Tax Bill Workshop

Willmar Lakes Area Chamber of Commerce

January 9th, 2020

Agenda

- 2020 Legislative Preview on State Tax Issues that Would and Could Impact Business
- MN Tax Law Changes and Challenges with Non-Conformity
- Federal and State Estate & Taxation Planning
- Standard vs. Itemized Deductions Discussion and Tax Planning Opportunities
- Guidance on New W-4 Requirements
- Entity Selection in the Wake of Tax Reform
- 199A Deduction Review and Business Tax Planning Opportunities
- Q & A

2020 LEGISLATIVE SESSION PREVIEW TAX ISSUES

Willmar Tax Workshop, Jan. 9, 2020

Beth Kadoun, VP Tax and Fiscal Policy

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GROWING MINNESOTA

Business Voice at the State Capitol

Member driven organization
2,300 members across state
All sizes and industries

We work to improve business climate for businesses to start, grow and thrive in Minnesota.

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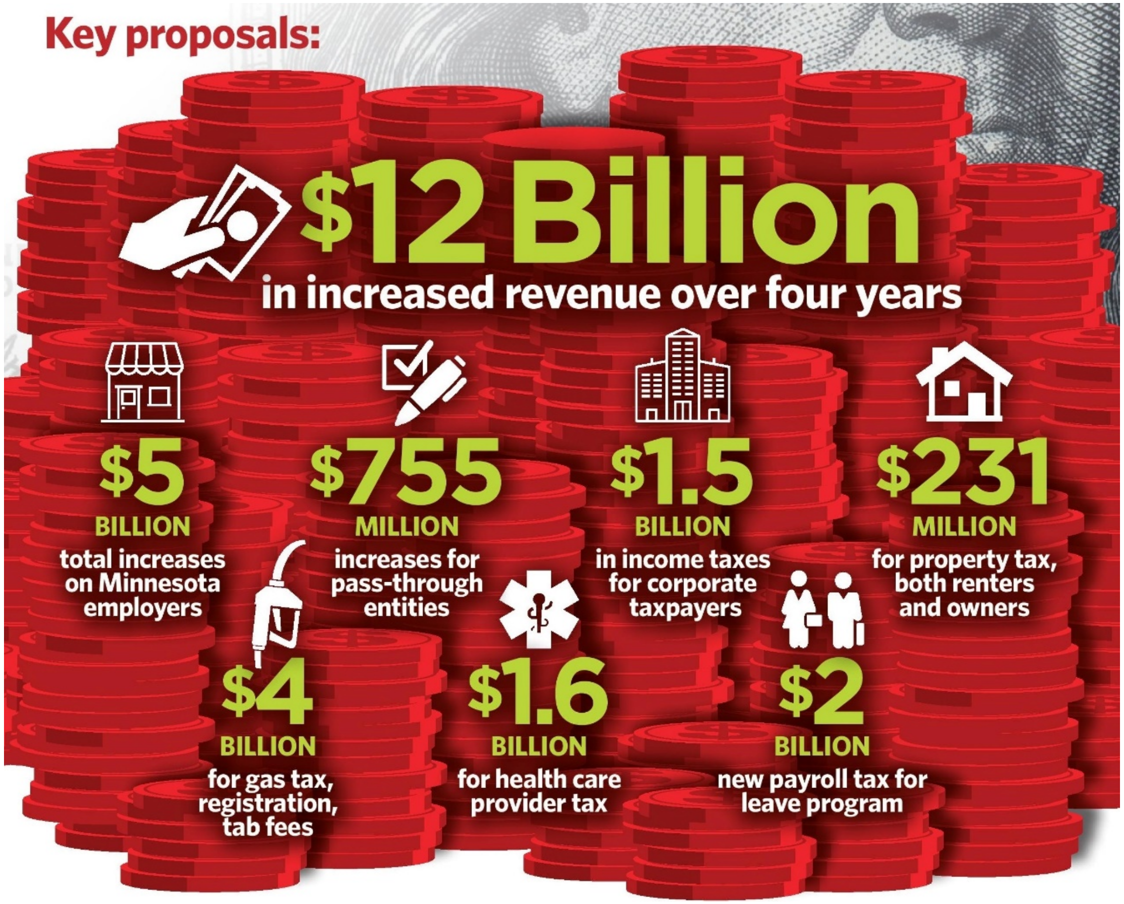
2019 SESSION REVIEW

- Divided government
- $1 billion surplus, $2 billion reserves
- Budget required for FY 2020/21
- Tax code not updated to TCJA
- No shortage of ideas - 2,925 bills
- Fundamental policy differences

2019 LEGISLATIVE SESSION - REVIEW

Large tax increases proposed – few adopted



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2019 LEGISLATIVE SESSION REVIEW

