ROUNDUP OF RECENT TAX DEVELOPMENTS

William E. Sigler, Esq.

Agenda

- Tax Cuts and Jobs Act Developments
- Planning Issues
- Other Developments

TCJA Developments

- IRS
- Treasury
- Congress
- Michigan

IRS

- Notice 2018-64 contains a proposed a revenue procedure providing three allowable methods for calculating W-2 Wages for section 199A purposes
- Rev. Proc. 2018-44 modifies the automatic changes list in Rev. Proc. 2018-31 for accounting methods to reflect the new rules on adjustments that are attributable to revocations of S corporation elections under TCJA

IRS

- Notice 2018-84 clarifies how the suspension of the personal exemption deduction applies for purposes of some rules under sections 36B and 6011 regarding the premium tax credit and under section 5000A regarding the individual shared responsibility provision

Department of Treasury

- Proposed regulations on bonus depreciation issued August 3, 2018
- Proposed regulations under Section 199A issued August 8, 2018
  - W-2 Wages
  - Unadjusted Basis Immediately after Acquisition
  - Qualified Business Income
  - Aggregation Rules

Department of Treasury

- Proposed regulations under Section 199A issued August 8, 2018 – con't.
  - Specified Service Trades or Businesses
  - Other Clarifications
  - Reporting Requirements
  - Anti-Abuse Provisions for Trusts

Department of Treasury

- Proposed regulations issued August 23, 2018, provide that taxpayers who make payments to charitable organizations must reduce their charitable contribution deduction by the amount of any state or local tax credit the taxpayer receives or expects to receive

Congress

- **The House of Representatives passed three new bills collectively referred to as Tax Reform 2.0 on September 28th**
  - Protecting Family and Small Business Tax Cuts Act of 2018 (H.R. 6760)
  - Family Savings Act of 2018 (H.R. 6757)
  - American Innovation Act of 2018 (H.R. 6756)

Congress

- **Protecting Family and Small Business Tax Cuts Act**
  - Permanently extend many of the TCJA provisions that would otherwise sunset after 2025
  - Includes:
    - revised income tax rates and thresholds
    - the elimination of personal exemptions
    - increased standard deductions and child tax credit

Congress

- Also includes:
  - increased alternative minimum tax exemption threshold
  - increased estate and gift tax exemption amounts
  - decreased cap on mortgage interest indebtedness subject to deductibility
  - the $10,000 cumulative cap on certain itemized deductions including state and local income and property taxes
  - the Section 199A deduction for qualified business income from pass-through entities

Congress

- **Family Savings Act**
  - Eliminate age limit on IRA contributions.
  - Create a Universal Savings Account (USA), to which individuals could contribute up to $2,500 annually. Withdrawals from the USA accounts would be tax-free. Tax-advantaged funds in the USA could be used for purposes other than retirement.
  - Expand Code Sec. 529 Plans to permit use for expenses related to trade schools, home schooling, and up to $10,000 in total distributions for repayment of student loans.

Congress

- **American Innovation Act**
  - Allow startups to deduct up to $20,000 of startup and organizational costs
  - new companies that experience changes in ownership would be eligible to claim certain tax breaks that were previously limited (e.g., pre-change net operating loss carryforwards, net operating losses, general business credit carryforwards, and general business credits)

Michigan

- **"PA 38" unlinks Michigan from some of the TCJA changes, e.g., personal exemptions would be:**

On and after January 1, 2014 and before January 1, 2018: $4,000
For the 2018 tax year: $4,050
For the 2019 tax year: $4,400
For the 2020 tax year: $4,750
For the 2021 tax year: $4,900

For the 2022 tax year and each tax year thereafter, the inflation-adjusted amount would be increased by an additional $600.

