Tax Reform and Partnerships: What CPAs Need to Know in 2019

WEDNESDAY, JANUARY 23, 2019, 1:00-2:50 pm Eastern

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Tax Reform and Partnerships

JANUARY 23, 2019

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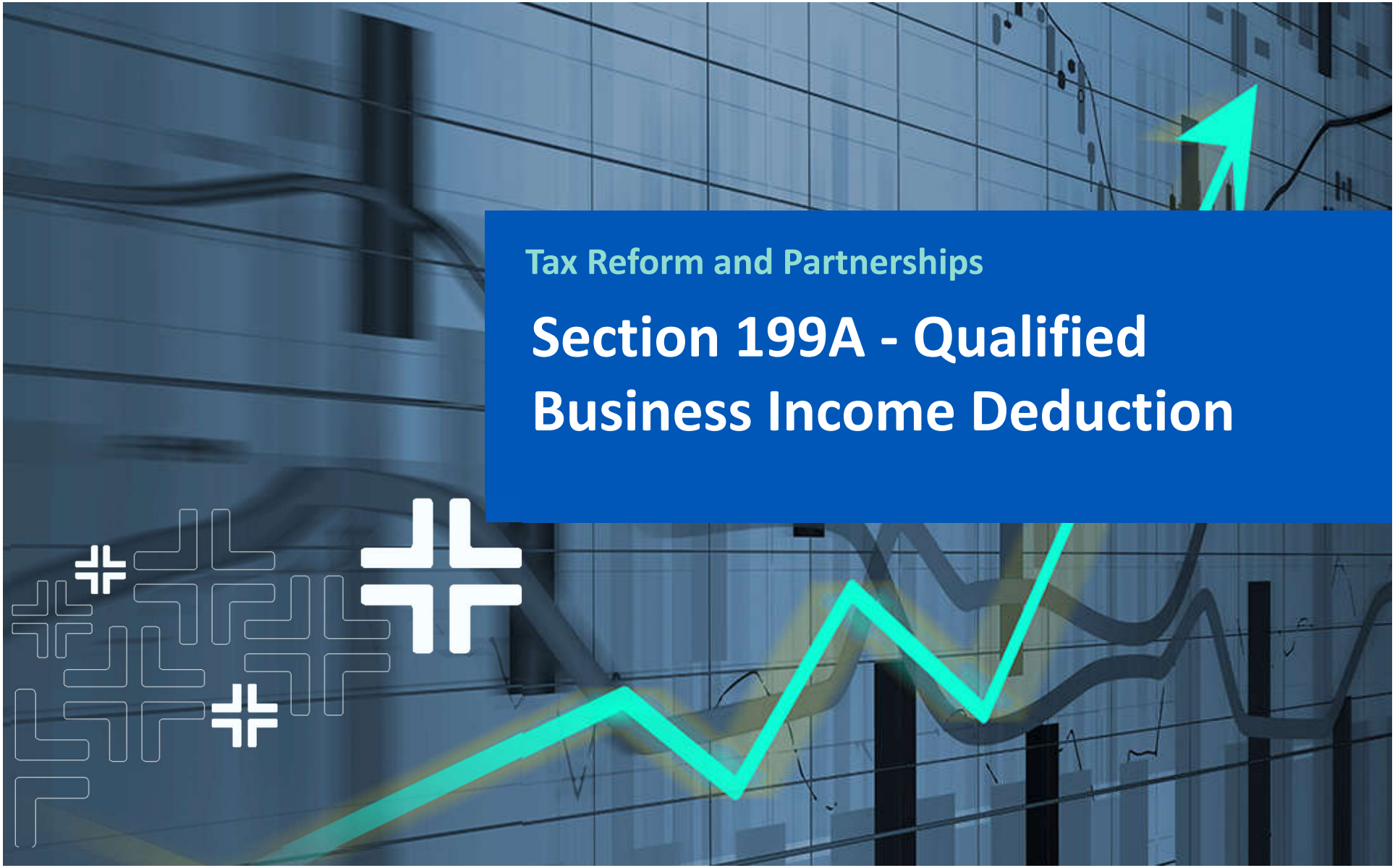


Tax Reform and Partnerships

Section 199A - Qualified Business Income Deduction

SERVICE. VALUE. RESULTS.

withum
ADVISORY TAX AUDIT

Agenda

- Determining Trade or Businesses
- SSTB Determinations
- Aggregation
- Computation of Deduction
- Wages
- UBIA
- Reporting

History of QBI

- TCJA signed into law December 22, 2017
- August 16, 2018 the IRS issued proposed regulations on Section 199A
- January 18, 2019 the IRS issued final regulations on Section 199A
- January 28, 2019 the IRS opens tax season

