199A Planning for Real Estate Investors and Professionals

Thursday, January 24, 2019

Free Webinar – Presented By:

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199A Updated

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What do the New 199A Regulations Say?

The New 199A Regulations were released today and Gassman, Crotty & Denicolo, P.A. have you covered. Join us for four special 30 minute complimentary presentations explaining the differences, implications, and new ways of thinking about this important topic.

Special 50 Minute Session for CPAs and Tax Advisors with CPE Credit*

Thursday, January 29, 2019 at 5:00 PM

To Register, Click HERE.

*CPE Credit Available within 30 Days

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We thank co-authors Martin M. Shenkman (Shenkman@shenkmanlaw.com) and Jonathan Blattmachr (Jblattmachr@hotmail.com) for their wisdom that make these webinars possible.

We wrote the book on 199A.
Please Contact us at 727-442-1200 with any questions

To register, click **HERE**.
(https://attendee.gotowebinar.com/register/ 8343072637662526721)

EVENT	DATE/TIME	LOCATION	DESC.	REGISTRATION
Maui Mastermind Scale and Grow Rich	January 25-27, 2019	Hilton Irvine-Orange County Airport	Preparing Your Company for Sale and Why	Please Click HERE.
American Bar Association Presentation	Tuesday, January 29, 2:00 PM – Join Alan for his presentation, *Lesser Known Traps and Strategies for the Well Versed Creditor Protection Planner, Including What You Really Must Know About Bankruptcy.*			Please Click HERE.
Dentists are Different Webinar	February 4, 2019	Gotowebinar	With Martin Shenkman	Please Click HERE.
Leimberg Services Webinar	January 30, 2019, 3:00 PM	Gotowebinar	With Martin Shenkman and Jonathan Blattmachr, "Planning Strategies Under the New Section 199A Final Regulations"	Please Click HERE.
Johns Hopkins All Children's Foundation 2019 Estate, Tax, Legal and Financial Planning Seminar **February 7, 2019**	**Resurgence of a Forgotten Problem for Family Limited Partnerships: Section 2036 (A)(2) and the *Powell* Case Panel Discussion with Paul Lee, Jerry Hesch, Jonathan Blattmachr and Moderater, Alan Gassman, Esq.** **Alan will be presenting a stand alone presentation, "Creative Planning with Section 199A After the New Regulations".**			Contact: Agassman@gassmanpa.com
Pinellas County Medical Association "What You Need to Know About" Webinar Series	February 12, 2019, 12:00 PM	Gotowebinar	Limiting Liability by Using Medical Practice Companies and Other Entities	Please Click HERE

Special Presentation Webinar	February 13, 12:00 PM – 1:00 PM	gotowebinar	Special presentation with Roger McEowen - QBID Final Regulations on Aggregation and Rents – The Meaning For Farm and Ranch Businesses	Email Agassman@gassmanpa.com
Pinellas County Medical Association "What You Need to Know About" Webinar Series	February 19, 2019, 12:00 PM	Gotowebinar	Employee Practices, Exposures and Insurances with Chuck Wasson.	Please Click HERE
University of Florida Tax Law Institute Conference	March 2, 2019,	University of Florida, Gainesville, FL	Professional Acceleration for Tax and Estate Planning Lawyer Workshop	Email Alan at Gassman@gassmanpa.com
New Jersey Bar Association Presentations	March 11, 2019, 9:00am and 1:00PM New Jersey Law Center, New Brunswick, NJ	**Alan will be speaking on two separate topics:** **What to Do for Clients Who No Longer Have to Worry About Federal Estate Tax with Deirdre Wheatley** **and** ***What New Jersey Lawyers Need to Know About Florida Law***		To Register click HERE
Special webinar presentation with Holly Kerr	March 5, 2019	**Insurance Coverage with Holly Kerr and Alan Gassman**		Email Alan at Gassman@gassmanpa.com
Special webinar presentation with John McDonald	March 6, 2019	**"Selling Your Business: Advanced Planning Considerations with Chris Denicolo and John McDonald"**		Email Alan at Gassman@gassmanpa.com

Pinellas County Medical Association "What You Need to Know About" Webinar Series	March 12, 2019, 12:00 PM	Gotowebinar	Anti-Kickback and Related Laws with Renee Kelly	Please Click HERE
9th Annual Pinellas County Medical Association Continuing Medical Education Cruise	March 14-18, 2019 	Port of Tampa	Biggest Mistakes Physicians Make in Medical Practice	FOR INFORMATION AND RESERVATIONS CONTACT JEN BOLL 727-526-1571 / 1-800-422-0711
Pinellas County Medical Association "What You Need to Know About" Webinar Series	April 9, 2019, 12:00 PM	Gotowebinar	Cornflakes and Estate Planning Mistakes with Mike Jensen	Please Click HERE
Florida Bar Association	April 18, 2019, 10:00 am – 2:00 PM	Stetson Tampa Law Center *Primary Florida and Federal Creditor Protection Laws, A Closer Look at Florida and Federal Creditor Exemption Laws and Planning* And *Putting it All Together with Leslie Share*		Contact: Agassman@gassmanpa.com
University of North Carolina Tax Institute	April 25-26, 2019	Creative Planning with Section 199A After the New Regulations		Contact: Agassman@gassmanpa.com
Maui Mastermind Financial Pillar Super Course	June 22-23, 2019	Hilton-Atlanta Airport	Crucial Legal and Tax Principals for Accumulating Wealth	Please Click HERE
45th Annual Notre Dame Tax Institute	October 26-27, 2019	South Bend, Indiana	TBD	Contact: Agassman@gassmanpa.com
Maui Mastermind Wealth Summit	November 3-8, 2019	Wailea Beach Resort, Maui	Essential Aspects and Decisions for Your Remarkable Financial Future	Please Click HERE

Deduction is Provided for Qualified Business Income

Qualified business income can only come from five places:

1. S corporation K-1 income (includes income from LLCs taxed as S corporations).

2. Partnership K-1 income (includes income from LLCs taxed as partnerships).

3. Trade or Business income reported on Schedule C of a taxpayer's Form 1040 (includes income from single member LLC that is disregarded for income tax purposes).

4. Net rental income reported on Schedule E of Form 1040.

5. Farm income reported on Schedule F of Form 1040.

Note - For most taxpayers, K-1 income is cash based, but pension deductions are commonly accrued - you have until December 31st to put new pension plans into place that may be funded next year for 199A and other planning.

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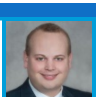
SECTION 199A - TWO MAIN RULES TO KNOW

			Situation	Result
1	Specified Service Trade or Business	A	Taxpayer's Taxable Income is under $315,000 for Taxpayers married filing jointly, or $157,500 for single filers	**No Limitation applies**
		B	Taxpayer's Taxable Income is between $315,000-$415,000 for Taxpayers married filing jointly or $157,500-$207,500 for single filers	Limitation is phased in by the amount Taxable Income exceeds threshold amount Example – MFJ Taxable Income of $365,000. Deduction is equal to 10% of QBI (50% ((365-315)/100) * 20% Deduction.
		C	Taxpayer's Taxable Income Exceeds $415,000 for Taxpayers married filing jointly or $207,500 for single filers	<u>**No Deduction**</u>
2	Wage and Qualified Property Test	A	Taxpayer's Taxable Income is under $315,000 for Taxpayers married filing jointly, or $157,500 for single filers	**No Limitation applies**
		B	Taxpayer's Taxable Income is between $315,000-$415,000 for Taxpayers married filing jointly or $157,500-$207,500 for single filers	Limitation is phased in by the amount Taxable Income exceeds threshold amount
		C	Taxpayer's Taxable Income Exceeds $415,000 for Taxpayers married filing jointly or $207,500 for single filers	Limitation applies unless 50% of Wages or 25% of Wages plus 2.5% of Qualified Property are met at the entity level





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ITEMS RELATING TO:
INDIVIDUAL TAXPAYERS
QUALIFIED BUSINESS INCOME (SECTION 199A)

Filing Status	Tax Year 2019	Tax Year 2018
Single	$160,700	$157,500
Married Jointly	$321,400	$315,000
Head of Household	$160,700	$157,500

Phase-out

Married Filing Jointly - $321,400 – $421,400

Single/Head of Household - $160,700 – $210,700



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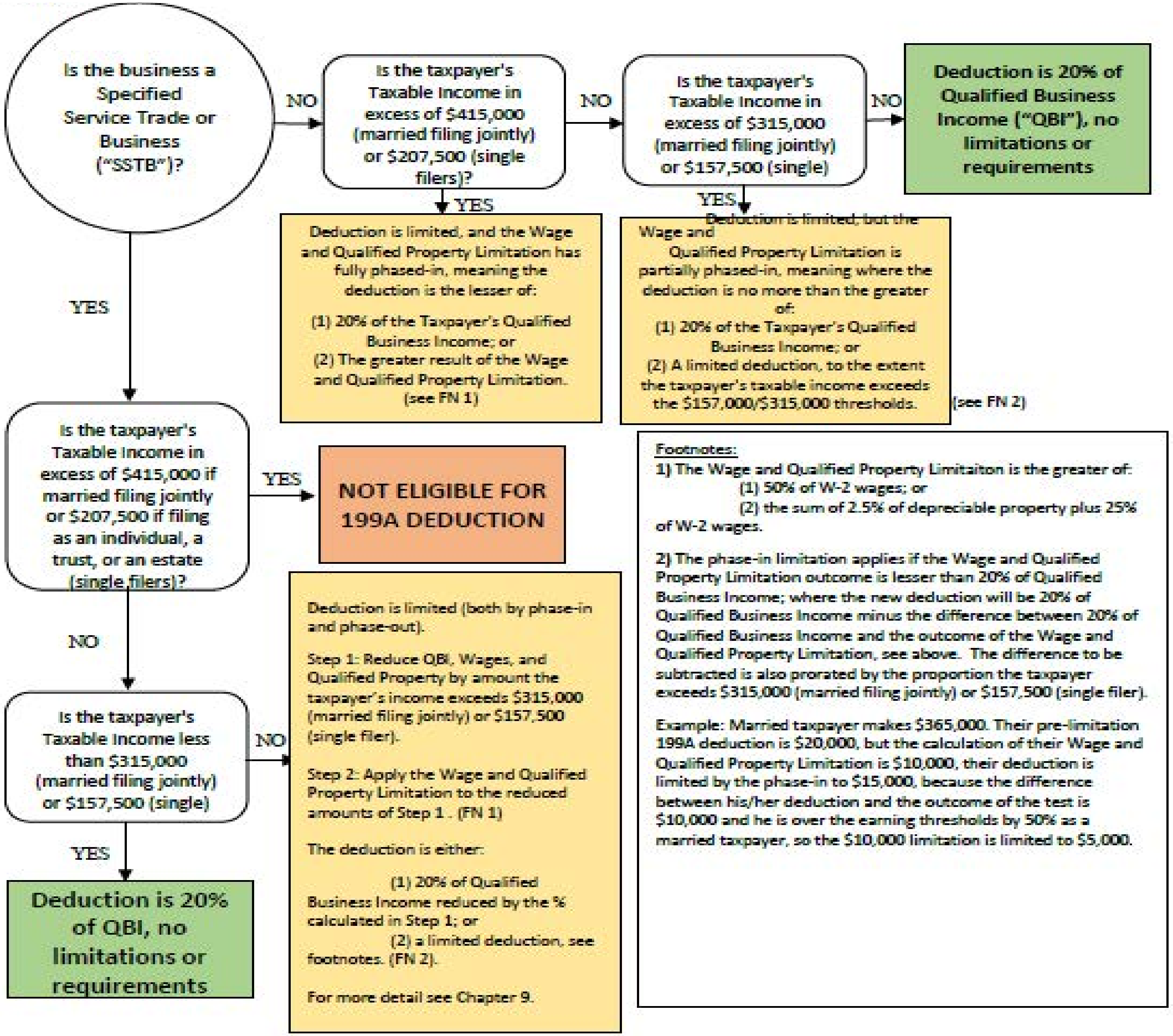
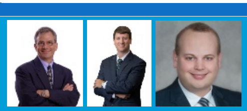
The following chart can help the reader understand where each aspect of Section 199A planning fits into the overall tax provision.



