Post Polak
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Welcome to Edition 9 of The Newsletter from Scott H. Novak, Attorney at Law. 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.

They're Coming For Your Passport

Way back in 2015, Congress enacted IRC Section 7345 as part of the Fixing America's Surface Transportation (FAST) Act. This new Code section requires the Department of the Treasury to notify the Department of State if a certification is made that an individual has a "seriously delinquent tax debt." What will that notification mean to you and your clients? The Department of State issues passports. Starting with January of 2018, upon receipt of the certification, the Department of State will generally deny an application for issuance or renewal of a passport and may revoke an existing passport.

Who is "seriously delinquent?" If you owe $50,000 or more in taxes (indexed for inflation, so $51,000 this year), and either a Notice of Federal Tax Lien has been issued (and the taxpayer's right to a hearing has lapsed), or a Federal Tax Levy has been issued, you have a seriously delinquent tax debt. It does not include:

- A debt that is being timely paid under an IRS-approved installment agreement;
- A debt that is being timely paid under an IRS-approved offer in compromise;
- A debt that is being timely paid under the terms of a settlement agreement with the Department of Justice;
- A debt in connection with a levy for which collection is suspended because of a request for a due process hearing;
- A debt for which collection is suspended because the individual made an innocent spouse election or requested innocent spouse relief.

The IRS must notify the taxpayer when a certification is sent to the Department of State. A taxpayer has 90 days to resolve the tax debt before the Department of State takes action. Rules apply if a taxpayer must travel within the 90 days. So if you or a client have a big trip coming up, put resolving your seriously delinquent tax debt on the to-do list. See IRS Notice 2018-01.

20% Deduction for Pass-Through Entities

There is a new and exciting provision that allows for a 20% write-off for pass-through income. New Code section 199A. But let's not get too excited - it doesn't

apply to lawyers and accountants. I try not to get too technical in this Newsletter, but this new provision is worthy of some in-depth discussion.

First, some basics - to qualify for the new deduction, you must be a partner in a business entity taxed as a partnership, a shareholder of an S corporation, or a sole proprietor engaged in a trade or business. This does not apply to C corporations, though their rate of tax has already been dropped substantially. Estates and trusts with interests in partnerships and S corporations are eligible for the deduction. We'll have to wait for Treasury guidance to know how to apportion the deduction between fiduciaries and beneficiaries.

Certain types of business are excluded from the deduction, but only if your taxable income (without regard to this deduction) exceeds $157,500 ($315,000 if you file a joint return with your spouse). Above that, it is phased out - completely at $207,500 for singles and $415,000 for married filing jointly. Let's say your income *does* exceed these amounts. Who is excluded? (1) Businesses involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services or brokerage services, (2) businesses where the business's principal asset is the reputation or skill of one or more of its employees or owners, and (3) businesses involving the performance of services consisting of investing and investment management, trading, or dealing in securities, partnership interests or commodities. All other businesses qualify and even the businesses listed here will qualify if you are under the dollar threshold.

To qualify, your business must be engaged in the conduct of a trade or business within the United States. The amount of the deduction depends on taxable income, without regard to this deduction. If taxable income is not more than $157,500 ($315,000 if married filing jointly), the deduction is 20% of your combined qualified business income, but not more than your taxable income attributable to ordinary income and qualified dividend income. Other rules for calculation come into play if taxable income exceeds $157,500, but does not go over $207,500 ($315,000 - $415,000 if married filing jointly). Still other rules apply when taxable income exceeds those amounts.

To compute the deduction, you must determine (1) the taxpayer's qualified business income from any particular activity, (2) the combined qualified business income from all such activities, and (3) the taxpayer's ordinary and dividend income.

Generally, *qualified business income* is the net amount of your items of income, gain, loss and deduction from an eligible trade or business, except that items of capital gain and loss are excluded. The term also does not include certain dividends from REITs, cooperatives and publicly-traded partnerships, as those items are subject to special rules.

Combined qualified business income. I would like to be able to tell you that this simply means the net sum of all of the taxpayer's trade or business activities. But that would be incorrect. Section 199A(b)(1)(A) defines the term to mean the sum of the deductible amounts from each trade or business activity. Section 199A(b)(2) generally provides that the deductible amount is 20% of the taxpayer's qualified

business income from the trade or business. BUT - for taxpayers who hit the thresholds mentioned earlier, the deductible amount cannot exceed 50 percent of the W-2 wages from the business, or, if greater, 25% of the W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property.

How are W-2 wages defined under the statute? From 199A(b)(4), a taxpayer's W-2 wages from a trade or business generally means the amount of wages and deferred compensation paid by the taxpayer that are attributable to qualified business income. In the case of a partnership or S corporation, Section 199A(f)(1)(A) tells us that each partner or shareholder is treated as having W-2 wages in an amount equal to such partner's or shareholder's allocable share of W-2 wages paid by the entity. Easy for S corporations. Not so much for partnerships (think Treasury Regs).

OK, then what is qualified property? Depreciable, tangible personal property on hand at the close of the taxable year and used in the production of qualified business income. The property must be within the depreciable period (generally defined as the first 10 years in which the taxpayer has placed the property in service).

Here is a Conference Committee Report example that explains the wage and capital-based limitation: "A taxpayer (who is subject to the limit) does business as a sole proprietorship conducting a widget-making business. The business buys a widget-making machine for $100,000 and places it in service in 2020. The business has no employees in 2020. The limitation in 2020 is the greater of (a) 50% of W-2 wages, or $0, or (b) the sum of 25% of W-2 wages ($0) plus 2.5% of the unadjusted basis of the machine immediately after its acquisition: $100,000 x .025 = $2,500. The amount of the limitation on the taxpayer's deduction is $2,500."

Limitation based on Taxable Income. Even after the application of the rules above, the total Section 199A deduction cannot exceed 20% of the excess of the taxpayer's taxable income over the sum of any net capital gain plus any qualified cooperative dividends. This provision means that the 199A deduction cannot exceed the taxpayer's ordinary and dividend income.

And where is this deduction taken? Above the line in determining adjusted gross income (AGI), where it would do the most good? No - after AGI. It's a below the line deduction. It can be claimed in addition to the standard deduction or itemized deductions.

By the way - in the list of excluded professions, notice who did NOT show up. Architects and engineers. Either they had a better lobbyist than we did or the next thing that's going to come down the pike is infrastructure repair and we want them in the governments good graces.

There is more to the Section 199A deduction than what is written here. The new provision does offer some interesting planning opportunities. We will all await regulations on 199A, which I assume will address many loopholes and make all of this more clear.

Entertainment Expenses

I've been telling my clients that entertainment expenses are no longer deductible under the new tax law, lest they continue to spend the way they had in the past. I anticipate that this will cause some businesses to suffer greatly, as a significant part of the income of some businesses were from company expense accounts.

CPE for the New Tax Law

For a free 3-credit CPE program on the evening of February 6, please click below:

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