Michigan

- **Michigan Department of Treasury Update, 05/01/2018 – preliminary thinking**:
  - Foreign income deemed repatriated and taxed as dividend could be deducted in determining CIT tax base
  - Amount of GILTI included in federal taxable income, and deducted from CIT tax base, is net of the 50% GILTI deduction and the 37.5% FDII deduction provided under the IRC

Planning Issues

- Deduction for pass-through income
- Choice of entity
- Business clients
- Individual clients
- Estate planning

Deduction for Pass-through Income

- Lower wages and increase profits taxed at a rate 20 percent lower than salary?
- Increase wages owners pay to themselves to increase the wage limitation?
- Split a business into separate labor-intensive and capital-intensive trades or businesses?

Deduction for Pass-through Income

- Invest in depreciable capital?
- Spin off a non-specified business from a specified service business?
- Recharacterize the role of key employees or owners "where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners"?

Deduction for Pass-through Income

- Put independent contractors on the payroll to increase the wage limitation?
- Become an independent contractor because business income earned as an independent contractor can reduce taxable income by the QBI deduction?
- Convert a C corporation into a pass-through business?

Choice of Entity

- **C Corporation Advantages**
  - C corp income is taxed at a flat 21% rate whereas partnership income flowing through to an individual partner is subject to tax at a maximum 37% rate
  - C corps can fully deduct state and local taxes whereas an individual's deduction is limited to a maximum of $10,000

Choice of Entity

- **Pass-Through Advantages**
  - May be eligible for a 20% QBI deduction (29.6% effective tax rate)
  - 20% QBI deduction not allowed for most service businesses
    - Exception if taxable income less than $315,000 ($157,500 if not married filing jointly), with the benefit phased out once the partner's taxable income equals $415,000 ($207,500 if not married filing jointly)
    - Other limitations generally only allow QBI deduction if business employs many people or owns depreciable tangible property

Choice of Entity

- **Two levels of tax**
  - one at the corporate level on earnings and one at the shareholder level, for example, on dividends
  - Dividends taxed at the qualified dividend rate of 20%, but usually no preferential tax rate at the state and local level
  - Dividends also may be subject to the 3.8% net investment income tax
  - Effective federal double tax rate is 39.8%.

Maddin Hauser Roth & Heller, P.C. - maddinhauser.com
28400 Northwestern Hwy., Southfield, MI 48034 | p (248) 354-4030 | f (248) 354-1422

Choice of Entity

- **C corporation structure**
  - Disadvantageous if business distributes all of its profit out to its owners annually
  - Advantageous if owners only take salary and perks and profits are reinvested - - but, watch for:
    - Accumulated earnings tax
    - Personal holding company tax

Choice of Entity

- **Sale of company**
  - Asset sale result in two levels of tax
  - Owner may consider whether he or she can own goodwill, client lists or other intangible assets in his or her own name rather than in the corporation to avoid double tax

Choice of Entity

- **Step-up at Death**
  - If an owner dies owning C corp stock, the stock will receive a step-up in basis to its fair market value
  - Avoids shareholder level tax if the C corp liquidates
  - Does not avoid tax to the corporation on any appreciated assets that are distributed in liquidation or later sold by the C corp

Choice of Entity

- **Losses**
  - If a partnership has losses that flow through to its partners, those losses would not flow through if the entity becomes a C corp, so C corp status would be disadvantageous

Choice of Entity

- **Timing and Related Issues**
  - S corp that terminates its S status has a five year waiting period to convert back to S status
    - Built-in gain tax
    - Two-years to take out AAA (TCJA treats distributions within this period partly as AAA (tax-free) and partly treated as previous C corp E&P (taxable 23.8% dividend)
  - Business owners may be reluctant to convert to C corp status and then get "stuck" if the rates or rules change

Business Clients

- **Acquire assets**
  - Generous Section 179 deduction rules
  - Above and beyond the Section 179 deduction, business clients can also claim first-year bonus depreciation
- **Use minimum tax credit carryovers**
  - MTCs can offset regular tax for any tax year
  - Corporations may be refunded up to 50% of their MTCs until 1/1/2022
  - After 2021, any unused MTC is fully refundable

Business Clients

- Adopt cash method of accounting
- Determine eligibility for credit for employer-paid family and medical leave
- Watch out for new business interest expense limit
- Set up a Qualified Small Business Corporation (QSCB) to shelter 100% of the gain from a stock sale if a more-than-five-year holding period requirement can be met