The author thanks Michael Kitces for permission to build upon his overall summary chart!



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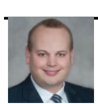
Partnership v. S Corporation- Which is Better to Hold Real Estate?

PARTNERSHIP	S CORPORATION
Advantages	*and Disadvantages*
Partners receive basis for indebtedness incurred by the partnership	DOI income insolvency exclusion is determined at the corporate level.
On the death of a partner, the partnership's (inside) tax basis of its assets can receive a step-up in income tax basis, if a Section 754 election is in place for the partnership	No similar basis adjustment mechanism applies to S corporations.
When a new partner buys into a partnership corporation, their depreciation write-off and underlying basis in their partnership interest will be based upon the price that they pay.	When a new shareholder buys into an S corporation, their depreciation write-off and underlying basis if and when the real estate is ever sold has to be based upon the historic basis and depreciation taken, versus being based upon the price they pay.
Appreciated real property can generally be distributed from the partnership tax-free to the partners.	Distributions of appreciated real property to the shareholders are treated as if the property was sold at its fair market value to the shareholders.
No restrictions apply as to who can own partnership interests.	S corporations can only be owned by certain individuals and trusts, and cannot be owned non-resident aliens, corporations or partnerships
Partnerships can have more than one class of stock, and income and distribution preferences can be drafted in virtually any manner, so long as they have substantial economic effect	S corporations cannot have a "second class of stock," and income allocation and distribution rights must be pro rata to ownership
DOI income insolvency exclusion is determined at each partner's level.	Shareholders do not receive basis for indebtedness incurred by the corporate, unless the loan is made by such shareholder.





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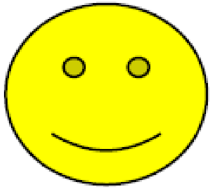
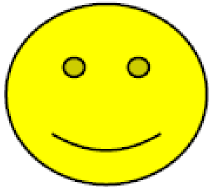
THE SECTION 108 INCOME FROM DISCHARGE OF INDEBTEDNESSS SHUFFLE

What entity will help protect a solvent taxpayer from income when his or her entity becomes insolvent and discharges debt?

DISREGARDED LLC	LLC TAXED AS PARTNERSHIP	LLC OR CORPORATION TAXED AS S CORPORATION	C CORPORATION
Income from discharge will be considered as having been received by the taxpayer/owner.	Income from discharge will flow through pro-rata to each partner with insolvency determined at the partner level.	Insolvency will be determined at the S corporation level and not flow through as K-1 income to the shareholder.	Income will be limited to the S corporation - many S corporations will convert to C corporation status before insolvency related sales or other transactions.



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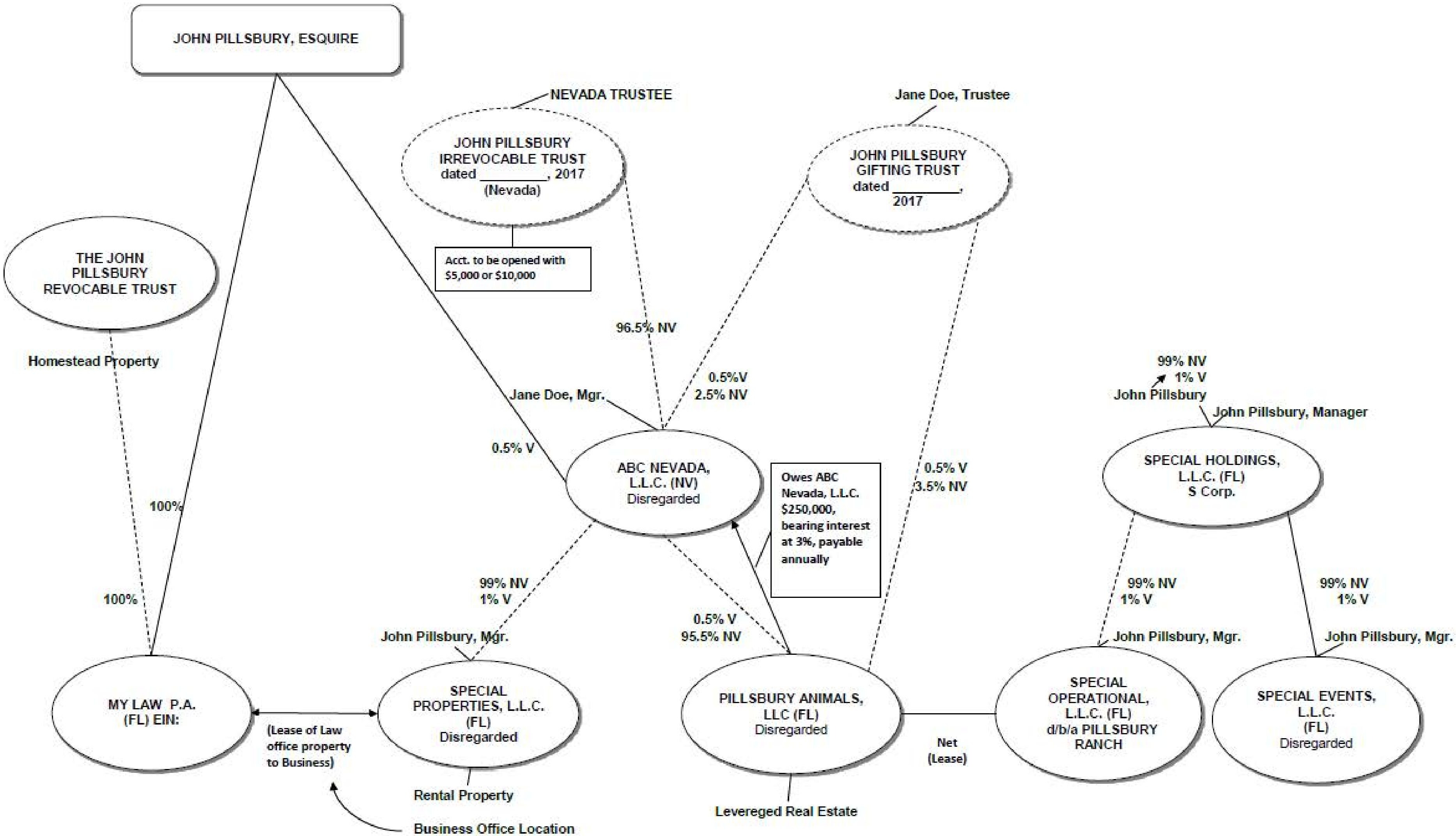
Leases and Master Leases, Illustrated



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~~Proposed~~ Final Regulations Blow The Roof Off Of Many Real Estate Deduction Opportunities

Alan Gassman Contributor
Retirement
I write about tax, estate and legal strategies and opportunities.

Planning strategies do exist to qualify situations for the 20% deduction – almost 199A of them!

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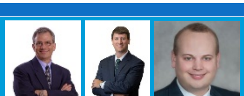
Most real estate investors and business people are well aware that new Internal Revenue Code Section 199A allows a 20 percent deduction for certain types of income, and that the real estate industry was favored under these new rules.



The issuance of Final Regulations on January 18th answers many questions and raises others about how these rules impact real estate and real estate professionals, while presenting both planning opportunities and traps for the unwary that need to be considered by real estate investors, developers, and companies that are in real estate, or real estate-related trades or businesses.

The Final Regulations retained many of the rules under the Proposed Regulations related to real estate, but also provided taxpayers with a safe harbor under which real estate investors can qualify as an active trade or business if certain requirements are met which will be discussed in more detail below.

The 20 percent deduction will apply to individuals, trusts, and estates that have “Qualified Business Income" from individual ownership, ownership of LLCs that are disregarded for income tax purposes, and income that is received via K-1 reporting from S Corporation and partnership ownership, subject to limitations that are discussed below.

The deduction only applies to ordinary income that comes from an active trade or business. It does not apply to short term or long term capital gains income, or to foreign income (Puerto Rico is not considered to be foreign), and the deduction cannot exceed the total net taxable income for the calendar year for the taxpayer, so that losses from one or more businesses or activities can cause a reduction or loss of the Section 199A deduction. In sum, because the total net taxable income includes income sources that are not considered to be deductible, the deduction can sometimes be larger than the total net taxable income after losses are accounted for. Since the deduction cannot exceed the total net taxable income, the deduction will be reduced or, in some cases, eliminated following these losses. Also, the deduction does not reduce income for the purposes of calculating employment taxes or the 3.8% Net Investment Income Tax, which will now need to be calculated independently. Independent contractors who report their income on the Schedule C of the individual 1040 tax return will normally be subject to the 15.3% employment tax on the first $128,400 of income, without regard to the 20 percent 199A deduction.

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The deduction does not apply to wages paid to an employee, or compensation earned by someone who reports the income as an independent contractor, but is found by the IRS to actually be an employee under the test described below.

Normally, single filing individuals, trusts and estates with taxable income of less than $157,500, and married couples filing joint returns with taxable income under $315,000 will qualify for the deduction with no questions asked as to whether the applicable activity or entity satisfies certain wage and qualified property hurdles which apply for high earner taxpayers, as discussed below.