2019 Session Results - Compromise Reached

✓ **Budget adopted FY 2020/2021**

- +6.7% general fund to $48.5 billion
- +8.8% all funds to $88.9 billion

✓ **Tax bill passed with federal tax conformity**

- Overall revenue neutral
- Tax increase on businesses to pay for individual
- Adopted many of the base broadening provisions but not tax offsets
- Business property tax reduction

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2020 LEGISLATIVE SESSION PREVIEW

- Bonding year
- Election year – all 201 legislators
- Short session – start date of February 11th
- $1.3 billion surplus forecasted
- Reserves at statutory target $2.4 billion
- Supplemental budget and tax bill
- Other issues debated – holdovers 2019 and new

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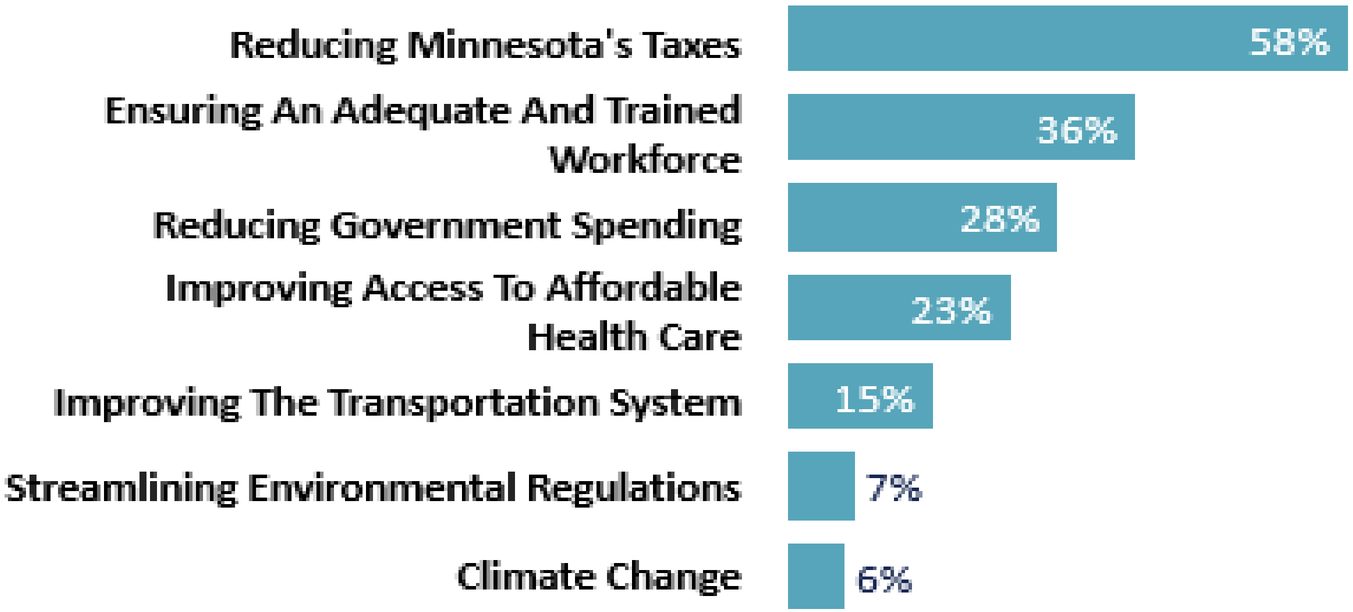
2020 LEGISLATIVE SESSION PREVIEW

WHAT BUSINESS THINKS,

MOST IMPORTANT ISSUE FOR GOVERNOR, LEGISLATURE



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2020 LEGISLATIVE SESSION PREVIEW

Tax Competitiveness

WHY DOES TAX COMPETITIVENESS MATTER?

Corporate tax rate

-4th highest in the nation

Individual income taxes

-5th highest

Overall State and Local Taxes

-8th highest

2020 SESSION PREVIEW

The Legislature must act

- Reduce corporate and all four individual income tax rates with goal of getting Minnesota out of top five highest tax rate states.
- Fully conform to Section 179 business expensing provisions to encourage investment in Minnesota operations by small businesses and farmers.
- Enact other reforms to enhance Minnesota's competitiveness and reduce complexity and compliance costs including eliminating the corporate alternative minimum tax and conforming to federal estate tax threshold.