Definitions

- SSTB – Specified Service Trade or Business
- RPE – Relevant Passthrough Entity
- QBI – Qualified Business Income
- UBIA – Unadjusted Basis Immediately after Acquisition
- T or B – Trade or Business

Qualified Businesses

- §199A(d) – A qualified business is any trade or business other than:
  - A specified service business, or
  - The trade or business of performing services as an employee
- Let's look at the 2nd bullet point first

Trade or Business of Being an Employee

- Trade or business of performing services as an employee:
  - Doesn't matter if the employer treats a service provider as an independent contractor, if the IRS determines that the service provider is an employee using established factors, no §199A deduction is available.
  - Solely for purposes of §199A: if an individual who was an employee is subsequently treated as an independent contractor, but continues to render substantially the same services to the former employer, the individual is presumed to still be an employee; thus, no §199A deduction.
  - This presumption may be rebutted by showing that under federal tax law, regulations, and principles, the individual is no longer an employee.

Trade or Business of Being an Employee

Ex. A is employed by PRS, a partnership, as a full-time employee and is treated as such for federal employment tax purposes. A quits his job for PRS and enters into a contract with PRS under which A provides substantially the same services that A previously provided.

- Because A continues to provide the same services to PRS, the presumption is that solely for the purposes of §199A, A is presumed to still be an employee.
- This presumption would exist even if A forms an S corporation to provide the services to PRS.
- A can rebut the presumption.

Trade or Business of Being an Employee

Ex. E is an engineer at an engineering firm, a partnership. After 10 years, E is promoted to partner, and begins to receive a Schedule K-1 from the partnership instead of a W-2.

- Because E provides the same services he did as an employee, the presumption is that E is still an employee, and thus his distributive share of income on Schedule K-1 is not QBI.
- E may rebut the presumption, however, by showing that he converted from employee to partner by virtue of firm policy and a career milestone.

Section 162 Trade or Business

- Not defined in Code and regulations
- A taxpayer must be involved in the activity "with continuity and regularity" (and not "merely sporadically"); and the taxpayer's primary purpose for engaging in the activity must be for income or profit.
- Factual determination

Trade or Business Requirement

- Extensive comments received regarding tests to determine trade or business
  - Declined to adopt suggestions for use of §469 or §1411.
  - You know it when you see it
- Rental Real Estate as a Trade or Business
  - This is an area they did expand upon

Problems for Rentals

- Rentals of a single property may not be a T or B
  - What about a triple net lease?
- Common scenario:
  - Taxpayer owns several properties but each is in its own LLC
  - Regulations do no provide for aggregation when determining the status of an activity

Rental Real Estate as a Trade or Business

- Commenters suggested safe harbors, tests or factors to help make determination.
- Revenue Procedures 2019-7 provide a safe harbor
  - Separate books and records for each rental activity or enterprise
  - 250 hours or more of “rental services”, and
  - Maintain contemporaneous records

Rental Real Estate as a Trade or Business

- Safe harbor does not allow for
  - Residence that taxpayer uses as a personal residence more than 14 days during the year.
  - Any property rented on a triple net basis.
- Taxpayer or RPE applying safe harbor must attach a statement to the return that claims 199A or pass through 199A info that Sec 3.03 of revenue procedure has been satisfied.

Rental Real Estate as a Trade or Business

- If your rental is a trade or business, make sure to file 1099's.
- If your rental is a trade or business, your mortgage interest is business interest expense now subject to the new interest limitation rules of §163(j).

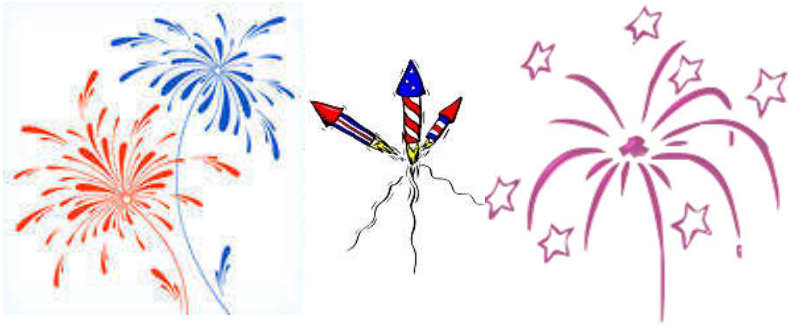
Rental Real Estate - Example

Ex: A owns 20 large commercial properties through 20 separate limited liability companies. A also owns a management company that oversees all 20 properties, and he works full time seeking tenants, negotiating leases, and handling the various needs of the buildings' occupants. Each building, however, is rented to tenants on a triple net basis. The buildings generate $5 million in net rental income annually, and A spends over 2,000 hours each year managing his combined rental business.