As the result of the above, an independent real estate broker, developer, contractor, or subcontractor engaged in the normal activities of those professions will typically qualify for this 20 percent deduction. For real estate leasing operations, the deduction will be based upon taxable income, which generally means the amount by which rent income exceeds the sum of (1) operating expenses, (2) interest deducted and (3) depreciation deductions.

One thing we have been very anxious to know is whether a passive landlord who collects rent under a triple net lease will be considered to be in the "trade or business" of leasing in order to qualify any positive taxable income for the Section 199A deduction.

The Final Regulations tell us that a "trade or business" will exist if the “active trade or business” requirements of Internal Revenue Code Section 162 are met. The Section 162 rules have been around since 1926 and basically allow expenses to be deducted when incurred for a legitimate and active trade or business.



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There is remarkably little case law or IRS interpretative references available to determine if and when the leasing of property will be considered to be a trade or business. It appears that a landlord who simply owns a property and does nothing but receive rent on a long-term triple net lease will not be considered to be in a "trade or business" unless or until that property owner engages in more activities, which might include actively working to purchase more investment property, and working to buy or sell or contract out rights concerning triple net leased property in the same manner as a "dealer" who works to sell real estate. As a result, many landlords will renegotiate terms with the tenants to have a more active role and responsibility in administering common area maintenance, being involved in tenant build outs and activities and otherwise acting like an active trade or business.

There is a valuable exception, however, that was retained in the Final Regulations which permits even passively held triple net leased property to be considered as an active business activity to the extent that the property is leased to another active trade or business that taxpayer has direct or indirect ownership, if the taxpayer and/or parties related by family attribution or common ownership of the business tenant own more than 50 percent of the business tenant. If the income comes from multiple tenants, one being a related party and the other an unrelated party, then only the portion attributable to the related party will automatically be considered an active trade or business, and the landlord will have to do more than just collect rent from the unrelated party in order for that portion to be considered an active trade or business and eligible for the Section 199A deduction.

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Qualified Business Income ("QBI") Must Be Income from an "Active Trade or Business"

The Final Regulations tell us to use the IRC Section 162 definition.

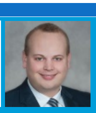
<u>Under the Final Regulations, most triple net lease will not qualify as a Trade or Business for the purpose of determining eligibility for the Section 199A deduction.</u>

Interest income from lending activities that are not "an active trade or business" will not qualify.

Exception for related party leasing - under the Final Regulations, a passive lease to an active trade or business with common ownership will be considered active if the tenant is not a Specified Trade or Business.

An active lease between a specified trade or business and affiliated owner will be considered to be a separate Specified Trade or Business under the Final Regulations.





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Rental Real Estate Safe Harbor –

IRS NOTICE 2019-7

Part III – Administrative, Procedural, and Miscellaneous
Section 199A Trade or Business Safe Harbor: Rental Real Estate

- Provides that real estate rented or leased under a triple net lease is <u>not</u> eligible under the safe harbor, even though a taxpayer who has an active business of entering into and selling triple net leases may still be considered to be sufficiently active to qualify as a trade or business under the case law.

- Defines a triple net lease to include an agreement that requires:

    - tenant to pay taxes, fees and insurance, and to be responsible for maintenance in addition to rent and utilities,

    - includes leases that require the tenant to pay common area maintenance expenses, which are when a tenant pays for its allocable portion of the landlord's taxes, fees, insurance and maintenance activities, which are allocable to the portion of the property rented.

The definition seems to leave open the ability to avoid triple net lease status by having tenant responsible for some portion of the maintenance, taxes, fees, insurances and other expenses that would normally be payable by a landlord.



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Rental Real Estate Safe Harbor –
IRS NOTICE 2019-7 (continued)

- Many landlords will be well advised to offer significant rent reductions to tenants who are willing to pay for some part of one or more items, so that the landlord can fit within the safe harbor to reduce the effective tax rate on taxable income from 37% to 29.6%, in addition to whatever may be saved in state income taxes and state sales taxes as a result of such adjustments.

- Safe harbor cannot be used by taxpayers who rent their personal residences out for part of the year.

- Rental Real Estate Enterprise under safe harbor

  - Defined as an ownership interest in real estate that is rented, and may consist of one or more properties.

  - An individual relying upon the safe harbor, or a partnership or S-corporation entity that owns the applicable interest in the real estate, the income from which may qualify for the Section 199A deduction <u>must</u> own the real estate directly or through another entity that is disregarded for income tax purposes (i.e. a single member LLC).

  NOTE – A tax lawyer or other advisor should be consulted if the individual or the entity taxed as an S corporation or partnership does not directly own the applicable real estate to see if the disregarded entity rules will apply.



Rental Real Estate Safe Harbor – IRS NOTICE 2019-7 (continued)

- Each individual taxpayer, estate or trust can elect to treat each separate party as a separate enterprise, or all similar properties as a single enterprise, for purposes of applying the safe harbor rules, except for the following notable exceptions:

  1. Commercial and residential real estate cannot be considered as part of the same enterprise for testing purposed; and

  2. Triple net leased real estate and real estate used as a residence by the taxpayer cannot be part of an aggregated enterprise for testing purposes, because they cannot qualify to be included in the safe harbor.

- The following requirements must be satisfied during each year to allow the income from the enterprise to be eligible for the safe harbor:

  1. Separate books and records maintained to reflect the income and expenses for each enterprise.

  2. Contemporaneous records created to include time reports, logs or similar documents which are kept regarding the hours of all services performed, the description of all services performed, the dates upon which the services are performed and who performed the services, with respect to tax years beginning January 1, 2019.

Rental Real Estate Safe Harbor –
IRS NOTICE 2019-7 (continued)

3. For years 2018 through 2022, 250 or more hours of rental services must be performed to qualify the property for the safe harbor in each calendar year.

   Rental services include:

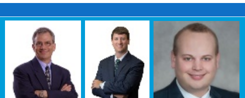
   - Time spent by owners employees, agents and independent contractors of owners, which can include management and maintenance companies who have personnel who keep and provide such contemporaneous records.

     NOTE: Time spent by computers that have artificial intelligence will not apply, so taxpayers may elect to use low cost offshore call room and similar workers to effectuate many task that may add to the time spent to facilitate reading 250 hours per year, i.e. providing tenants with additional services that can be provided by such inexpensive call center employees to schedule periodic inspections, insect treatments, insurance renewals and the condition of building systems, etc.

   - Advertising to rent or lease the properties.

   - Negotiating and executing leases.

   - Verifying information contained in tenant applications.



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Rental Real Estate Safe Harbor –
IRS NOTICE 2019-7 (continued)

Rental services include:

- Collecting rent.
- Daily operation, management and repair.
- Management of the real estate.
- The purchase of materials.
- Supervision of employees and independent contractors.

250 hours divided by 52 weeks is 4.8 hours a week, or approximately 21 hours each month.

In addition, the Treasury released IRS Notice 2019-7 which provides a safe harbor for real estate investors to be considered an active trade or business and eligible for the deduction if certain requirements are met. In order to qualify as an active trade or business under the safe harbor, the taxpayer must spend 250 or more hours on rental services during the tax year, which includes negotiating and executing leases, verifying information contained in applications, advertising to rent or lease properties, collecting rent, daily operation management and repairs, the purchase of materials, or the supervision of employees and independent contractors. The safe harbor requires that each individual taxpayer maintain contemporaneous records to document the amount of time spent on the activity during the tax year, and without written evidence of such records, then the taxpayer will not be eligible for the safe harbor.

While the real estate safe harbor specifically provides that triple net leases will not be eligible under the safe harbor, a taxpayer who has an active business of entering into and selling triple net leases may still be considered to be sufficiently active to qualify as a trade or business and thus eligible for the Section 199A deduction under case law defining a trade or business under Section 162.

Section 199A coined the term "Specified Service Trade or Business" (SSTB) and provides that individuals, trusts and estates that have income derived from SSTBs will not qualify for the deduction if the individual trust or estate has taxable income exceeding $207,500 (or $415,000 with respect to a married couple filing jointly), and there is a ratable phase out of the deduction where the income is from a SSTB and the Taxpayer has income between $157,500 and $207,500 if filing single, or $315,000 and $415,000 if married filing joint.

Fortunately, real estate professionals, including brokers, agents, developers and property managers are not considered to be SSTBs, although if the real estate is used and rented by a SSTB and is 50% or more commonly owned by owners of the SSTB and the landlord, then the real estate income attributable to rent received from a commonly controlled SSTB will be treated as SSTB income and ineligible for the Section 199A deduction if their income exceeds the above thresholds.