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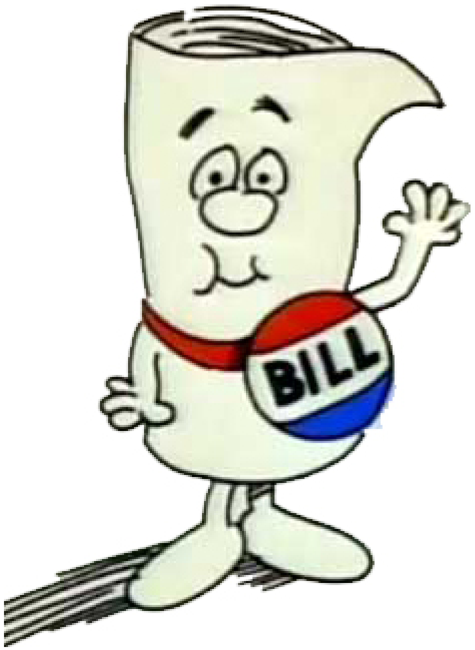
Minnesota Conformity-H.F.5

- H.F. 5 enacted May 30, 2019
  - Some changes retroactive to 2017 and 2018, other conformity for 2019 tax year
- Allowed filing on old (2018) forms until August 15, 2019
- Department of Revenue requested no amended returns



2017 and 2018 Conformity-Retroactive (Individuals and Passthrough Entities)

	Pre H.F. 5	Post H.F. 5
Bonus Depreciation-Addback	40% bonus treated usual way (80% addback over 5 years), regular MACRS calculation on remaining 60% for 5, 7, 15 (etc) assets	80% addback on full bonus amount with 5 year spread
Bonus Depreciation-Used Assets	Adjustment added back 100% bonus on used assets and took normal MACRS	Used assets where bonus was taken for federal purposes 80% addback
Section 179 Depreciation	Maximum Deduction $520,000 with Phase-Out at $2,070,000 of additions	Maximum Deduction $1,000,000 with Phase-Out at $2,500,000 of additions
Farm Assets	Adjustment to 150% DB method and 7 year life for new farm assets	5 year life and 200% DB method allowed for new farm assets

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Like-Kind Exchange Example

Old Law		New Law	
Trade in piece of farm equipment for new piece		Trade in piece of farm equipment for new piece	
Trade in value of old equipment: 200,000		Trade in value of old equipment: 200,000	
Value of new equipment: 300,000		Value of new equipment: 300,000	
Other Income: 200,000		Other Income: 200,000	
<u>Federal:</u>		<u>Federal:</u>	
Other Income	200,000	Other Income	200,000
Gain on Sale	0	Gain on Sale	200,000
Depreciation on New Asset	(100,000)	Depreciation on New Asset	(300,000)
Taxable Income	100,000	Taxable Income	100,000
<u>Minnesota:</u>		<u>Minnesota:</u>	
Federal Taxable Income	100,000	Federal Taxable Income	100,000
MN Depreciation Addition	80,000	MN Depreciation Addition	240,000
MN Taxable Income	180,000	MN Taxable Income	340,000

Results in almost $15,000 increase to MN tax liability for married farmer!

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2017 and 2018 Conformity-Retroactive (Individuals and Passthrough Entities)

	Pre H.F. 5	Post H.F. 5
"Luxury" Automobile Limitation-Passenger Vehicles	1st Year-$11,160 2nd Year-$5,100 3rd Year-$3,050 4+ Years-$1,875	1st Year-$18,000 2nd Year-$16,000 3rd Year-$9,600 4+ Years- $5,760
Interest Expense Limitation-163(j)	Subtraction for any disallowed interest for federal purposes	Federal limitation applies-no adjustment
Like Kind Exchange-Sect 1031	Adjustment to gain or loss for exchange treated as sale for federal purposes	No adjustment to federal taxable income for gain/loss on trade-in
Excess Business Losses	Subtraction for losses disallowed for federal purposes	No adjustment, losses disallowed for federal purposes are not allowed for MN

2017 and 2018 Conformity and Non Conformity with TCJA

	Pre H.F. 5	Post H.F. 5
Net Operating Loss	No limitation	Net Operating Loss Deductions limited to 80% of taxable income. Carryforward for 15 years (different than unlimited Federal)
529 Plans	Distributions used for K-12 expenses added back to Federal AGI	No change-MN did not conform to 529 TCJA changes
199A	No 199A deduction for MN	No change-MN did not conform to 199A

2019 Conformity/H.F. 5 Highlights (Individuals and Passthrough Entities)

	Pre H.F. 5	Post H.F. 5
Fringe benefits: Entertainment, employer operated eating facilities, transportation	Subtraction for federal disallowance of entertainment and transportation benefits, subtraction for limitation on employer eating facilities	Subtraction allowed for 2018, starting in 2019 no adjustment for federal limitation
Standard Deduction/Exemptions	Minnesota kept the original pre TCJA standard deduction and exemption amounts for individuals	For 2019 and later years MN conforms to the new higher standard deductions. Exemptions are allowed for dependents only.
Home Equity Interest Deduction & 750,000 Limit	Prior limitations allowed mortgage and home equity deduction up to $1 Million of indebtedness	Federal limitation applies-no deduction for home equity unless acquisition debt and $750,000 maximum indebtedness
Taxes Paid Itemized Deduction	No limit on property taxes/license tabs/non income taxes	$10,000 limit