Self-Rental

- Rental of tangible or intangible property is automatically treated as a T or B if the property is rented to a commonly controlled business
- Important for self-rentals on a triple net lease basis
- Watch out for 80% rule discussed later

Congratulations



- Now that your client's activity has successfully risen to the level of a §162 T or B, what's next?
- Determine whether the activity is a specified service trade or business (SSTB)

Specified Service Trade or Business

- An SSTB is: *"Any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees or owners."*

- Also includes investing and investing management, trading, or dealing in securities, partnership interests, or commodities.

- If the business owner's taxable income exceeds the threshold plus the phase-in range ($415,000 for married taxpayers, $207,500 for everyone else), no deduction is available against income from an SSTB.

Specified Service Trade or Business

- The determination of whether a business is an SSTB is made at the business level. Reg. §1.199A-6(b)(3): an RPE must separately identify and report on the Schedule K-1 issued to its owners whether any business engaged in directly by the RPE is an SSTB.

- This is very important. Consider the following example:

A is a CPA. A works for an engineering firm S corporation, but performs all accounting functions, which IS an SSTB. The determination of the nature of the business is done at the S corporation level. Because engineering is not an SSTB, on the K-1 the S corporation provides A, it will not designate the business as an SSTB. Thus, A should not be prohibited from claiming the §199A deduction.

Field of Health

- Proposed regulations disqualified:
  - Doctors, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologist, and other similar healthcare professionals who provide medical services "directly to a patient."
- Not disqualified:
  - Health clubs, health spas, personal trainers, Pilates instructors, etc., or research, testing and manufacturing and/or sales of pharmaceuticals and medical devices.
- Clarified by the final regulations:
  - Those who are skilled medical professionals but who might not treat patients directly: radiologist? ANSWER: "directly to a patient" language has been removed from the final regulations. Radiologists and technicians are now included as disqualified medical professionals.
  - If taxpayer meets the right facts, an assisted living facility and a surgery center may not be considered in the field of health.

Field of Law

- Disqualified:
  - Lawyers, paralegals, legal arbitrators, mediators, judges, anyone with skills unique to the field of law.
- Not disqualified:
  - Stenographers, printers.
- Unanswered questions:
  - Stanley case: Lawyer owns 5% of a property management LLC, does mostly property management, but also acts as in-house counsel. Shouldn't be in field of law. Should be in field of property management.

Field of Accounting

- Disqualified:
  - Accountants, enrolled agents, return preparers, financial auditors, bookkeepers.
- Not disqualified:
  - We’re all doomed.

Field of Performing Arts

- Disqualified:
  - Those who “create” art, like actors, singers, musicians, entertainers, directors, writers
- Not disqualified:
  - Those who broadcast or otherwise disseminate video or audio of performing arts to the public. Unanswered questions:
  - Famous DJ that only plays other peoples’ music?
  - Authors? Seems OK to me.
  - Stunt men? Body doubles?

Field of Consulting

- Disqualified:
  - Those who provide professional advice and counsel to clients to assist the client in achieving goals and solving problems. Includes lobbyists.
- Not disqualified:
  - Does not include consulting that is embedded into the sale of goods or services that is not separately billed for.

Field of Consulting

Ex. C is in the business of providing services that assist unrelated entities in making their personnel structures more efficient. C studies its client's organization and structure and compares it to peers in its industry. C then makes recommendations and provides advice to its client regarding possible changes in the client's personnel structure, including the use of temporary workers. C is engaged in the performance of services in an SSTB in the field of consulting.

Ex. D is in the business of licensing software to customers. D discusses and evaluates the customer's software needs with the customer. The taxpayer advises the customer on the particular software product it licenses. D is paid a flat price for the software license. After the software is sold, D helps to implement the software for no extra fee. D is engaged in the trade or business of licensing software; not consulting. This is not an SSTB.

Field of Athletics

- Disqualified:
  - Athletes, coaches, team managers.
- Not disqualified:
  - Maintenance and operation of equipment or facilities used for athletic events.
  - Broadcasting or disseminating video or audio of a sporting event.
- Unanswered questions:
  - Why is the owner of a sports team barred? The team is not in the business of participating in sporting events; the athletes are. The team merely showcases the athletes. FINAL REGS – operation of an athletic team is an SSTB

Field of Financial Services and Investment Management

- Disqualified:
  - Financial advisors, investment bankers, wealth planners, retirement advisors, arranging lending transactions
- Not disqualified:
  - Taking deposits and making loans, banks
- Disqualified:
  - Receipt of fees for providing investing, asset management, or investment management services, including providing advice with respect to buying and selling investments.
- Not disqualified:
  - Property management, insurance

Field of Brokerage Services

- Disqualified:
  - A person who arranges transactions between a buyer and seller with respect to securities as defined in §475 for a commission or fee.
- Not disqualified:
  - Real estate brokers, insurance agents or brokers.
- Unanswered questions:
  - Sounds like other brokers (business, etc.) are OK.

