?(5)

STOP

50% Deduction

80% Deduction

50% Deduction Until 12/31/2025

No Deduction
DEFINITIONS

(1) Ordinary: Not defined in the Internal Revenue Code (IRC) or Treasury Regulations; generally refers to items common in taxpayer’s business

(2) Necessary: Generally refers to items appropriate & helpful to taxpayer’s business

(3) Entertainment: An activity of the type generally considered to constitute entertainment, amusement or recreation, e.g., entertaining at night clubs. This may include meals provided at such activities; however, it’s unclear what meals constitute entertainment at this point absent IRS guidance.

(4) Recreation: Except when provided for employees who are officers, shareholders or other owners who own a 10 percent or greater interest in the business or any other highly compensated employees as defined in IRC Section 414(q)

(5) Lavish or extravagant: No deduction allowed to the extent food or beverage expense is lavish or extravagant under the circumstances. In addition, taxpayer [or employee] must be present at the furnishing of such food or beverages

(6) De minimis fringe benefit: Includes any service or property so small that accounting for it would be unreasonable & impractical, e.g., coffee, doughnuts, etc. After 12/31/2025, de minimis fringe benefits related to meals provided at an on-premises, employer-operated eating facility are nondeductible

(7) Federal Hours of Service: Individuals subject to the U.S. Department of Transportation’s (DOT) Hours of Service limitations for purpose of this provision:
- Certain air transportation employees such as pilots, crew, dispatchers, etc.
- Certain interstate truck operators & bus drivers
- Certain railroad employees such as engineers
- Certain merchant mariners

(8) Certain other de minimis fringe benefits: De minimis fringe benefits other than:
- Related to meals provided at an on-premises, employer-operated eating facility
- Provided for recreational, social or similar activities primarily for benefit of employees
- Furnished on business premises
Example: coffee provided primarily for an employee while away from taxpayer’s business premises

(9) Tax-exempt organization: Under IRC Section 501(c)(6) & 501(a), this includes business leagues, chambers of commerce, real estate boards, boards of trade, etc.

(5) Substantiated: No deduction allowed unless taxpayer substantiates expense by adequate records or sufficient evidence corroborating taxpayer’s own statement to include:
- Amount of each separate expense
- Time & place
- Business purpose
- Business relationship to the taxpayer of the persons entertained
Let’s address the controversy …

• Business meals with clients
  ▪ Generally deductible under §162 or §212 if ordinary & necessary to taxpayer’s trade or business
  ▪ If not generally considered to constitute entertainment, recreation or amusement under §274(a)
  ▪ Limited to 50 percent under §274(n)(1)
  ▪ Not lavish or extravagant & taxpayer or employee present per §274(k)
§162 Trade or business expenses

(a) IN GENERAL There shall be allowed as a deduction all the ordinary & necessary expenses paid or incurred during the taxable year in carrying on a trade or business
§274 Disallowance of certain entertainment, etc., expenses

(a) ENTERTAINMENT, AMUSEMENT, OR RECREATION
   (1) IN GENERAL No deduction otherwise allowable under this chapter shall be allowed for any item—
       (A) Activity. With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial & bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer’s trade or business, or
       (B) Facility. With respect to a facility used in connection with an activity referred to in subparagraph (A)

TAKEAWAY: Entertainment expenses no longer deductible
§274 Disallowance of certain entertainment, etc., expenses

(e) SPECIFIC EXCEPTIONS TO APPLICATION OF SUBSECTION (a)

(1) Food & beverages for employees
(2) Expenses treated as compensation
(3) Reimbursed expenses
(4) Recreational, etc., expenses for employees
(5) Employee, stockholder, etc., business meetings
(6) Meetings of business leagues, etc.
(7) Items available to public
(8) Entertainment sold to customers
(9) Expenses includible in income of persons who are not employees

TAKEAWAY: Above exceptions not changed under the TCJA
§274 Disallowance of certain entertainment, etc., expenses

(n) ONLY 50 PERCENT OF MEAL & ENTERTAINMENT EXPENSES ALLOWED AS DEDUCTION

(1) IN GENERAL The amount allowable as a deduction under this chapter for—

(A) any expense for food or beverages, &
(B) any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such activity, shall not exceed 50 percent of the amount of such expense or item which would (but for this paragraph) be allowable as a deduction under this chapter

(2) EXCEPTIONS Paragraph (1) shall not apply to any expense if—

(A) such expense is described in paragraph (2), (3), (4), (7), (8), or (9) of subsection (e),
(B) in the case of an expense for food or beverages, such expense is excludable from the gross income of the recipient under section 132 by reason of subsection (e) thereof (relating to de minimis fringes), …

TAKEAWAY: 50 percent limitation still applies to meals that do not meet certain exceptions. Meals provided to employees as de minimis fringe benefit no longer a 100 percent exception
### Meals & Entertainment