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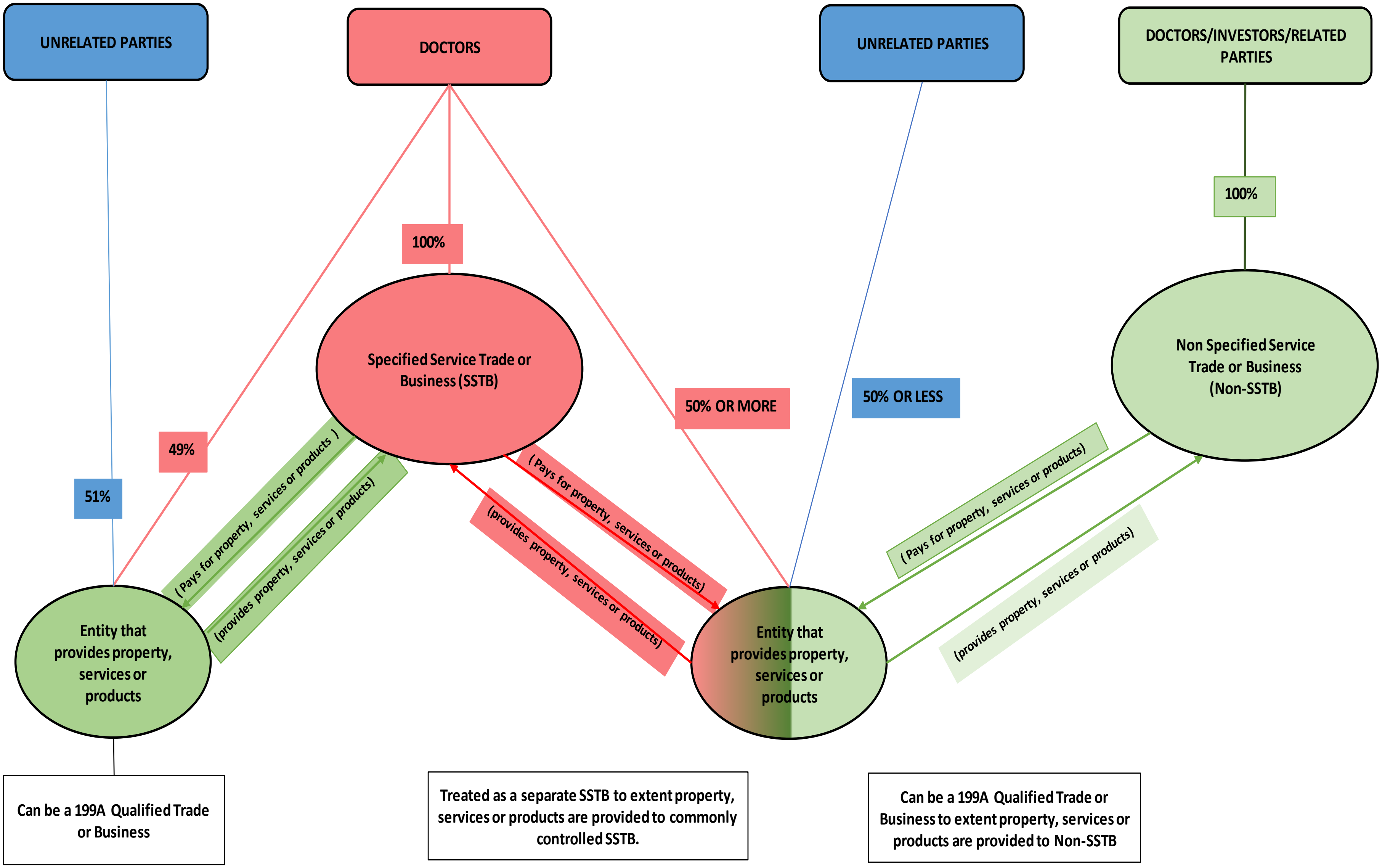
(When a Related Trade or Business Becomes a Pseudo-SSTB)

SERVICE TRADE OR BUSINESS ILLUSTRATION CHART

Green = Non-SSTB Income
Red = SSTB Income



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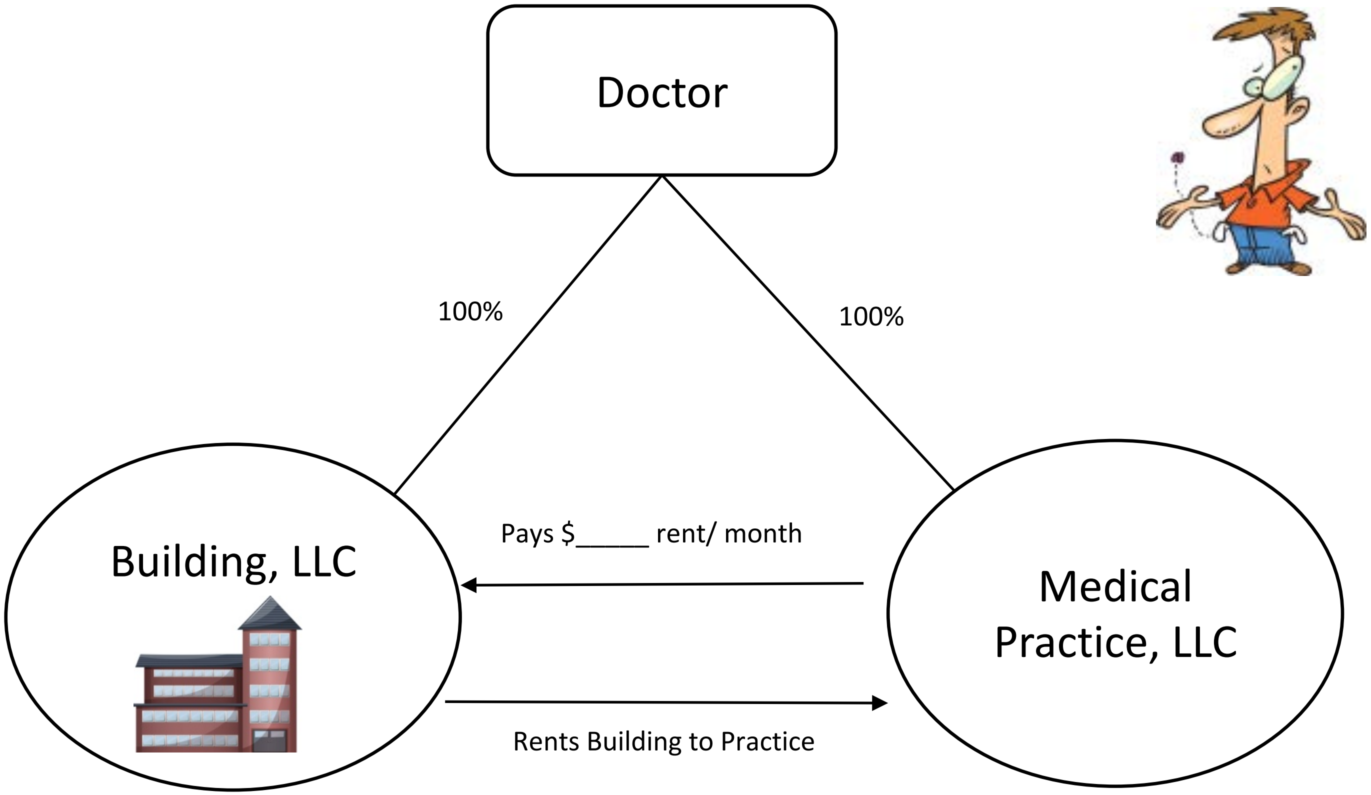
Common Examples of Psuedo SSTBs



Rent received by Building, LLC will be considered SSTB income.

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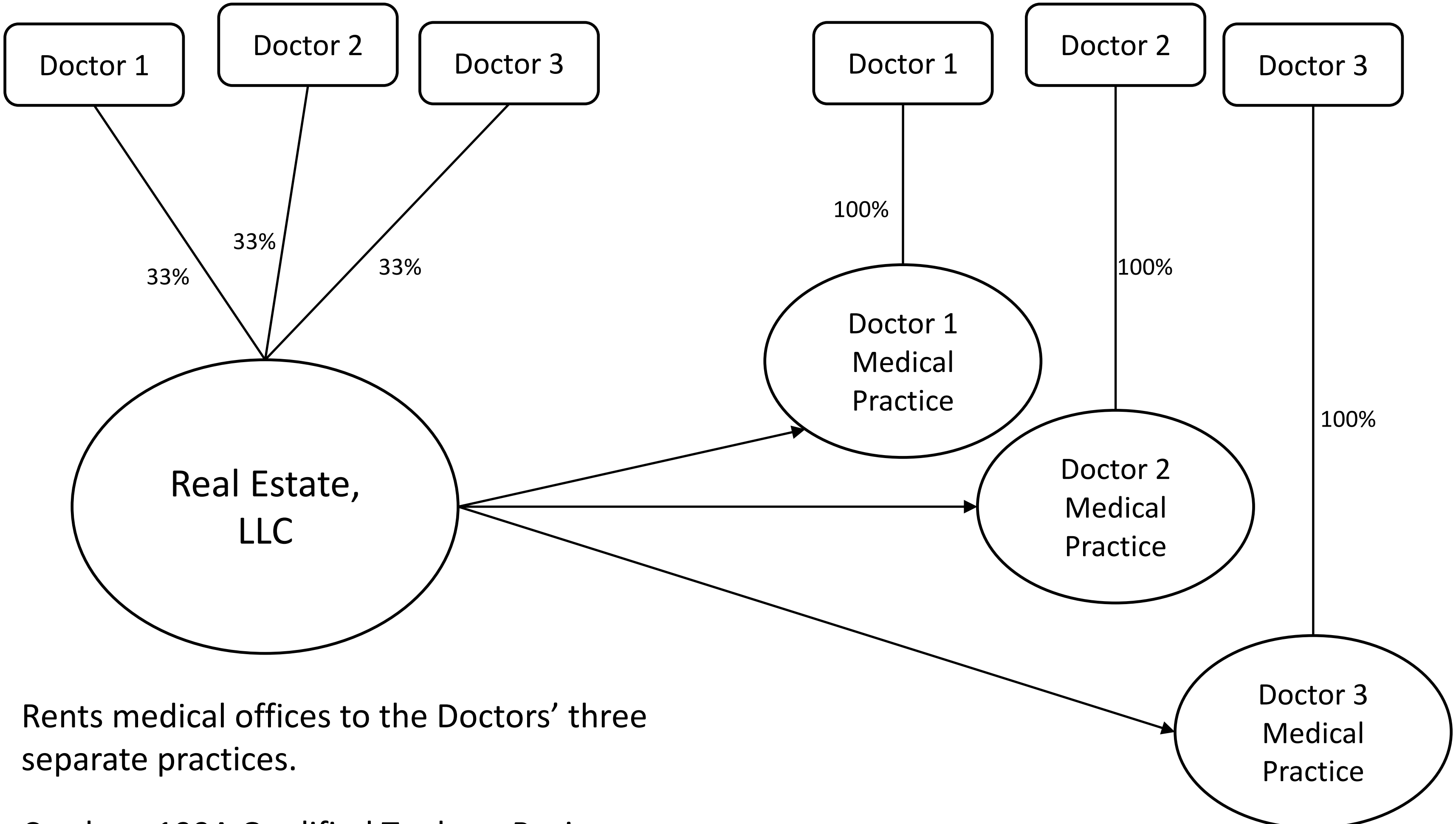
Non-SSTB Real Estate Company



Rents medical offices to the Doctors' three separate practices.

Can be a 199A Qualified Trade or Business.

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When a Related Trade or Business Becomes a Psuedo SSTB

The Proposed Regulations had provided special rules for when a trade or business has 50% or more common ownership with an SSTB, and provides property or services to the commonly owned SSTB.

The Proposed Regulations provided that a trade or business that provided more than 80% of its property or services to an SSTB and had at least 50% common related party ownership would be treated as an SSTB. When there was at least 50% common ownership and less than 80% of the property or services were provided to the related party SSTB then the related entity would be considered to be an SSTB in proportion to the products and services provided to the SSTB.

The Final Regulations eliminate the 80% rule, and simply provide that if there is more than 50% or more common ownership, the portion of the trade or business providing property or services to the 50% or more commonly owned SSTB, will be treated as a separate SSTB, with the income attributable to the services provided to non-SSTBs being considered to be non-SSTB income.