The Catch-All

- An SSTB includes: *"Any trade or business where the principal assets of such trade or business is the reputation or skill of one or more of its employees or owners."*
- This was very concerning prior to the proposed regulations.
- The regulations, however, interpret this VERY narrowly.

The Catch-All

- A business will only be a "*trade or business where the principal assets of such trade or business is the reputation or skill of one or more of its employees or owners*" if:
  - A person receives fees, compensation, or other income for endorsing products or services,
  - A person licenses or receives fees, compensation or other income for the use of an individual's image, likeness, name, signature, voice, trademark, or other symbols associated with the individual's identity, or
  - A person receives fees, compensation, or other income for appearing at an event on radio, television, or another media format.

The Catch-All

Ex. H is a well known chef and the sole owner of many restaurants. H is so well known, H receives $500,000 in endorsement income for the use of his name on a line of cookware.

- Regulations: The business of endorsements is an SSTB. The restaurants, however, are not an SSTB, even though the chef is extremely skilled and famous. This is great news.

- But query: What if the endorsement income is collected by an entity that owns one of the restaurants? Is the endorsement treated as a separate business, so that only it is treated as SSTB income, and the income from the restaurant is preserved as non-SSTB income? Can we use the de minimis rule (discussed shortly) to make the endorsement income non-SSTB income?

De Minimis Rule

- A business will not be an SSTB if:
  - Gross receipts are less than $25M for the year,
  - Less than 10% of the gross receipts are attributable to the performance of services in one of the disqualified fields.

Ex. S Co., an S corporation, earns $20M in 2018 from the sales of computer software. It also earns $2M from separately-billed consulting revenue from helping the clients implement the software. While the consulting work is an SSTB (it was separately charged for), because the revenue from the work is less than 10% of the total revenue, it is ignored and none of the business is from an SSTB.

De Minimis Rule

- A business will not be an SSTB if:
  - Gross receipts are greater than $25M for the year,
  - Less than 5% of the gross receipts are attributable to the performance of services in one of the disqualified fields.

Ex. S Co., an S corporation, earns $50M in 2018 from the sales of computer software. It also earns $2M from separately-billed consulting revenue from helping the clients implement the software. While the consulting work is an SSTB, because the revenue from the work is less than 5% of the total revenue, it is ignored and none of the business is from an SSTB.

Cliff Rule

- Final regulations confirm this to be a cliff rule.
  - If a business has more than a de minimis amount of SSTB revenue, the ENTIRE business become treated as an SSTB
  - A single tax entity may have two trades or businesses for purposes of 199A. This determination should be made based upon all the facts and circumstances of each taxpayer
  - A taxpayer can split the two activities into two tax entities but the SSTB activity cannot be aggregated
    - Additionally, the non-SSTB activity may be partially considered an SSTB if there is common ownership. We will discuss next.

Commonly Controlled Businesses

- Proposed regulations provided that an SSTB includes any business that provides 80% or more of its services or property to a commonly controlled business. FINAL REGS – remove this 80% requirement
- Common control: the same owners own 50% or more of both businesses, using the relationship rules of Sections 267(b) and 707(b) to determine indirect ownership.
- This kills off the "cracking" idea.

Ex. LLC provides legal services. To maximize §199A benefits, the owners form P2 to own the office building that will be rented entirely to LLC, and P3, which will provide administrative services to LLC. Because P2 rents all of its property to LLC, and because P3 provides all of its services to LLC, and because LLC, P2 and P3 are commonly controlled, ALL THREE BUSINESSES ARE TREATED AS SSTBs.

Commonly Controlled Businesses

- If a business provides any of its services or property to a commonly controlled business, only the income from that property or those services is treated as SSTB income.

Ex. A, a dentist, owns a dental practice and also an office building. The building is rented 50% to the dental practice and 50% to unrelated parties. Because the businesses are commonly controlled, A must treat 50% of the rental income as earned in an SSTB. The 50% earned from the unrelated party is not SSTB income.

Commonly Controlled Businesses

- Query: what if the property or services are rendered to a commonly controlled C corporation that is an SSTB? Is the income treated as SSTB income? The regulations say the property or services have to be provided to an SSTB, but can a C corporation be an SSTB?