Business Clients

- Subchapter C corporation could purchase another corporation, make a section 338(h)(10) election, and potentially be eligible for full expensing of all the qualified property of the acquired company under Section 168(k)

Individual Clients

- Take advantage of the new child tax credit
- Bunch charitable contributions through donor-advised funds
- Revisit qualified tuition plans
- Maximize the qualified business income deduction

Estate Planning

- Update formula clauses in trusts
- Convert life insurance intended to cover estate tax into fully paid-up insurance?
- Full charitable deduction available for distributions to charity from IRA after 70 ½ up to $100,000
- Draft charitable bequests to be paid out of income to get an estate or trust income tax deduction
- Engage in basis step-up planning (e.g., "SUGRIT"?)
- Beware the anti-abuse provisions for trusts

Other Developments

- Federal
- Michigan
- Employee Benefits
- Health Care
- Estate Planning
- M&A
- Real Estate

Federal Tax Developments

- New partnership audit rules effective for tax years after December 31, 2017
- Three sets of proposed regulations previously released
- Final regulations on electing out of centralized partnership audit regime published 1/2/2018

Federal Tax Developments – con't.

- **Offshore Voluntary Disclosure Program to end 9/28/2018**
- **Proposed regulations on the treatment of liabilities for disguised sale purposes withdrawn 6/18/2018**
  - Proposed rules on bottom-dollar guarantees (situations in which a partner guarantees a certain amount of outstanding debt to increase his or her basis in the partnership interest) are not withdrawn

Federal Tax Developments – con't.

- ***South Dakota v. Wayfair, Inc.*, U.S. S.Ct., Dkt. No. 17-494, 06/21/2018**
  - overturns physical presence standard espoused in *Quill* and *National Bellas Hess*
  - correct standard in determining the constitutionality of a state tax law is whether the tax applies to an activity that has "substantial nexus" with the taxing state

Federal Tax Developments – con't.

- **IRS announced (IR-2018-146) plans to streamline Form 1040**
  - Half page form, but must supplement with schedules
  - Replaces Forms 1040, 1040A, and 1040EZ
  - For the 2019 tax filing season

Maddin Hauser Roth & Heller, P.C. - maddinhauser.com
28400 Northwestern Hwy., Southfield, MI 48034 | p (248) 354-4030 | f (248) 354-1422

Michigan Tax Developments

- **Alternative Dispute Resolution**
  - Previously able to negotiate settlements only after appeal to the Michigan Tax Tribunal or Michigan Court of Claims
  - PA 215 creates a new, non-judicial dispute resolution process
  - Settlement standard: after taking into consideration the factual and legal issues involved and the risks of litigating the dispute, it is in the State's best interests to accept a lesser amount of tax than owed

Michigan Tax Developments

- 6/05/2018 STC memo removes requirement that personal residence remain unoccupied in order for person in nursing home or assisted living facility to claim PRE as long as they have intent to return
- *Breakey v. Dept. of Treasury* case found spouse entitled to PRE for residence owned by irrevocable trust granting her the ability to remain in the marital home rent-free in order to maintain her standard of living

Michigan Tax Developments

- Michigan Revenue Administrative Bulletin No. 2018-12, 05/23/2018, updates the control test and the two alternative relationship tests that determine whether two or more entities are a unitary business group under the corporate income tax
- L. 2018, H5620, effective 01/01/2019, allows a purchaser to apply for a sales tax refund from the Michigan Department of Treasury when the purchaser fails to claim a tax exemption at the time of purchase

Michigan Tax Developments

- On June 21, 2018, the U.S. Supreme Court in South Dakota v. Wayfair, Inc. overturned its previous decision in Quill Corp. v. North Dakota that required only a physical presence to require out-of-state retailers to collect sales tax
- RAB 2018-16, issued August 1, 2018, requires all applicable mail order and online retailers physically located outside of Michigan with sales exceeding $100,000 to, or more than 200 transactions with, Michigan purchasers in the previous calendar year to remit sales tax and file tax returns for taxable sales made after September 30, 2018

The End