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Common Examples of Psuedo SSTBs

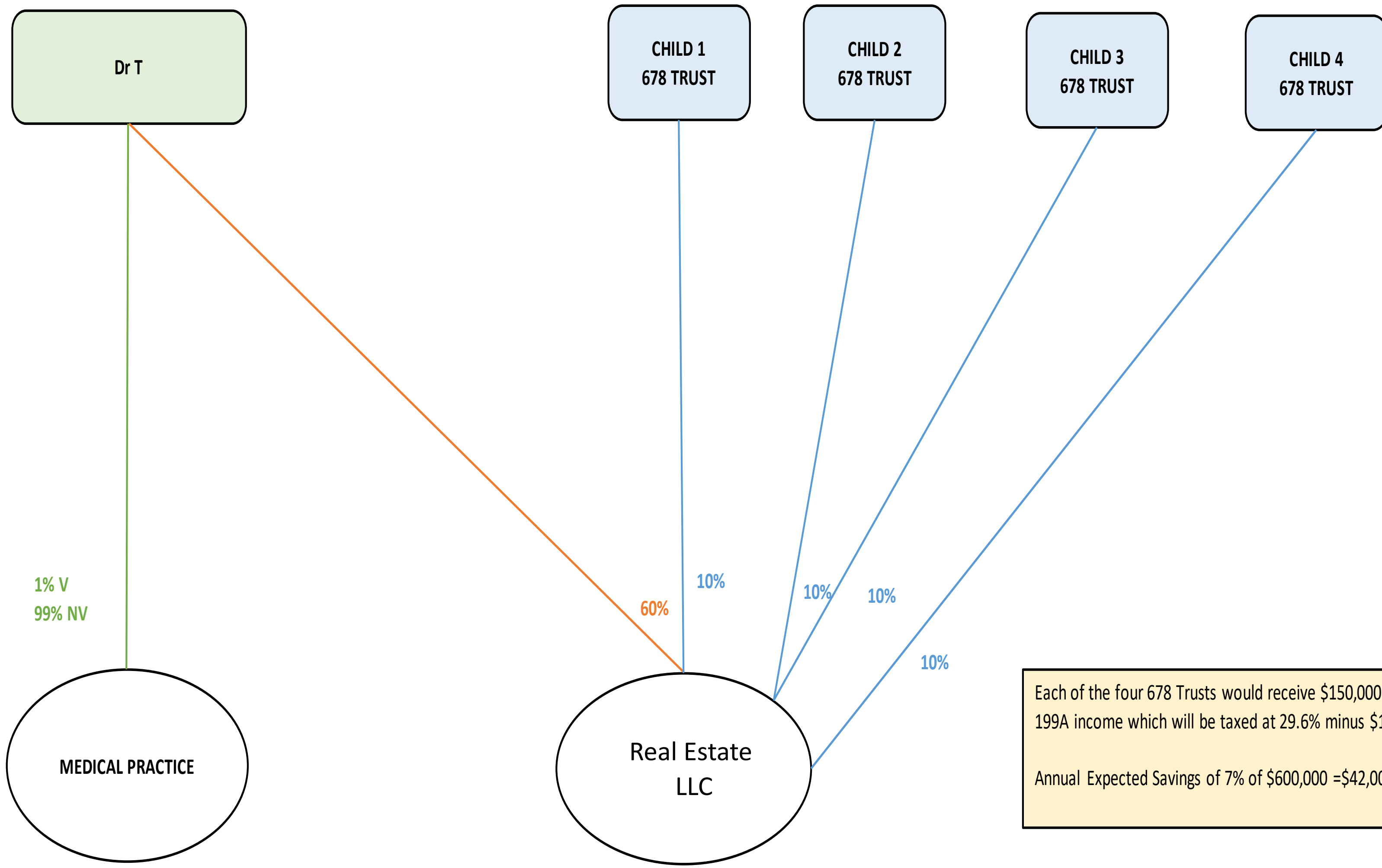
1. Commonly Owned Management Company

2. Commonly Owned Marketing, Billing, Intellectual Property Company

3. Rental of Office Building to Commonly Owned SSTB

Convey 40% of Management Company to Four Separate Section 678 Trusts

CONCEPTUAL CHART (DAY 2)



Each of the four 678 Trusts would receive $150,000 of Section 199A income which will be taxed at 29.6% minus $1,000.

Annual Expected Savings of 7% of $600,000 =$42,000 per yr.

Net Income $1,500,000 (Per Year)

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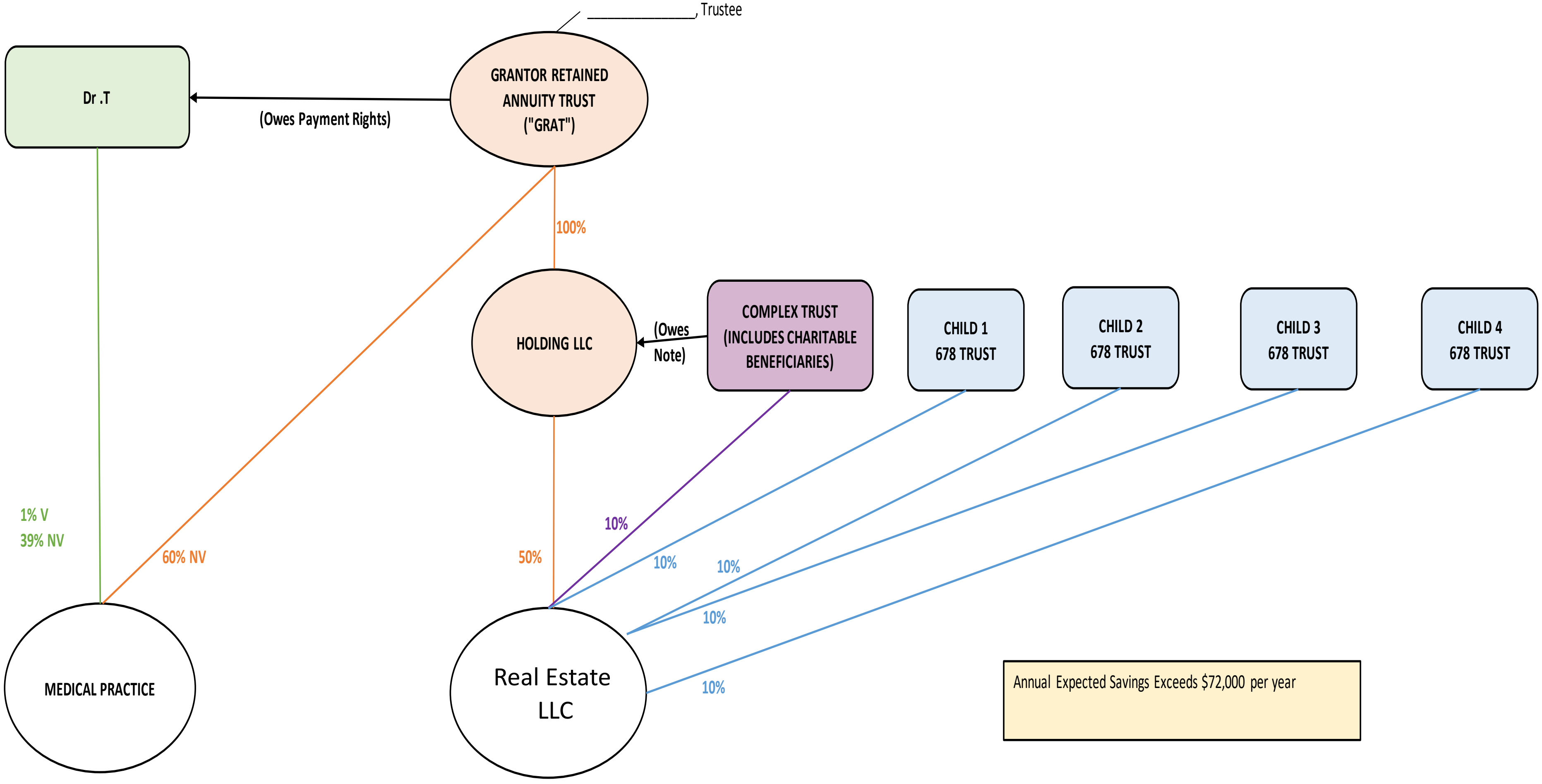
Combined Section 199A and Estate Tax Savings

Charitable and SALT Trust Alternative Conceptual Chart



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Use of Section 678 Grantor Trust

The Final Regulations did not impose any limitation on the use of Section 678 Trusts, which are irrevocable trusts which are considered as owned by the beneficiary or beneficiaries thereof. In fact, Final Regulations specifically state that trusts that are considered as owned by a specific individual or individuals under the “Grantor Trust Rules”[2] will be “treated as owned by the grantor or other person,” and therefore appear to not be subject to these rules.

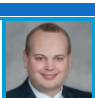
- For example: a mother and father could place part ownership of their S corporation stock into a trust that is considered as owned by their daughter for income tax purposes.

- This is accomplished by special provisions in the trust that may give the daughter the right to withdraw the stock contributed to the trust within thirty days of when it is contributed thereto.

- After the thirty days lapses, the daughter will have no further withdrawal or control rights, and an Independent Trustee who is replaceable by the parents (which may be the daughter) can determine if and when the trust will make distributions to the daughter.

- The K-1 income from the S corporation with respect to such stock will be reported on the daughter’s personal income tax return, to qualify for the Section 199A deduction assuming that the daughter’s income is below the threshold levels.





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FORBES BLOG – ORIGINALLY POSTED AUGUST 28, 2018, AS UPDATED AFTER FINAL REGULATIONS WERE RELEASED ON JANUARY 18, 2019. (continued)

Another Forbes blog post that I have recently posted describes what the Specified Trades or Businesses are, and what can be done for those who are under this limitation entitled *Beautiful Losers: The Discriminatory Nature of the 199A Proposed Regulations*. The most common ones include doctors, lawyers, accountants, consultants and financial services companies.

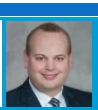
Individual taxpayers, trusts and estates that have taxable income greater than these $215,000/$415,000 thresholds will also not receive a deduction on pass through income unless the income has sufficient associated wages and/or Qualified Property, based upon the apparent intent to encourage businesses and business people to pay wages to employ Americans or to have property of fairly recent vintage in order to obtain the deduction.

The amount of the deduction as to the Qualified Business Income will be no more than the greater of (a) 50 percent of wages paid by the applicable trade or business or (b) the sum of (i) 25% of wages paid, plus (ii) 2.5 percent of the "Unadjusted Basis" (generally the cost of the property) of property used in the trade or business.