- §199A(d)(2) would certainly indicate that a C corporation can be an SSTB. As a result, I would argue that the rental of property/provision of services to a commonly controlled SSTB C corporation will be treated as having been earned in an SSTB.

Aggregation

- Final Regulations give us an elective aggregation regime, when:
  - Each business considered arises to the level of a §162 trade or business.
  - The same persons or group of persons, directly or indirectly, own 50% or more of each business to be aggregated. Look to attribution rules under §267 and §707.
  - The control test is met for the majority of the year – which includes the LAST day of the tax year.

Aggregation

- The businesses share the same tax year.
- None of the businesses are SSTBs.
- The businesses to be aggregated must satisfy two of the three following factors:
  - Provide products, services, or property that are the same or customarily offered together;
  - Share facilities or significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, HR, or information technology resources; or
  - Are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group.

Aggregation – Important Notes

- The electing owner does not have to own more than 50% of each business directly, they must simply establish that someone owns 50% or more of all of the entities they wish to aggregate.
- This is not an all or nothing election. You can pick and choose which to aggregate.
- You may now aggregate at the pass-through entity level.
- If you miss aggregation in the first year, you can aggregate for the first time in a future year.
- For 2018 only you can elect to aggregate on an amended return.

Benefits of aggregation

- Ex. *F, a single taxpayer, owns 100% of X, Y, and Z. None have UBIA, but each have QBI and wages as follows:*
  - *Business X - $1,000,000 in QBI and $500,000 in wages*
  - *Business Y - $1,000,000 in QBI and no wages*
  - *Business Z - $2,000 in QBI and $350,000 in wages*
- *F's taxable income for the tax year after removing any capital gain is $2,850,000*

Aggregation Example

	Business X	Business Y	Business Z
QBI	$ 1,000,000	$ 1,000,000	$ 2,000
W-2 Wages	$ 500,000	$ -	$ 350,000
UBIA	$ -	$ -	$ -
QBI Deduction			
Tentative deduction	$ 200,000	$ 200,000	$ 400
50% of W-2 Wages	$ 250,000	$ -	$ 175,000
QBI Deduction	$ 200,000	$ -	$ 400

Taxable income	$ 2,850,000
Maximum QBI Deduction	$ 570,000
Actual QBI Deduction	**$ 200,400**

Aggregation Example

	Business X	Business Y	Business Z	Total
QBI	$ 1,000,000	$ 1,000,000	$ 2,000	$ 2,002,000
W-2 Wages	$ 500,000	$ -	$ 350,000	$ 850,000
UBIA	$ -	$ -	$ -	$ -
QBI Deduction				
Tentative deduction				$ 400,400
50% of W-2 Wages				$ 425,000
QBI Deduction	$ -	$ -	$ -	$ 400,400
Taxable income	$ 2,850,000			
Maximum QBI Deduction	$ 570,000			
Actual QBI Deduction	**$ 400,400**			

But be careful!!

- Ex. F, a single taxpayer, owns 100% of X and Y.
  - Business X – QBI of $1,000,000 and $500,000 in wages
  - Business Y – QBI of $1,000,000 and $4,500,000 of UBIA
- Taxable income after removing any capital gain is $2,200,000

Aggregation Example

	Business X	Business Y	Total
QBI	$ 1,000,000	$ 1,000,000	$ 2,000,000
W-2 Wages	$ 500,000	$ -	$ 500,000
UBIA	$ -	$ 4,500,000	$ 4,500,000
QBI Deduction			
Tentative deduction			$ 400,000
Greater of:			
- 50% of W-2 Wages			$ 250,000
- 25% wages/ 2.5% UBIA			$ 237,500
QBI Deduction	$ -	$ -	$ 250,000
Taxable income	$ 2,200,000		
Maximum QBI Deduction	$ 440,000		
Actual QBI Deduction	**$ 250,000**		

Aggregation Example

	Business X	Business Y
QBI	$ 1,000,000	$ 1,000,000
W-2 Wages	$ 500,000	$ -
UBIA	$ -	$ 4,500,000
QBI Deduction		
Tentative deduction	$ 200,000	$ 200,000
Greater of:		
- 50% of W-2 Wages	$ 250,000	$ -
- 25% wages/2.5% UBIA	$ 125,000	$ 112,500
QBI Deduction	$ 200,000	$ 112,500
Taxable income	$ 2,200,000	
Maximum QBI Deduction	$ 440,000	
Actual QBI Deduction	**$ 312,500**	

Netting of QBI Income and Losses

- If the net of all QBI for the year is a loss it carries forward. However, the W-2 or UBIA from that year does not.
- If the net of all QBI for the year is positive but at least one business produces a loss, the loss must be allocated among all businesses that produce QBI in proportion to their respective amounts.
  - Only after this allocation does the taxpayer apply the W-2 and basis limitation.
  - No part of the W-2 or basis of property attributable to the loss are taken into account by the income-producing businesses.