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2019 Conformity/H.F. 5 Highlights (Individuals and Passthrough Entities)

	Pre H.F. 5	Post H.F. 5
Charitable Contributions	Limited to 50% of Adjusted Gross Income	Limit conforms with federal 60% of Adjusted Gross Income
Unreimbursed Employee Expenses	Allowed for MN even though disallowed for Federal	No change, MN will still allow employee business expenses in excess of 2% of AGI as an itemized deduction
Casualty and Theft Losses	Disallowed for federal (unless declared disaster area)but allowed as an itemized deduction for MN	No change, still allowed as MN itemized deduction for non disaster areas. Loss limited to 10% AGI
Individual Tax Rates	5.35%, 7.05%, 7.85%, 9.85%	5.35%, **6.8%,** 7.85%, 9.85% Second tier lowered

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2019 Conformity/H.F. 5 Highlights (Individuals and Passthrough Entities)

	Pre H.F. 5	Post H.F. 5
MN Starting Point	Federal Taxable Income	Federal Adjusted Gross Income (return to 2017 method)
Alimony	Deductible for payer and includible in income for recipient	For divorces after 12/31/18 not deductible or includible. No change for divorces prior to 12/31/18.
Working Family Tax Credit	Lower maximum credit, lower income eligibility, must be age 25 with no dependent children to claim	Maximum credit increased, maximum income eligibility increased, individuals age 21-25 without children now eligible for credit
Social Security Subtraction	$4,700 MFJ Maximum Subtraction $2,350 MFS, $3,660 HOH/Single	Increased by $450 MFJ or $360 for Single/HOH

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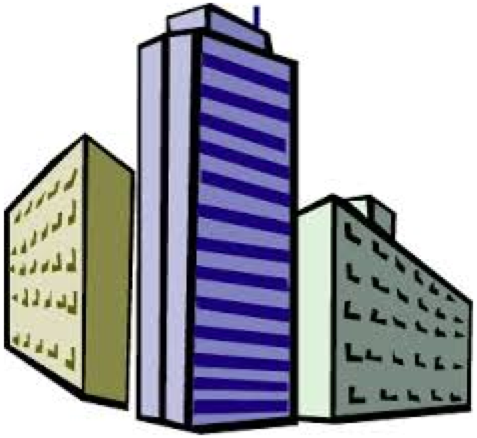
Corporate Changes

- NOL:
  - Limited to 80% of taxable income like individual NOL's
  - Carryforwards from prior to 2018 also subject to 80% limitation
- MN Corporate AMT continues to be imposed
- Entertainment and fringe benefits changes are effective for corporations for tax years beginning after 12/31/2017 unlike passthrough entities



Desk Audits

- 2017 Audits should be completed by Spring 2020
- 2018 Audits should be completed by Summer 2020
  - C Corporations/Nonprofits- Many have received proposed adjustments/information requests
  - Individuals and Passthroughs- Only a few have started
- 30 day response time
- May be some issues when changes from 2018 carryover to 2019 if not completed by 2019 return due date

"Auditor's here."

What to Expect

- 2017 Tax Year-Substantially all 2017 changes result in refunds
- 2018 Tax Year-
  - Individuals who aren't pass-through owners: no change
  - C Corporations and Passthrough Owners:
    - Possible large refunds from bonus and 179
    - Possible large assessments from interest limitation, excess business losses, NOL, like kind exchanges
  - Nonprofits- Corporate NOL rules apply
  - Adjustments are all due to law change, not errors you or your tax preparer made!
  - Penalties and interest may be assessed on notices
  - No change letters are being issued as well

Federal And Minnesota Estate And Gift Taxes

(another reason why you cannot (MAY NOT) take it all with you)

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FMV Of Assets Owned

The Estate Tax is a tax on your right to transfer property at your death. It consists of an accounting of everything you own or have certain interests in at the date of death (Refer to Form 706.) The fair market value of these items is used, not necessarily what you paid for them or what their values were when you acquired them.

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Less Transfers, Debts, And Deductions

Once you have accounted for the Gross Estate, certain deductions (and in special circumstances, reductions to value) are allowed in arriving at your "Taxable Estate." These deductions may include mortgages and other debts, estate administration expenses, property that passes to surviving spouses and qualified charities. The value of some operating business interests or farms may be reduced for estates that qualify.

