Post Polak
Goodsell & Strauchler P.A.

Welcome to Edition 13 of The Newsletter from Scott H. Novak, of Counsel, Post, Polak, Goodsell & Strauchler, P.A. The Newsletter is designed to bring timely and interesting topics to accountants and attorneys. Comments and suggestions are always welcome. Feel free to call or write at any time.

SALT Deductions. Those of you who prepare individual income tax returns for clients will no doubt experience the wrath of your clients who get stung by the limitation on state and local tax (SALT) deductions. At the risk of stating the obvious, think about your high-earning clients who live in high tax neighborhoods. The $10,000 limitation may cover one half or a third of their property taxes, but none of their state income taxes. The states that this impacts are keenly aware of what the new tax law means for their residents and many have tried to come up with work arounds. One such work around is the idea of making contributions to a state charitable fund in exchange for tax credits. Instead of trying to take a deduction for property taxes paid, the taxpayer would take a fully-allowed charitable contribution deduction. While those of us in the tax business may have seen this strategy as highly suspect, others were enthusiastic about its utility as a work around. The Treasury Department has thrown cold water on the enthusiasm felt by some.

The Treasury Department has issued proposed regulations (that means that public comment is welcome) that in essence, say that receiving tax credits in exchange for a charitable contribution is a quid pro quo that may preclude a full charitable deduction. Directly from the preamble to the regulations: "the Treasury Department and the IRS believe that the amount otherwise deductible as a charitable contribution must generally be reduced by the amount of the state or local tax credit received or expected to be received, just as it is reduced for many other benefits." They go on to say that the tax credit constitutes a return benefit, or quid pro quo, to the taxpayer, thereby reducing the charitable contribution. So no charitable contribution deduction when the taxpayer receives tax credits. Except .....

..... there is a de minimis rule to be aware of. If the tax credit is no more than 15% of the charitable contribution, the entire contribution may be deducted as a charitable contribution.

Section 199A Proposed Regulations. You likely are aware that proposed regulations for the section 199A 20% tax break for pass-through entities came out a few weeks ago. This newsletter is not the place for a full explanation of all of the provisions (the explanation and regs are 184 pages), but your author has been hitting the lecture circuit about the regs and is happy to provide a few insights.

The deduction is generally taken at the individual level. The 20% deduction is the smaller of your qualified business income or taxable income. There are certain service businesses that cannot take the deduction, like lawyers and accountants. But ..... that rule does not apply if your taxable income is under the threshold amount. For

2018 (it is subject to inflation adjustment), the threshold amount is $157,500 for singles and married filing separately, and $315,000 for married filing jointly. Under those amounts, it doesn't matter what your business is and you are not subject to other limitations that come into play for those above the threshold amount. You don't fall off a cliff if you are one dollar over the threshold amounts. There is a phase-in range - $50,000 (to $207,500) for singles and married filing separately and $100,000 (to $415,000) for married filing jointly. Keep in mind that since the limitations apply at the individual level, you may have one partner under the threshold and therefore not subject to limitations and another partner over the limit, to whom all of the limitations apply.

What if you do exceed the threshold amount and in fact are over the phase-in range? Then all of the statutory limitations apply to you. First, you must figure out if you are a service trade or business that is excluded under the statute or regulations. If you are, no deduction for you. If you are not a specified service trade or business, then you have two limitations to apply - the regs say that you determine the lesser of 20% of the qualified business income of the trade or business, or the greater of (1) 50% of the trade or business's W-2 wages, or (2) 25% of the trade or business's W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition of qualified property with respect to the trade or business.

A few special rules that you may want to be aware of:

- Underpayment Penalty: Section 6662(a) of the Code provides for a penalty when there is a substantial underpayment of tax required to be shown on your return. A substantial underpayment is defined as the greater of $5,000 or 10% required to be shown on the return. When section 199A is involved, it's the greater of $5,000 or 5% of the amount required to be shown on the return.
- Fiscal years: What do you do for the 2018 tax year when your partner or S corporation shareholder is a calendar year taxpayer and the partnership or corporation is a fiscal year taxpayer? The regs make it clear that for purposes of determining qualified business income and the items that make up the limitations, if an individual receives any of these items from a trade or business with a taxable year that begins before January 1, 2018 and ends after December 31, 2017, those items are treated as having been incurred by the individual during the individual's taxable year in which the trade or business's taxable year ends. This means that you do not have to try and determine how much of each of these items was incurred solely in 2018. Take the whole year of the trade or business, even if the fiscal year of the trade or business was partially in 2017.
- Reasonable compensation paid to S corporation shareholders and guaranteed payments to partners are not considered when calculating qualified business income.
- Aggregation. Generally, you must do the 199A calculations for each business that you are involved with separately. However, you are allowed to aggregate under certain circumstances. The same person or group of persons must directly or indirectly own 50% or more of each trade or business to be aggregated. Then, the trades or businesses to be aggregated must meet at least

two of the following: (1) the trades or businesses provide products and services that are the same or customarily offered together; (2) the trades or businesses share facilities or share significant centralized business elements, such as personal, accounting, legal, manufacturing, purchasing, human resources or information technology resources; and (3) the trades or businesses are operated in coordination with, or reliance upon, one or more of the trades or businesses in the aggregated group, and they use supply chain interdependencies as an example. Once you aggregate, you must continue to aggregate. There are reporting requirements for aggregation.

- Trades or businesses where the principal asset is the skill or reputation of one or more of its employees or owners. This type of trade or business is a specified service trade or business that cannot take the 20% deduction if taxable income is over the threshold amount. Fortunately, this is narrowly defined in the regulations and is limited to fact patterns where the individual is engaged in the trade or business of (1) receiving income for endorsing products or services, including an individual's distributive share of income or distributions from the trade or business for which the individual provides endorsement services; (2) licensing or receiving income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity, including an individual's distributive share of income or distributions from the trade or business for which the individual provides endorsement services; or (3) receiving appearance fees or income.
- The deduction does not apply to employees. As you might expect, how you classify a worker is not conclusive. If the worker meets the tests to be classified as an employee, the worker is an employee and therefore entitled to no 199A deduction. Moreover, there is a presumption that anyone who was an employee still is an employee, despite a change in classification. This presumption is rebuttable, but applies whether the person is providing services directly or indirectly through an entity.

There is much more to the regulations, including what must be reported to clients on their K-1s. Please feel free to call if questions arise.

Post Polak Goodsell & Strauchler P.A.
425 Eagle Rock Avenue, Suite 200, Roseland, NJ 07068
134 Nassau Street, Princeton, NJ 08542
(973) 228-9900