Netting of QBI Income and Losses

- If the taxpayer aggregated the qualifying businesses:
  - QBI income and loss, W-2 wages and UBIA are all combined.

Netting of QBI income and loss

- Assume Taxpayer is the sole shareholder of X, Y and Z, all of which are taxed as S corporations. X has net ordinary income of $250,000, $200,000 in wages paid to employees and $50,000 in UBIA. Y has $250,000 in net ordinary income, $350,000 of wages paid to employees and $50,000 of UBIA. Z has $120,000 in net ordinary loss, $120,000 in wages paid and $50,000 of UBIA. Taxypayer has taxable income of $425,000, or which $15,000 is net capital gain income. How do we calculate QBI deduction assuming no aggregation?

Netting of QBI income and loss

	S Corp X	S Corp Y	S Corp Z
Ordinary income	$250,000	$250,000	$(120,000)
Allocation of current losses	$(60,000)	$(60,000)	$120,000
Qualified Business Income	$190,000	$190,000	$0
Tentative Deduction (20%)	$38,000	$38,000	$0
Wages paid	$200,000	$350,000	$120,000
UBIA	$50,000	$50,000	$50,000
50% of wages limitation	$100,000	$175,000	$60,000
25% wages/2.5% UBIA	$51,250	$88,750	$31,250
Deduction after limitation	$38,000	$38,000	$0

Netting of QBI income and loss

- Both X and Y would provide for $38,000 in QBI deduction, totaling $76,000. The final limitation is 20% of taxable income less net capital gains ($425,000 - $15,000 = $410,000 x 20% = $82,000). As a result, QBI deduction is $76,000.

W-2 Wage Limitation

- IRS issued additional guidance in Rev. Proc. 2019-11 on computation of wages.
- Final regulations allow for allocation of W-2 wages paid by another party on behalf of common-law employees.
  - If this is done, the business who paid the wages must reduce their W-2 wages for purposes of 199A by that amount.

UBIA of Qualified Property

- §1031 exchange, §1033 involuntary conversion and §168(i)(7) carryover exchange:
  - The transferee taxpayer takes a UBIA equal to the transferor's UBIA. This is a change from the proposed regulations.

Ex: A acquired machinery in 2016 for $10,000 for use in their sole proprietorship. As of 12/31/18 the adjusted basis is $4,000. On 1/1/19 A contributes the property to an S corp in a §351 transfer in exchange for stock in the S corp. Under proposed regulations, on S Co.'s 2019 tax return the UBIA of the machinery would have been only $4,000. Under the final regulations the corporation gets to take a UBIA equal to A's UBIA of the property, or $10,000.

Note – S Co. will have one basis for tax purposes - $4,000 and another basis for UBIA purposes - $10,000.

UBIA of Qualified Property

- Final regulations provide that we can include a §743 step-up pursuant to a §754 election in our UBIA of property
  - This is included only to the extent the step-up exceeds what it would have been if it were made in relation to the original UBIA, rather than tax basis of the property.
- UBIA allocation
  - Partnerships – the manner in which the book depreciation is allocated
  - S corporations – per-share/per-day pro-rata allocation

UBIA §743 Adjustment Example

Ex: A, B and C put in $300,000 each to a parntership and the partnership buys a building with a UBIA of $900,000. When the building is worth $1,200,000 and the adjusted basis of the property is $600,000, A sells his interest to D for $400,000. D has a $200,000 §743 adjustment ($400,000 sales price less A's $200,000 share of basis). This $200,000 adjustment DOES increase D's UBIA of property but only to the extent that the step-up exceeds the adjustment that would have occurred if the purchase price ($400,000) were compared to A's original UBIA of the property ($300,000), or $100,000. Thus, the UBIA to D related to the step-up is only $100,000.

Miscellaneous Items

- §199A deduction does not reduce:
  - Partners or shareholders basis.
  - Net earnings from self-employment or net investment income tax.
- §199A deduction is allowed for AMT purposes.
- §199A deduction related accuracy penalties:
  - Any understatement that exceeds greater than 5% of tax or $5,000.

Disclosures

- An RPE is required to identify on the K-1 to its owners a determination of whether it is an SSTB or not
- The RPE must also report on an attachment any SSTB determination reported to it by any RPEs in which it has a direct or indirect ownership

Disclosures

- Pass-through entities are required to allocate and disclose QBI, W-2 wages and UBIA of property.
  - No exception provided for pass-through entities that know their taxpayers are below thresholds.
  - If any the allocation of any one item is not disclosed, that item is presumed to be zero.
  - If there are multiple trades or businesses, allocations of QBI, wages and UBIA must be done for each AND must each indicate whether or not they are an SSTB.