Taxable Estate Limits

- A filing is required for estates with combined gross assets and prior taxable gifts exceeding $1,500,000 in 2004 - 2005; $2,000,000 in 2006 - 2008; $3,500,000 for decedent’s dying in 2009; and $5,000,000 or more for decedent's dying in 2010 and 2011 (note: there are special rules for decedents dying in 2010); $5,120,000 in 2012, $5,250,000 in 2013, $5,340,000 in 2014, $5,430,000 in 2015, $5,450,000 in 2016, $5,490,000 in 2017, $11,180,000 in 2018, $11,400,000 in 2019, and $11,580,000 in 2020.
- Reverts back to $5.0 MIL in 2026
- Current estate tax at 40%

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Gifting Annual Exclusion

- The annual exclusion for gifts is $11,000 (2004-2005), $12,000 (2006-2008), $13,000 (2009-2012) and $14,000 (2013-2017). In 2018, 2019, and 2020, the annual exclusion is $15,000.
- No limits on educational or medical gifts on behalf of DONEE
- Gifts greater than annual exemption reduce allowed exempt estate

Married, Domestic Partnerships, Portability

- Marrieds and domestic partnerships double the annual exclusion($23,160,000)
- Unused exclusion amount gets carried over to survivor’s estate(return needs to be filed)
- Unlimited marital transfers
- Unlimited charitable donations
- Split gifting

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Minnesota Estate Tax

- Applies to residents and non residents owning Minnesota based assets
- The threshold for the estate tax in Minnesota was $2.4 million in 2018. Increased to $2.7 million for 2019 and $3 million for 2020 and after. Any wealth below the exemption is not taxed by the state. Wealth above that mark is taxed in a series of progressive brackets. TAX RATE OF 13-16%

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Pass-thru For Non Residents

- If a nonresident decedent holds an interest in a pass-through entity, their share of the entity's real or personal tangible property located in Minnesota is assigned to Minnesota as if the pass-through entity does not exist.
- Pass-through entities include S corporations, partnerships, limited liability companies, and trusts. The Minnesota Estate Tax due is reduced if an estate or inheritance tax is paid to another state for that property.
- Effective for estates of those who died after Dec. 31, 2012.

Qualified Small Business and Farm Property Deduction

- The deduction is for decedents that meet all of the following requirements:
  - Date of death is after June 30, 2011
  - Owned qualified small business (operating assets) or farm property (land)
  - Qualified small business or farm property was passed to a qualified heir at death
  - The deduction cannot exceed $2.3 million for decedents whose dates of death are in 2019 and $2.0 for 2020.
- Qualified heirs must file and pay recapture tax if the ownership, participation, or maintenance requirements for the three-year holding period are not met.
- MAXIMUM $5.0 MIL EXEMPTION FROM ESTATE TAX (including small biz and farm deductions)

Income Tax Consequences

- Income in respect of a decedent (IRA'S and pensions)
- Step up in tax basis (gains normally LT capital) –tax on appreciation to DOD forgiven.
- Inheritances property are normally tax free

Planning

- Probate, wills, and trusts
- Forms of ownership-joint tenancy, beneficiaries, TOD, POD, life-estates
- Ease and cost of administration
- Gifting transfers basis (cannot gift income, you can gift income producing property)
- Nursing home care costs and protecting assets
- IRA's and retirement plan income
- Charitable giving

Standard vs. Itemized Deductions & Planning Opportunities

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Taxpayers Itemizing Under TCJA

- The Tax Cuts and Jobs Act increased the standard deduction
  - $12,200 single
  - $24,400 married filing joint
- The Tax Cuts and Jobs Act also reduced the value of certain itemized deductions
  - State and local taxes capped at $10,000
  - Home mortgage interest on principal reduced from $1 million to $750,000
- An estimated 13.7% of all taxpayers will itemize in 2019
  - More than 17% lower than it would have been under pre-TCJA law
- TCJA also decreased the tax benefit of deductions by lowering the individual income tax rates

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Percentage of Itemizing Taxpayers by Income Group

Source: Tax Foundation General Equilibrium Model, April 2019.

Income Group	Current Law (2019)	Pre-TCJA Law (2019)
0% to 20%	1.2%	3.7%
20% to 40%	2.5%	9.3%
40% to 60%	5.3%	21.9%
60% to 80%	13.8%	45.3%
80% to 90%	30.3%	67.8%
90% to 95%	50.2%	82.2%
95% to 99%	72.8%	91.5%
99% to 100%	91.5%	92.1%
TOTAL	13.7%	31.1%

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Medical Deductions

- Floor is 7.5% of AGI (SECURE Act)
- Strategies to remove medical expenses from taxable income
  - Timing of procedures
  - Employer Flexible Spending Arrangement (FSA)
  - Health Savings Account with a high-deductible plan
    - Funded with pre-tax dollars
    - Money grows tax-deferred
    - Withdrawals are tax-free as long as used for qualified medical expenses
    - No required minimum distributions
    - Employers can contribute
    - No income limits
  - Self-employed health insurance deduction and Section 105 Plans

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State & Local Income Tax Deduction