<table>
<thead>
<tr>
<th>Description</th>
<th>Meals Before</th>
<th>Meals After(1)</th>
<th>Meals cannot be lavish or extravagant &amp; taxpayer present(2)</th>
<th>Meals no longer deductible after 12/31/2025(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>§162 or §212 Ordinary &amp; Necessary Business Meal Expenses Not Considered Entertainment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Client business meals                                                     50%</td>
<td>50%</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Employee meal expenses excluded from their compensation as §132(e)(1) de minimis fringe benefit &amp; not meeting a §274(e) exception</td>
<td>100%</td>
<td>50%</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>• Expenses incurred in the operation of an employer eating facility treated as de minimis to employees under §132(e)(2) &amp; not meeting a §274(e) exception</td>
<td>100%</td>
<td>50%</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>• Meals provided to employees excluded from their compensation under §119(a) for the convenience of the employer &amp; furnished on the business premises &amp; not meeting a §274(e) exception</td>
<td>50%</td>
<td>50%</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

(1) §274(n) limitation – Deduction limited to 50 percent for meals
(2) §274(k) limitation – Meal expense not lavish or extravagant & taxpayer (or employee) present
(3) §274(o) limitation – Meals excluded from an employee’s income by reason of §132(e)(2) or §119(a) no longer deductible after 12/31/2025. Note §132(e)(1) de minimis fringe meals still 50 percent deductible after 12/31/2025
Meals & Entertainment Resources

• Flowchart: *Meals & Entertainment Deduction After the TCJA*

• Articles:
  • *Tax Reform Modifications to the Deduction for Meals & Entertainment*
  • *The IRS Confirms Business Meal Deductibility*

• Podcast: *No Such Thing As A Deductible Lunch?*
Accounting Methods &
State Considerations
**Uniform Capitalization Rules for Inventory**

Required when gross receipts > $25 million for property acquired for resale or manufactured property

(Previously gross receipts > $10 million for property acquired for resale; no threshold for manufactured property)

---

**Percentage-of-Completion Method**

Required when gross receipts > $25 million

(Previously gross receipts > $10 million)

---

**Cash Method of Accounting**

Allowed for C corporations with < $25 million in gross receipts

(Previously allowed for C corporations that do not exceed $5 million gross receipts test)
Enhanced Bonus Depreciation

- Increase in applicable percentage on qualified property acquired after September 27, 2017 & made available for both new & used assets

<table>
<thead>
<tr>
<th>Applicable Percentage</th>
<th>Placed in Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>100 percent</td>
<td>After September 27, 2017 &amp; before January 1, 2023</td>
</tr>
<tr>
<td>80 percent</td>
<td>After December 31, 2022, &amp; before January 1, 2024</td>
</tr>
<tr>
<td>60 percent</td>
<td>After December 31, 2023, &amp; before January 1, 2024</td>
</tr>
<tr>
<td>40 percent</td>
<td>After December 31, 2024, &amp; before January 1, 2025</td>
</tr>
<tr>
<td>20 percent</td>
<td>After December 31, 2025, &amp; before January 1, 2026</td>
</tr>
<tr>
<td>None</td>
<td>After December 31, 2026</td>
</tr>
</tbody>
</table>

- Applicable percentage for longer production period property & certain aircraft differs from above

- Made changes to qualified improvement property (created need for technical correction)

- Proposed guidance issued August 3, 2018
Qualified Improvement Property
Before 12/31/17 – eligible for bonus
After 12/31/17 – not eligible for bonus
(Absent technical correction, cannot take bonus on QIP after 12/31/17)

“Written Binding Contract”
Eligible for increased bonus if binding before 9/28/17
See Reg. §1.168(k)-1(b)(4)(ii) for definition of binding contract
(Were there substantial modifications to terms & conditions of a pre-9/28/17 binding contract?)

Coordination with §163(j)
Real property trade or businesses electing out of §163(j) must use ADS for nonresidential real estate, residential rental & QIP
ADS property is not eligible for bonus
(Farming businesses electing out must use ADS on farming property with a recovery period of 10 years or more)
Accounting Method Planning

- Automatic changes must be made by due date of tax return (including extension)
- Nonautomatic changes must be made by last day of taxable year
To Decouple or Conform?