For example, if an S Corporation that has $200,000 of income that pays $70,000 in wages is owned by an individual, single filer making more than $207,500, then the deduction will be limited to $35,000. Alternatively, if the S Corporation paid no wages and has a building originally purchased for $1,400,000, then the deduction would also be limited to $35,000. Under either scenario, the S Corporation could acquire more property or pay more wages in order for the individual to qualify for the full deduction.

Wages can include wages paid to the taxpayer by an S Corporation owned in whole or in part by the taxpayer, but compensation paid from a partnership to a partner who works in the partnership will not be considered to be wages, although there are ways around this limitation, such as by having the taxpayer establish an S Corporation which in turn owns the partnership interest so that wage payments made by the partnership to the individual owner are not considered to have been made "to a partner".





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FORBES BLOG – ORIGINALLY POSTED AUGUST 28, 2018, AS UPDATED AFTER FINAL REGULATIONS WERE RELEASED ON JANUARY 18, 2019. (continued)

Wages for this test also include most forms of contributions to pension and 401(k) plans and employer provided health insurance and many other employee benefits.

As the result of the above, a high earner real estate broker (we refer to individuals, trusts and estates that are above the $157,500/$315,000 thresholds as high earners) will need to pay out wages that come out to be about 28.57% of what her net income from the brokerage would be to have the 20% deduction apply to her non-wage income. Most brokers will continue to use S Corporations so that the remaining income comes out as dividends that are immune from the 3.8% Net Investment Income Tax and employment taxes.

Real estate professionals who are employees may consider becoming independent and setting up S Corporations to hire the person to provide services to their former employers, but the Proposed Regulations provide that individuals who have been treated as employees will be presumed to continue to be employees if they are continuing to work primarily for the same employer, even if this is done through another entity like an S Corporation. Therefore, this tactic of becoming independent and setting up S Corporations may not always be a viable method of increasing a professionals Section 199A deductible.

A separate blog post will discuss how to try to make sure that a taxpayer is treated as an independent contractor as opposed to an employee, and the following chart will be included in that post, and should be of assistance in structuring.

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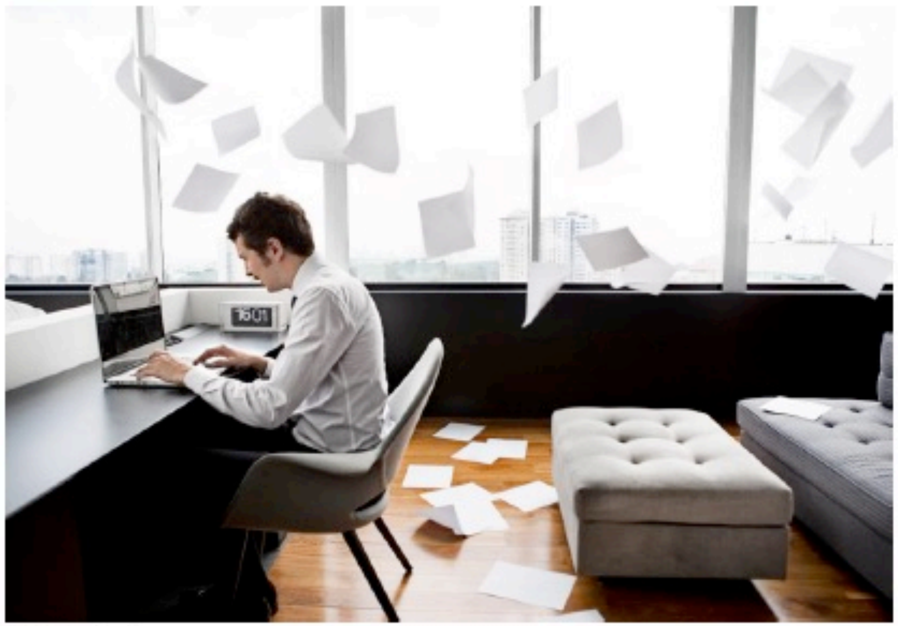
FORBES BLOG – ORIGINALLY POSTED AUGUST 28, 2018, AS UPDATED AFTER FINAL REGULATIONS WERE RELEASED ON JANUARY 18, 2019. (continued)

	Common Law Test Factor	Behavioral Control	Financial Control	Relationship of the Parties
1	Compliance with instructions	x		
2	Training	x		
3	Integration	x		
4	Services rendered personally	x		
5	Hiring, supervision, and paying assistants	x		
6	Set hours to work	x		
7	Full time required	x		
8	Doing work on employer's premises	x		x
9	Order or sequence test	x		
10	Oral or written reports	x		
11	Payment by the hour, week, or month		x	
12	Payment of business and/or traveling expenses		x	
13	Furnishing tools and materials		x	
14	Significant investment		x	
15	Realization of profit or loss		x	
16	Making services available to the general public		x	
17	Continuing relationship			x
18	Working for more than one firm at a time			x
19	Right to discharge			x
20	Right to terminate			x

Real Estate Investing With Section 199A: Don't Let Your Deductions Fly Out The Window

Alan Gassman Contributor ⓘ
Retirement
I write about tax, estate and legal strategies and opportunities.



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My August 28, 2018 post *entitled Proposed Regulations Blow The Roof Off Of Many Real Estate Deduction Opportunities* discussed how the new Section 199A 20% deduction rules apply for real estate investors and professionals, and referred to certain other rules to be covered in a future posting.

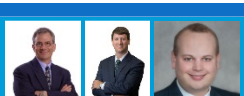
By way of brief review, the Section 199A deduction allows up to a 20% deduction from net income received from a qualified trade or business. The active rental of real estate, being a dealer or developer in real estate, and other associated activities and vocations can qualify, but several special rules apply.

This may be best described by an example.

Assume that Jane Buildart is a real estate investor who has a consulting and brokerage firm that provides services to people who want to buy and sell real estate. She receives most of her income from commissions on her sales and the sales of her employees. In addition, she owns ten rental properties that are conducted under ten separate LLC's which are each disregarded for income tax purposes, causing the net rental income to be reported on her Form 1040 personal income tax return.

Jane has a positive net income for all of her properties because she has very little debt and the rental income exceeds her depreciation, interest and other expense deductions each year. Her brokerage firm is taxed as an S Corporation and pays her a reasonable salary. She also has a net dividend/K-1 income above and beyond the salary.

If Jane has a total net income of less than $157,500 and she files as a single individual or as married filing separately, or if Jane is married and she and her spouse have less than $315,000 in total taxable income on their joint tax return, then she will qualify for the 20 % deduction on net income from the active leasing of real estate and her brokerage firm activities if her rental activities are active enough to be considered as one or more "active trades or businesses" under the definition set forth in Internal Revenue Code Section 162.



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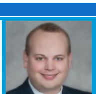
Triple Net Leased Properties

As discussed in a previous Forbes blog article entitled *Does Rental Income Qualify For The New 20% Section 199A Deduction,* when properties are triple net leased with no active management or other obligations or activities that would make them an active trade or business, the net income from non-active rental properties would not be eligible for the deduction.

If Jane's ten rental properties mentioned above are triple net leased and, as a landlord, Jane does not engage in an active managerial or some kind of business activity associated therewith, such as actively buying and selling rental properties, then the 20% deduction will not be available.

In addition, the Section 199A deduction cannot exceed the ceiling limit of 20% of her total net income, or the total marital net income if she and her spouse file a joint return, so that losses from other activities may reduce the Section 199A deduction that would otherwise apply for her.





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High-Income Taxpayers and the Wage or Qualified Property Test

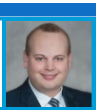
The deduction changes if Jane's income is above $207,500, if she is a single filer, or $415,000, if she files jointly with a spouse. If Jane's income is above these levels, then she cannot take any deduction under Section 199A, unless there are sufficient wages or qualified property basis to satisfy the wage or qualified property test. This test that applies to high earners limits the Section 199A deduction to the greater of 50% of the taxpayer's share wages paid by the Section 199A businesses or the sum of (a) 25% of wages and (b) 2.5% of the taxpayer's share of the unadjusted basis of qualified property.

If Jane's personal taxable income is between the base of $157,500 and the ceiling of $207,500 if single, or between $315,000 and $415,000, if married filing jointly, and if the wage or qualified property test described above is not satisfied, a "phase out" occurs that is generally in proportion to where the income lays between the two amounts, without regard to whether the wage or qualified test applies. If the wage or property test is partially satisfied, then the phase out calculation becomes even more complicated.

In addition, Jane's deduction could be limited by the fact that she provides some consulting services, which is considered as specified service, trade or business. There is a *de minimis* exception that applies if her gross receipts from consulting is less than 10% of the combined receipts of the consulting and brokerage firm activities. If this exception is satisfied, then the consulting income will not be considered as specified service trade or business income, and thus eligible for the Section 199A deduction, if the requirements discussed above are satisfied. If the firm has more than $25,000,000 a year in volume, then the *de minimis* threshold would be reduced to 5% of gross receipts.

If the consulting income exceeds these thresholds, then the income attributable to Jane's consulting services will not be eligible for the deduction.

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Aggregate Entities

Many assumed that each separate entity would have to stand on its own for purposes of passing these tests, but the Proposed Regulations issued in August permit the taxpayer to aggregate two or more entities or activities. This allows wages and qualified property to be considered as paid for all of the entities so that the deduction can be taken for income received from a partnership, an S Corporation or a proprietorship that has little to no wages or qualified property if owned by the same taxpayer who has other entities with more than enough wages or qualified property.

For example, if 50% of the wages paid by Jane's S Corporation exceeds what the Section 199A deduction would otherwise be from all 11 entities, then she can take the deduction for all 11 entities. Alternatively, she can aggregate only those entities that she wishes to aggregate, as long as she or some any other person owns 50% or more of each entity that is aggregated, and the entities are interrelated to one another. Once entities are aggregated by a given taxpayer, they cannot be taken apart again for Section 199A purposes, according to the Proposed Regulations.



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Why Aggregation is Crucial

(Excerpt from recent Forbes Blog article by Alan Gassman, published October 5, 2018)

Flow-Through Business Owners Line Up For Advice On New 199A Deduction

Alan Gassman Contributor

Retirement

I write about tax, estate and legal strategies and opportunities.

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The 2017 Tax Cuts and Jobs Act (TCJA) introduced Internal Revenue Code Section 199A, which could potentially provide millions of taxpayers with a 20% deduction for qualifying "flow-through" income, known under the statute as qualified business income.

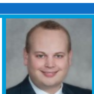
This will include the personal "Schedule C" income for people who have their own businesses, and K-1 income that comes from ownership in S-corporations and partnerships when certain requirements are met. It does not apply to income from a C corporation.