- TCJA imposed a maximum limit of $10,000
- Not indexed for inflation, so more people will be effected over time
- No marital status difference
- House passed a bill to address SALT on December 19th
- In 2016, 11% of taxpayers with incomes less than $50,000 claimed SALT deduction, 80% with income over $100,000 claimed SALT deduction

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Interest Deduction

- TCJA limited mortgage interest on new loans to the first $750,000 of debt for new or modified loans after 12/31/17
  - Home must be secured by the loan
  - Must be the taxpayer's main or second home ($750,000 combined principal limit)
  - Taxpayer must have an ownership interest in the home
- TCJA repealed the deduction for home equity line interest
  - No grandfathering of deductions
  - Exception if used to buy, build, or improve taxpayer's home that secures the mortgage
  - Taxpayer must have an ownership interest in the home
- Use 10-T election to deduct interest on appropriate business schedule
  - Physically attach to return in the year of borrowing
- A mortgage on a 2nd home should be secured by a mortgage on the 2nd home, not a equity line on 1st home

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Charitable Donations

- No limit
- Bunching deductions
- Donor-Advised Fund
  - Receive an immediate deduction
  - Fund grows tax-free
  - Recommend grants from the fund over time
- Qualified Charitable Distribution (QCD)
  - IRA
  - Must be 70 ½ (SECURE Act did not change)
  - Meets RMD requirement
  - Maximum amount is $100,000 per year per IRA owner (SECURE Act may limit amount)

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Guidance on new W-4 requirements

Presented by:

Michelle Hanson, CPP, CHRS

Partner and Director of Payroll Services

2020 W-4

Form was recently finalized on 12-4-2019.

Form **W-4**

Department of the Treasury
Internal Revenue Service

Employee's Withholding Certificate

▶ Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay.
▶ Give Form W-4 to your employer.
▶ Your withholding is subject to review by the IRS.

OMB No. 1545-0074

2020

Step 1: Enter Personal Information

(a) First name and middle initial | Last name | (b) Social security number

Address

City or town, state, and ZIP code

▶ **Does your name match the name on your social security card?** If not, to ensure you get credit for your earnings, contact SSA at 800-772-1213 or go to *www.ssa.gov*.

(c) ☐ **Single or Married filing separately**
☐ **Married filing jointly** (or Qualifying widow(er))
☐ **Head of household** (Check only if you're unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)

Complete Steps 2–4 ONLY if they apply to you; otherwise, skip to Step 5. See page 2 for more information on each step, who can claim exemption from withholding, when to use the online estimator, and privacy.

Step 2: Multiple Jobs or Spouse Works

Complete this step if you (1) hold more than one job at a time, or (2) are married filing jointly and your spouse also works. The correct amount of withholding depends on income earned from all of these jobs.

Do **only one** of the following.

(a) Use the estimator at *www.irs.gov/W4App* for most accurate withholding for this step (and Steps 3–4); **or**

(b) Use the Multiple Jobs Worksheet on page 3 and enter the result in Step 4(c) below for roughly accurate withholding; **or**

(c) If there are only two jobs total, you may check this box. Do the same on Form W-4 for the other job. This option is accurate for jobs with similar pay; otherwise, more tax than necessary may be withheld . . . . . ▶ ☐

TIP: To be accurate, submit a 2020 Form W-4 for all other jobs. If you (or your spouse) have self-employment income, including as an independent contractor, use the estimator.

Complete Steps 3–4(b) on Form W-4 for only ONE of these jobs. Leave those steps blank for the other jobs. (Your withholding will be most accurate if you complete Steps 3–4(b) on the Form W-4 for the highest paying job.)

Step 3: Claim Dependents

If your income will be $200,000 or less ($400,000 or less if married filing jointly):

Multiply the number of qualifying children under age 17 by $2,000 ▶ $

Multiply the number of other dependents by $500 . . . . ▶ $

Add the amounts above and enter the total here . . . . **3** $

Step 4 (optional): Other Adjustments

(a) Other income (not from jobs). If you want tax withheld for other income you expect this year that won't have withholding, enter the amount of other income here. This may include interest, dividends, and retirement income . . . . **4(a)** $

(b) Deductions. If you expect to claim deductions other than the standard deduction and want to reduce your withholding, use the Deductions Worksheet on page 3 and enter the result here . . . . **4(b)** $

(c) Extra withholding. Enter any additional tax you want withheld each **pay period** . **4(c)** $

Step 5: Sign Here

Under penalties of perjury, I declare that this certificate, to the best of my knowledge and belief, is true, correct, and complete.