BUSINESS INTEREST

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BUSINESS INTEREST

- Properly allocable T/B
- Not investment interest
- Investment interest D/N/A to corporations
- Many limitations remain
  - Ex personal interest
  - 750,000 Limit pers. Residence
  - Tracing rules remain
- Prior earnings stripping removed
  - Pay related person without tax effect

30% ADJUSTED TAXABLE INCOME

- Plus interest income
- Limitation D/N/A to floor plan financing
- Negative income – deemed T/B zero
- Prior to interest Exp. or NOL
- 199A Deduction not considered
- Before 1/1/2022 – Depreciation, Amortization & Depletion

EXAMPLE:
BUSINESS INTERST $15,000

- Corporation $10,000 ATI
- Business Interest Income $2,000
- Limit = $5,000
- Disallowed Interest $10,000
- Carry Forward **Indefinitely**

ASSUME ATI ($50,000)

- Deemed to be zero
- Can deduct $2,000 interest
- $13,000 carried forward

SMALL BUSINESS EXCEPTION

- Limitation D/N/A
- $25 Million Threshold
- 3 year average
- Ending prior tax year
- Sole Proprietorship – Compute as Corp.
- D/N/A to tax shelters
- Don’t count employee wages

OTHER EXCEPTIONS

- Electing real property T/B
- Electing Farming Business
- Regulated public utilities

ELECTING REAL PROPERTY T/B

- Described in §469(c)(7)(c)
- Makes Election – Irrevocable
- Must use ADS
- Applies to R/P T/B

REAL PROPERTY TRADES OR BUSINESSES

- Development, Redevelopment, Construction, & Reconstruction
- Acquisition & Conversion
- Rental & Leasing
- Operation & Management
- Brokerage
  - TCJA - Management & Lodging

ALTERNATIVE DEPRECIATION SYSTEM

1. Straight line method (no salvage)
2. Recovery Period
   - Resident Rental – 30 years
   - Non Residential Real Property – 40 years
3. Apply separately to each Rental/Real Property

PARTNERSHIP/S CORP.

- Special Rules Limit
- Prevents Double Counting

PARTNERS

- Can only use excess available pass through income.

PARTNERSHIP

- Excess business interest
- Allocated to each partner
- In same manner as P’ship non-separately stated income

PARTNERSHIP

- Excess business interest
- Treated as paid by Partner
- In next tax year
- Only to extent of excess taxable income
- Carry forward rule D/N/A to S Sh.

PARTNER

- May deduct its share
- Excess Business interest
- In future year
- Limited to excess taxable income
  - Of P'ship attributed to Partner
- Deduction reduces excess taxable income

FURTHER LIMIT

- P’ship excess TI allocated
- Must apply to P’ship business interest
- Before used to deduct other Busi. Int.

BASIS REDUCTION

- For excess Busi. Int. allocated
- Even though not yet used
- Use in future year
  - D/N reduce Partner's Basis
- If sell – increase basis – unused interest
  - But not if loss

CORPORATE INTEREST CARRYOVER

- To prevent in §332 liquidation
- §381 – carryover items
- But §382 limitations

EXAMPLE P'SHIP XYZ

- TI $200,000
- Business Interest Income $4,000
- Business Interest Expense $15,000
- XYZ can deduct $15,000
  - Limit 30% 200,000 + $4,000

EXAMPLE P'SHIP ABC

- TI $200,000
- Int. Income $4,000
- Busi. Int. Exp $75,000
- Limit 30% 200,000 + 4,000= $64,000
- Excess $11,000 – To PTR. Future Years
- But decrease basis for full $75,000

YEAR 1 EXAMPLE

YEAR 1	XYZ	ABC
TI before Int.	100	50
Interest Exp.	65	-
K-1 Income	70	50

YEAR 2 EXAMPLE

YEAR 2	XYZ	ABC	T
Excess Int.	**-**	**-**	**35**
TI before Int.	**100**	**50**	**-**
Interest	**25**	**0**	**-**
K-1	**75**	**50**	**-**

- Excess Income **5**
- T's use limited **5**
- No ABC Income Available

- **T'S BASIS REDUCED BY 35**

- **NO DOUBLE COUNTING XYZ K-1 INCOME**

LOSSES

- **Excess Business Losses**
- **Net Operating Losses**

LOSSES

- Sec. 199A Carryover Losses
- Excess Business Losses
- Net Operating Losses

STILL HERE

- Basis Rules
- At-Risk Rules
- Passive Activity Loss Rules

SECTION 199A LOSS

- Net Losses from QT/B
- Loss from QT/B in Succeeding Year
- Reduces Future QBI Deduction
- May still use loss to offset income