- Types of conformity
  - Rolling conformity (currently in effect)
  - Fixed date conformity (in effect on a certain date)
  - Selective conformity (conform/decouple from specific provisions)
  - No conformity (no income tax levied)

- Typically start with
  - Taxable income (C corporations) or
  - AGI (individuals)
STATE CONSIDERATIONS

Business Provisions

- Business interest expense limitation
- Pass-through business deduction
- Bonus depreciation & §179 immediate expensing
- Net operating loss
- Domestic & foreign dividends received deduction
- Transition tax
- Other international provisions (GILTI, FDII, BEAT)
Individual Provisions

• Deduction cap on state & local tax deduction
• Increased standard deduction
• Limitation of mortgage interest deduction
• Suspension of other itemized deductions
• Repeal of personal exemption
• Enhanced child tax credit

(Above federal modifications effective for tax years beginning after 12/31/17 & before 1/1/2026)
Opportunity Zones
QUALIFIED OPPORTUNITY ZONES

Qualified Opportunity (QO)

• **Zones**: Low-income census tracts identified by states
• **Fund**: Corporation or partnership that invests in QO zone property

Not limited to real estate

• Businesses with substantially all of tangible property owned or leased in QO zone
• Cannot be golf course, country club, gaming, etc.
QUALIFIED OPPORTUNITY ZONES

Temporary Deferral of Gain

• 180-day reinvestment of gain directly in fund
• Deferral ends on earlier of date of next sale, or 2026
• Percentage of deferred gain recognized depends on length of holding period
  • < 5 years: 100 percent
  • > 5 but < 7 years: 90 percent
  • > 7 years: 85 percent
QUALIFIED OPPORTUNITY ZONES

Permanent exclusion of gain on sale of QO fund

- Appreciation in the investment after 10 years
- 10-year hold requirement
QUALIFIED OPPORTUNITY ZONES

Example

On August 15, 2018, Kate sold stock with a tax basis of $150,000 for $1.15 million. She reinvested the entire $1 million gain in a QO fund in a timely manner. Consider the following potential scenarios:

1) Kate sells the investment in October 2022 (year four); the entire $1 million deferred gain would be taxable.

2) Kate sells the investment in October 2023 (year five); only $900,000 of the deferred gain would be taxable.

3) Kate sells the investment in October 2025 (year seven); only $850,000 of the deferred gain would be taxable.

4a) Kate holds the investment through December 31, 2026 (the end of the temporary deferral period); she would recognize an $850,000 gain on her 2026 tax return.

4b) Kate sells the investment in October 2028 (year 10); she wouldn’t recognize any additional gain (beyond the $850,000 recognized in scenario 4a).

In this example, if Kate keeps her QO fund investment for the full 10-year holding period (scenario 4b), the only tax liability associated with her investment would be on the $850,000 gain recognized at the end of the temporary deferral period on December 31, 2026. Any appreciation in value occurring after August 15, 2018, would be permanently excluded.
QUALIFIED OPPORTUNITY ZONES

Guidance

• Many areas of uncertainty under the statute created need for guidance

• Clarification provided with two rounds of proposed regulations issued to date:
  • October 19, 2018
  • April 17, 2019

• Recent informal comments from Treasury suggest we may not see an expected third round of guidance
QUALIFIED OPPORTUNITY ZONES

April 17, 2019 Proposed Regs

• Trade or business to follow code section 162

• Can purchase raw land and it does NOT need to be substantially improved
  • Could have issues meeting the trade or business test

• Sale of assets instead of equity stake after 10 years
  • Get to exclude capital gains from the sale
  • However do not get to exclude any ordinary gain

• Death is NOT considered an inclusion event for deferred gain. Instead gain carries over to heirs.
QOZ Resources

• Summary: Qualified Opportunity Zones Under The TCJA

• Article: Opportunity Zone Guidance Released by IRS

• Webinar: Critical New Insights on Proposed Opportunity Zone Regulations

• Podcast episodes:
  • What's A Qualified Opportunity Zone?
  • The Opportunity Zone
TCJA Takeaways from Tax Season
Determining if a rental activity is a trade or business is challenging

Changes to the business interest expense limitation created challenges for passthrough businesses & their owners

Schedule K-1 reporting has become more complex & in some cases may be incorrect!

Disallowance of the deduction for expenses of qualified transportation fringe affects more taxpayers than anticipated

Most closely-held businesses & real estate companies did not make a change in their choice of entity, but many did the analysis & are still evaluating
Still awaiting guidance from the IRS & Treasury or action in Washington in many key areas:

- Fix for 39 year depreciable life for QIP
- Guidance on new excess business loss limitation under §461(l) to include clarification on whether §1231 gain/losses & W-2 wages count
- Guidance on self-charged interest for purposes of amended §163(j)
- Addback of COGS depreciation for purposes of calculating adjusted taxable income under amended §163(j)
• Review 2018 tax returns
• Understand how tax changes affected your personal tax situation
• Identity & evaluate planning opportunities
  • Accounting method changes
  • Manage taxable income
  • Tax bracket management
• Review/revisit choice of entity considerations
• Consider affect on 2019 estimated tax payments and future income tax liability
Questions?
LEARN MORE & STAY CURRENT

- Tax Reform Resource Center
  bkd.com/taxreform
- Simply Tax Podcast
  bkd.com/simplytax
- BKD Thoughtware®
  bkd.com/thoughtware
Thank you!

Matthew Haase | mhaase@bkd.com