▶ **Employee's signature** (This form is not valid unless you sign it.) ▶ **Date**

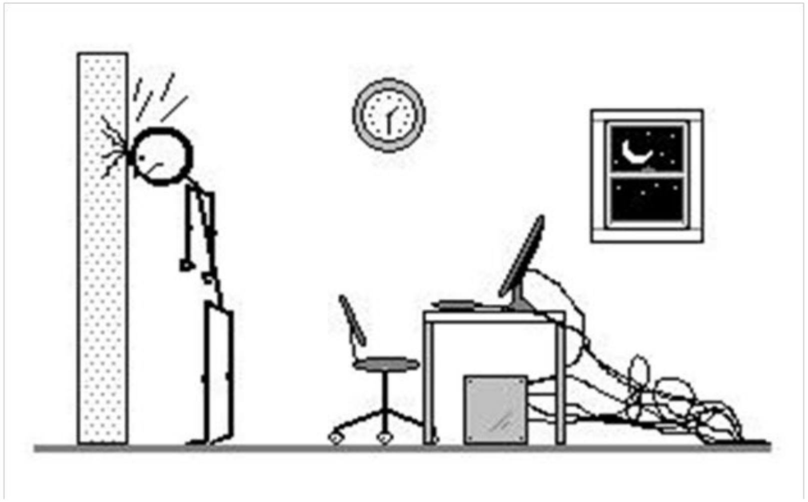
Employers Only

Employer's name and address | First date of employment | Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 3. Cat. No. 10220Q Form **W-4** (2020)

2020 W-4

How payroll feels about this change…



Employees attempting to fill it out…

2020 W-4

- Employees who submitted Form W-4 in any year before 2020 are not required to submit a new form unless a change is needed.
- Allowances have been eliminated and have been replaced by dollar values to calculate withholding.
- The form is divided into 5 steps. Employees will provide information for the steps that apply to them.
- Only two steps are required for all employees. Step 1 and Step 5.

2020 W-4 (Cont'd.)

- All new employees hired as of Jan. 1, 2020, must complete the new form.
- Any adjustments made after Jan. 1, 2020, must be made using the new form.
- You can ask employees hired previous to 2020 to use the new form, but they are not required to do so. Then explain that withholding will continue based on their previous W-4 form.

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Form W-4MN Now Required for Every Employee

The 2020 federal Form W-4 will not compute allowances for determining Minnesota withholding tax. **Every employee** that completes a 2020 Form W-4, **must complete Form W-4MN** for you to determine their Minnesota withholding tax. If the employee does not complete a Form W-4MN, you must withhold tax at the single filing status with zero allowances.

2020 W-4 (Cont'd.)

- Step 1
  - Enter personal information (including marital status)
    - Single or Married Filing Separately = 2 allowances
    - Married Filing Jointly = 3 allowances
    - Head of Household = 2 allowances

2020 W-4 (Cont'd.)

- Step 2-4 (Complete ONLY if they apply; otherwise skip to step 5)
  - **Step 2** - Complete if you hold more than one job at a time or are married filing jointly and your spouse also works

    (a) Use the estimator www.irs.gov/W4app

    (b) Use Multiple Jobs Worksheet on page 3 of W-4

    (c) Check the box if there are <u>only</u> two jobs total

    - **Step 2(c):** If you (and your spouse) have a total of only two jobs held at the same time, you may check the box in Step 2(c) on the Forms W-4 for **both** jobs. That is, to use this option, you should complete a Form W-4 for **each** job with the box in Step 2(c) checked. The standard deduction and tax brackets will be cut in half for each job to calculate withholding. You will not need to furnish a new Form W-4 to account for pay changes at either job. *This option is accurate for jobs with similar pay; otherwise more tax than necessary may be withheld from your wages.* This extra amount will be larger the greater the difference in pay is between the two jobs.

2020 W-4 (Cont'd.)

- Steps 3-4(b) should only be completed for ONE of the jobs (most accurate if done on highest paying job)
  - Step 3
    - Multiply the number of qualifying children under age 17 by $2,000
    - Multiply the number of other children by $500
  - Step 4

    (a) Other income (not from jobs)

    This will increase your withholding

    (b) Deductions – other than the standard deduction

    This will decrease your withholding

    (c) Extra Withholding

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2020 W-4 (Cont'd.)

- Step 5
  - Sign and date the form

2020 W-4 Resources

FAQs found on IRS.gov

- https://www.irs.gov/newsroom/faqs-on-the-2020-form-w-4

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Entity Selection in the Wake of Tax Reform

Presented by Jennifer Lownsbury, CPA

Partner

Summary of Changes Under Tax Reform

- Corporate Tax Rates
  - BEFORE Top rate 35%
  - AFTER Flat rate 21% (“permanent”)

  Note - Double tax applies, dividends taxed at 23.8%, effective rate of 39.8%

- Individual Tax Rates
  - BEFORE Top rate 39.6%
  - AFTER Top rate 37% (expires after 2025)

  Reminder – Net investment income tax at 3.8% applies to passive income

- Section 199A Deduction
  - 20% qualified business income deduction (QBID) created an effective tax rate of 29.6% (expires after 2025)