Tens of thousands of taxpayers will be able to change how their businesses, rental activities, and professions are structured to be eligible to take this deduction, and proposed regulations that should help decipher these rules and define avenues of permissible and sometimes frowned upon strategies will be released any day now to be studied by thousands of tax advisors.

It provides owners of flow-through trades or businesses (often called pass-through entities) a significant tax break to rival the new, lower tax rate for C corporations. However, the 21% rate for C corporations is deceptive, because double taxation, state corporation taxes, as well as Net Investment Income tax on higher income individuals can distort the effective tax rate to above 40%.

Likewise, many advisors have touted the 29.6% tax rate on flow-through income, which represents income taxed at 37% individual bracket reduced by the 20% deduction (37% * 20% = 29.6%), but this only applies to income in the highest individual tax bracket, which for single filers is income above $500,000, and for married filers is income above $600,000. Individuals with taxable income in the 24% bracket may have their flow-through income taxed at 19.2% (24% * 20% = 19.2%) for a savings of only 4.8%. The 199A deduction represents a significant opportunity for a great many savvy business owners to save money.





Proposed Regulations permitted election to aggregate multiple trades and businesses for purposes of wage and qualified property testing under section 199A.

The Regulations create a new method of aggregation of trades and businesses so that taxpayers can combine multiple trades or businesses for the purposes of applying the wage and Qualified Property limitations and maximizing the deduction. In order to be aggregated, the businesses must meet the following requirements:

a. The same person or group of persons directly or indirectly own 50% or more of each trade or business; (although minority owners may aggregate if 50% or more test is met by other owners – Each owner makes separate decision on what to aggregate – a minority owner may still aggregate if there is 50% or more common ownership with others.)

b. For purposes of determining ownership under this subsection, ownership by spouses, as well as children, grandchildren, and parents, can be attributed to each other;

c. The ownership existed for a majority of the tax year;

d. The items must be reported on returns within the same taxable year;

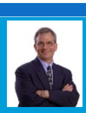
e. None of the businesses must be a Specified Service Trade or Business; and

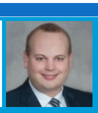
f. The aggregated trades or business must also satisfy at least two of the following requirements:

i. The trade or businesses provide products or services that are the same or customarily offered together;

ii. The trade or businesses share facilities or significant centralized business elements such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources; and

iii. The trades or businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group (for example, supply chains interdependencies).





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Election to aggregate under Proposed Regulations, *continued*

A series of fourteen well-written examples beginning at Section 1.199A-4(d) demonstrate that a taxpayer owning less than 50% of multiple entities when another taxpayer owns more than 50% of each entity, and elects to aggregate the minority interests therein, if the other rules are satisfied.

Aggregation will allow wages and Qualified Property to be considered as paid for all of the entities, so that the deduction can be taken for an entity that has little or no wages or Qualified Property if another entity has sufficient wages and Qualified Property for both its own income and the income of affiliates. The examples point out that losses from an entity that could be aggregated must be netted against the aggregate profits of other applicable entities, if any aggregation occurs.

One example indicates that ownership of a sailboat racing team and a marina by separate companies would not be aggregated, but that ownership of a trucking company that delivers lumber and other supplies in one company, operation of a lumber yard in another company, and operation of a construction business that presumably uses lumber and other supplies, can be aggregated.

Once a taxpayer chooses to aggregate two or more trades or businesses, they must be consistently reported and aggregated for all subsequent taxable years, unless there is a change in facts and circumstance so that a taxpayer's prior aggregation no longer qualifies for aggregation.

The implications of all of this to professional advisers can be daunting. In some instances, modeling the various options may be the only way to determine what the actual impact of various decisions might be. Practitioners should be cautious about providing conclusions to clients with specificity without the opportunity to perform the appropriate analysis. The costs of the level of detailed analysis that might be necessary in many instances will be a concern for many clients.



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Unadjusted Basis of Qualified Property

Landlords who are active enough to qualify for the deduction will have to pay wages to the extent that 2.5% of their unadjusted basis of qualified property is not sufficient to meet the deduction requirement.

The unadjusted basis of qualified property is the original depreciation basis of assets used in the trade or business, which means the original cost, plus improvements, without reduction for depreciation taken. This does not include assets such as land, which is normally not depreciable, notwithstanding the expenses paid to develop land can be deductible.

The original cost will be considered $0 for any asset that has been placed in service for the later of 10 years or its depreciable life.

For example, a building purchased in 1990 may be subject to a 39 year depreciation schedule, so 2.5% of the original depreciation basis in the building can be used for 39 years to allow Section 199A deductions.

<u>1031 Property Exchanges</u>

Subsection 199A(h) gives the IRS the ability to create anti-abuse rules. Subsection (1) of this Section prevents the manipulation of depreciable periods, and Subsection (2) creates regulations for determining the unadjusted basis in Qualified Property acquired in like-kind exchanges or involuntary conversions.

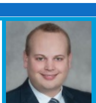
A 1031 exchange occurs when either (1) one property is exchanged for another, or (2) a property is sold, with the sales proceeds being escrowed and then used to purchase a replacement property while following the deferred exchange rules. The property that is sold tax free in a 1031 exchange is called the relinquished property, and the property that is acquired in exchange for the relinquished property is the replacement property.

The Section 199A regulations provide that the acquisition basis and holding period relate back to the relinquished property, as if it was never exchanged. As a result of this, taxpayers who are selling real estate may reconsider whether they want to engage in a 1031 exchange, given that the replacement property cannot be used in the 2.5% qualified property calculation once it has been fully depreciated.

Many taxpayers don’t realize that they would be better off paying the 15% or 20% capital gains tax on the sale of real estate, and then receiving large depreciation deductions that can reduce ordinary income over time that would otherwise be taxed at a 37%. In addition, much of this can be written off in the year of acquisition by using what is called component depreciation, which often allows an immediate deduction for components and operating systems of a building, such as the air conditioning, heating, plumbing and electrical systems.

Taxpayers who are involved in the real estate industry should be generally aware of the above issues, and also seek direct advice from whoever will prepare their tax returns and possibly other tax advisers. This is too complicated to be handled without expert advice.





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Leimberg Information Services, Inc.

Steve Leimberg's Income Tax Planning
Email Newsletter Archive Message #167

Date:20-Jan-19

Subject: Alan Gassman, Brandon Ketron & John Beck - Section 199A Final Regulations Leave Open Many Avenues for Tax Planning

"Section 199A of the Internal Revenue Code was added by the Tax Cuts and Jobs Act (TCJA) of 2017, and slightly modified in 2018 to provide up to a 20% tax deduction for 'Qualified Business Income' that is taxable to individual taxpayers and certain trusts and estates. This complicated law limits the deduction available to high earner taxpayers who have dividend or ownership income from certain trades or businesses (Specified Service Trades or Businesses ('SSTBs')), or who have income from the ownership of trades or businesses that do not pay sufficient wages or have sufficient qualified property to allow the deduction.

Proposed Regulations were released in August of 2018 which provided for rules to prevent certain structuring from being used to reduce taxable income, and Final Regulations were released on Friday, January 18th, which carry forward most, but not all, of the same limitations to planning that were provided in the Proposed Regulations. The good news is that the Final Regulations leave open a number of planning opportunities that advisors can now review and recommend with a good degree of certainty.

This newsletter will briefly review the limitations provided under the Final Regulations, and then discuss planning structures that are available and may be appropriately implemented without delay, to maximize the 2019 income that can be taxed to individuals and trusts for individuals that can qualify for the deduction."



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Here is their commentary:

EXECUTIVE SUMMARY:

Section 199A of the Internal Revenue Code was added by the Tax Cuts and Jobs Act (TCJA) of 2017, and slightly modified in 2018 to provide up to a 20% tax deduction for "Qualified Business Income" that is taxable to individual taxpayers and certain trusts and estates. This complicated law limits the deduction available to high earner taxpayers who have dividend or ownership income from certain trades or businesses (Specified Service Trades or Businesses ("SSTBs")), or who have income from the ownership of trades or businesses that do not pay sufficient wages or have sufficient qualified property to allow the deduction.

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FACTS:

Limitation 1 - Specified Service Trades or Businesses

The Opportunity - Transfer Ownership to Family Members Below Threshold Amounts

Many high earner taxpayers have ownership interests in directly owned businesses and entities taxed as partnerships and S corporations, which constitute Specified Service Trades or Businesses, including health, law, accounting and consulting.

A taxpayer's Section 199A deduction on income from a Specified Service Trade or Business will begin to be limited if the taxpayer's 2019 taxable income exceeds $160,700 if single, or $321,400 if married filing jointly, and will be completely eliminated if the taxpayer's 2019 taxable income exceeds $201,700 if single, or $421,400 if married filing jointly.

Although the deduction will be limited or completely eliminated for high earners, part ownership in these entities may be held by related individuals who have less than $160,700 if single or $321,400 if married filing jointly, so that income from a Specified Service Trade or Business can qualify for the deduction.

This can include children, grandchildren, and the parents - and possibly even grandparents - of the professional.

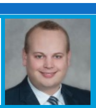
When state law does not allow the ownership of such interests by non-licensed professionals, it will be possible to establish a management company that will provide arm's-length management services to the Specified Service Trade or Business and receive reasonable revenues to generate a reasonable profit, which may commonly be approximately 15% of what the bottom line income of the Specified Service Trade or Business and salaries of owners of the Specified Service Trade or Business have been in the past.

This "Management Services Organization" ("MSO") may provide marketing, personnel, intellectual property, IT, and associated services, and should be adequately capitalized and should employ managerial and other workers directly to be a legitimate separate entity.

In addition, the MSO or a different parallel entity may provide the factoring of accounts receivable for the Specified Service Trade or Business, and may become the owner of the goodwill of the Specified Service Trade or Business, if the professional who owns the business and has significant personal goodwill executes a long-term employment agreement with non-competition covenants in the same manner as is commonly used in the physician, dental and veterinary medicine industries where venture capital, publicly traded companies, hospitals and other entities purchase personal goodwill for significant consideration in exchange for the right to receive a significant portion of the former practice income by charging management and use fees that may typically range in the 35% to 40% of otherwise applicable bottom line income.

The transfer of personal goodwill and execution of non-competition covenants will be considered to be a gift by the professional to the MSO entity that can provide income and financial stability for family members, while also protecting the assets of a professional practice from potential future creditors.