SEC. 199A LOSS EXAMPLE

- Year 1
- QB1: QBI = $20,000
- QB2: Net Losses = $50,000
- No QBI deduction in Year 1
- Future QBI Deduction reduced

SEC. 199A LOSS EXAMPLE

- Year 2
- QB1: QBI = $20,000
- QB2: QBI = $50,000
- Year 2 Deduction: ($70k – $30K) * 20%
- $8,000

EXCESS BUSINESS LOSSES

- New Sec. 461(l)
- Non-Corporate Taxpayer
- Cannot deduct Excess Business Losses

EXCESS BUSINESS LOSSES

- Excess of
- T/B Deductions over
- T/B Income/Gain ***PLUS***
- Single = $250,000
- Married – Joint = $500,000

EXAMPLE

- Married TP: T/B Deductions = $500,000
- T/B Gross Income = $200,000
- No Excess Business Loss
- Deductions < Gross Income + $500,000
- TP uses entire loss

EXAMPLE - MARRIED

- T/B Deductions = $800,000
- T/B Income = $200,000
- $800,000 – ($200,000 + $500,000)
- Excess Business Loss = $100,000
- Carried to Next Year
- EBL becomes NOL

PARTNERSHIPS & S CORPS

- EBL applied to partner/shareholder
- Example:
- Year 1: A (single) and B (married)
- Form Partnership with $500,000 each
- Net Loss: $700,000
- A & B Materially Participate
- Sec. 469 applies first

PARTNERSHIPS & S CORPS

- A's EBL: $350,000 - $250,000 = $100,000
- $100,000 becomes NOL next year
- B has no EBL
- $350,000 < $500,000

NET OPERATING LOSSES

- Excess Deductions over Gross Income
- **Prior Law**:
- No Limitation
- Required to carryback 2 years
- Required to carryforward 20 years

NET OPERATING LOSSES

- New Law
- Limited to 80% of Taxable Income
- Taxable Income Determined w/o NOL
- Cannot Carryback
- Carryforward indefinitely

LOSS EXAMPLE

- Interplay b/w 199A, EBLs, & NOLs
- 2017
- Married Taxpayer
- NOL = $3m

- TI before NOL = QBI
- **QBI** = $2 Million
- $3m NOL Carryover from 2017
- **Taxable Income** = 0
  - NOL ***not limited*** to 80%
- No 199A Deduction
- NOL Carryover = $1m (2017)

EXAMPLE – YEAR 2019

- **2019**
- QBI = - ($1m)
- No 199A Deduction & 199A Carryover
- Excess Business Loss = $500,000
- $1m added to NOL (80% limit applies)
- Total NOL = $2m

TCJA EFFECTIVE DATE

- TCJA §13302(e)
- Amendments made by Subsection (a)
- Shall apply to losses
- Arising in taxable years
- Beginning **after Dec. 31, 2017**

EXAMPLE YEAR 2020 - $2m QBI

- **QBI**: $2m - $1m Carryover
- **Taxable Income = $400k? $200k?**
- GI – 2017 NOL – 2019 NOL Limit
  - 2019 Limit: 80% of TI = **$600k? $800k?**
- $2m – $1m – (TI * 80%) = $400? $200k?
- **199A Deduction** = $80k? $40k?
- **NOL** = $400k? $200k?

2019 Example XYZ Restaurants

- T Owns 70% A 30%
- A Executive Chef; Central Ordering
- T married TI = $520,000
- Negative QBI carryforward $150,000
- Not NOL

SECTION 199A LOSS

- Net Losses from QT/B
- Loss from QT/B in Succeeding Year
- Reduces Future QBI Deduction
- May still use loss to offset income

EXAMPLE CONTINUED

	X	Y	Z
• QBI	$200,000	$150,000	<$120,000>
• W-2	$100,000	0	500

- Loss Allocated:
- Carryover $150,000 + $120,000
- **Net Positive QBI $80,000**

Loss Allocated

- To X = 57.14% (200/350)
- To Y = 42.86%

	X	Y
QBI	$45,722	$34,278
W-2	$100,000	$0

199A Deduction

	X	Y
20% QBI	$9,144	$6,856
50% W-2	$50,000	0
199A	$9,144	0

20% TI higher - **119A = <u>$9,144</u>**

Aggregated XYZ

- 20% QBI $80,000 = $16,000
- 50% Wages $100,500 = $50,250
- 199A Deduction = $16,000