Entity Selection Considerations

- Ownership - number and type
- Liability – risk level
- Income tax implications
- 199A eligibility (20% pass-through deduction)
- Profit or loss
- Cash flow needs

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Entity Comparison Chart

Entity Type	# of Owners	Liability	Tax Rate	199A Eligibility
Sole Proprietor	1	Unlimited personal liability	Individual rates to 37% Self-employment tax	Yes
Partnership	2 or more	Unlimited personal liability	Pass-through entity (PTE) Individual rates to 37% Self-employment tax	Yes
Limited Liability Company (LLC)	1 or more	Protect owners from personal liability	Pass-through entity (PTE) Individual rates to 37% Self-employment tax	Yes
S-Corporation	1 to 100	Protect owners from personal liability	Pass-through entity (PTE) Individual rates to 37% No self-employment tax	Yes
C-Corporation	1 or more	Protect owners from personal liability	21% tax rate Dividends = Double Tax	No

Illustration Using Top Marginal Rates

	C Corporation at 21%	PTE Individual Rate at 37%	PTE w/199A Individual Rate at 29.6%
Earnings	$100,000	$100,000	$100,000
Tax on earnings	$21,000	$37,000	$29,600
Available for dividend	$79,000	$63,000	$70,400
Dividend tax (the “double tax”) at 23.8%	$18,800	$0	$0
Total tax	$39,800	$37,000	$29,600
% of earnings	39.8%	37.0%	29.6%
Net to owner	$60,200	$63,000	$70,400

CHRISTIANSON
CPAs & Consultants

199A Deduction Review and Business Tax Planning Opportunities

Presented by
Joel Gratz, CPA, Partner

Creating clients for life

Section 199A Qualified Business Income Deduction

- Needs to be income from a trade or business
- Subtracts 20% of sole proprietorship, partnership or S-corporation qualified business income (QBI) against overall taxable income (TI)
- The deduction calculated separately for each business
- QBI does not include any guaranteed payments paid to a partner, nor wages paid to an S corporation shareholder
- Deduction limits are phased in over certain TI amounts
- Limited to 20% of TI

Calculating the 199A QBI Deduction

- Limitations do not apply until TI > $321,400 MFJ/$160,700 single
- Limitations fully phase in at $421,400 MFJ ($210,700 single)
- QBI for sole proprietors = Schedule F or C net income
- QBI for partnerships or S-corps = owner’s share of ordinary income plus ordinary gains on business asset sales
- QBI is reduced by the SE tax and health insurance deductions and for sole proprietors (not partnerships or S-Corps)
- Deduction and limitations are applied at the individual level

Calculating the Farmer 199A QBI Deduction

- Special calculation done when farmer receives 199A from a coop
- Schedule F QBI is split into coop and non-coop amounts
- Coop QBI amount is reduced by lesser of:
  - 9% of the coop QBI or
  - 50% of W-2 wages allocated to coop QBI
- Done to avoid "double-dipping" of same QBI

Business Type Limitations for 199A

- The 199A QBI deduction is **not** allowed for businesses that perform services where the principal asset of such trade or business is the reputation or skill of one or more of its employees – except for architects and engineers.
- This limitation applies only if the individual has TI over thresholds
- Regular corporations are **not** eligible for the 199A QBI deduction
- Cooperatives are eligible for a 9% 199A QBI deduction
- Rental activities and Real Estate LLCs can be eligible if considered a self-rental and/or allowed to be **aggregated** or if it rises to the level of a trade or business

199A Aggregation Rules

- Aggregating businesses for the QBI deduction if have the following:
- Same persons own > 50% of each trade or business for most of year
- All businesses have the same tax year
- None of the businesses are a service business
- Business has 2 of the following factors
  - Products/services are the same and offered together
  - Share facilities or centralized business elements
  - Are operated in coordination with one or more of the aggregated businesses
- Minority owners can also utilize the 199A deduction
- Cannot aggregate with a C-Corporation

What Makes an Activity a Trade or Business?

- Good question!
- IRC not very definitive
- Case law is often used to determine
- Facts on a case-by-case basis
- Taxpayer time is reviewed for activity on a regular, continuous and substantial basis
- If Rental = Business = must issue 1099s

IRS Rental Safe Harbor Rules for 199A

- 250+ hours of rental service per year
- Document with contemporaneous records
  - Hours of all services including dates
  - Description of all services
  - Who performed the services
- Exclusions from the Safe Harbor
  - Triple net leases
  - Primary residence
  - Real estate aggregated with commonly controlled business
  - SSTB affiliation

Planning Considerations for 199A

- Review wages to S-Corp owners/spouses
- Review guaranteed payments to partners
- Prepare system to report attributes to owners
- Scrub depreciation schedules for asset limitation
- Better TI planning, level it out as much as possible
- Review investments/business structures/ ownership for 199A

THANK YOU!
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