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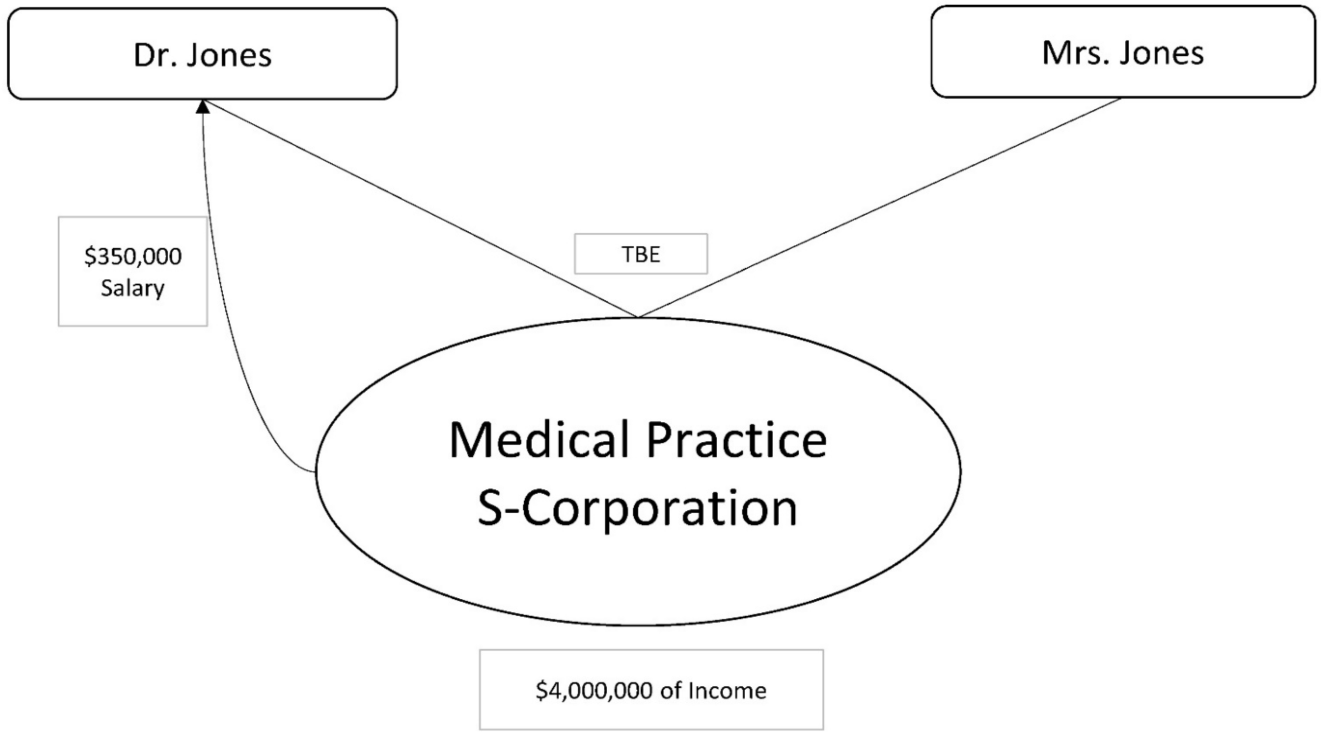
BEFORE 199A PLANNING



Dr. and Mrs. Jones have $4,350,000 of taxable income and pay income taxes of $1,548,879 for an effective tax rate of 35.61%.

Dr. Jones will also owe $26,972 in Employment Taxes.

Total Taxes = $1,575,851

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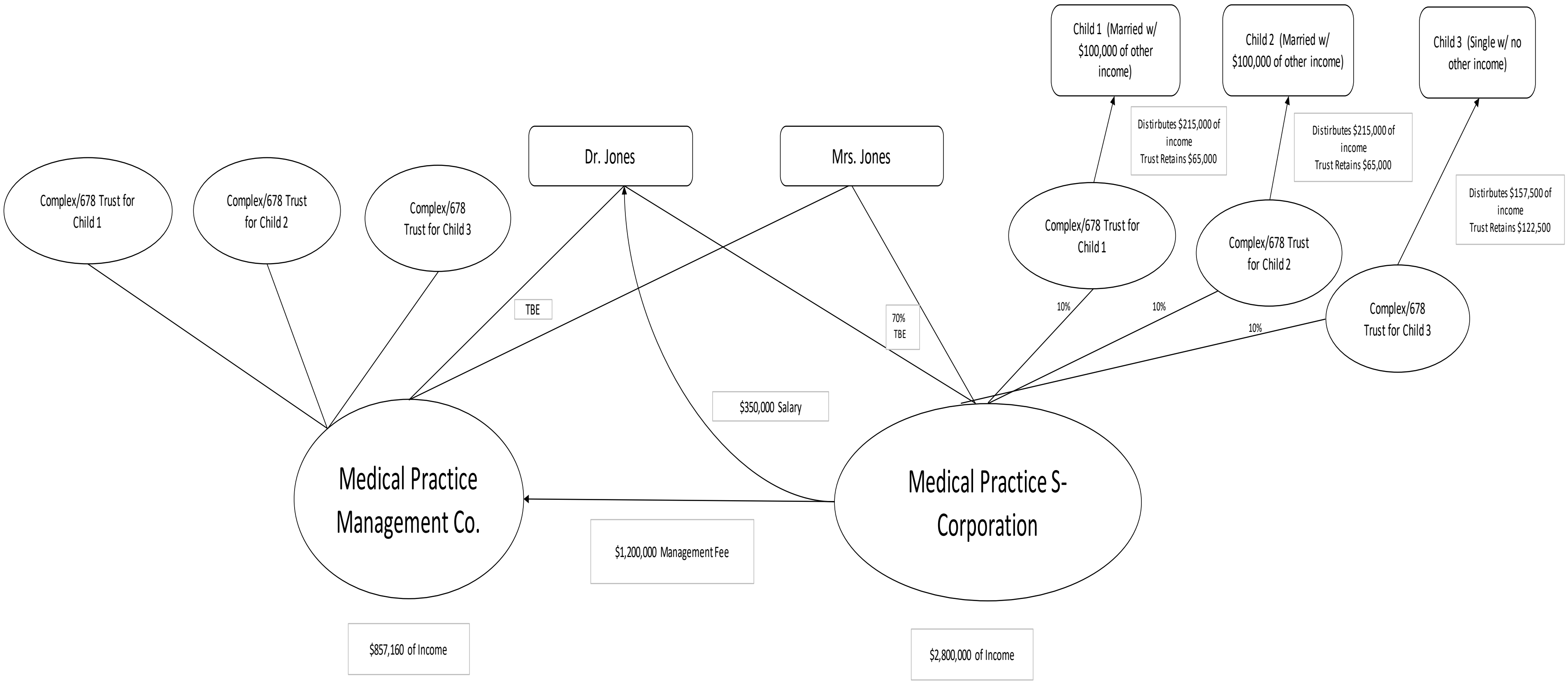
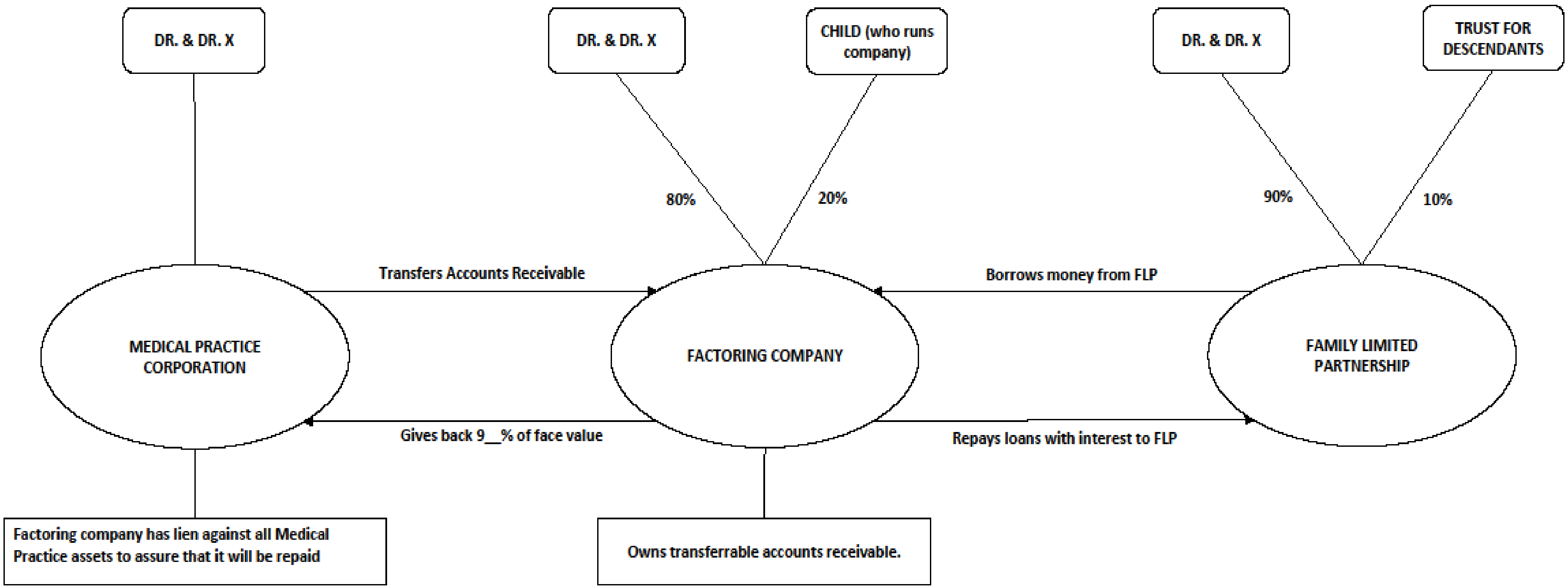
AFTER 199A PLANNING



FLOW THROUGH ENTITY DEDUCTION PLANNING EXAMPLE



NOTE - Transfer Pricing means what one related company charges another for goods and/or services, and must be "at arm's-length at fair market value."

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TAX SAVINGS THROUGH USE OF TRUSTS

In Florida, a medical practice entity can be owned in part directly by a child or the children of a medical doctor or osteopath, or presumably by a trust held solely for one or more children and/or the spouse of the physician without having to register under the Clinical Licensing Act.

- Therefore, 15% ownership of an S corporation medical practice that has $1,000,000 per year of bottom line income could be given to a "678 Trust" that would benefit a grandchild, the parent of that grandchild, and the spouse of the physician.

- About $150,000 per year of income would be considered to be the income of the grandchild and allow the grandchild to benefit from the Section 199A deduction, the grandchild's lower tax brackets, and the grandchild's standard deduction.

- The use of the 199A deduction would save approximately $11,100 per year and the grandchild's lower tax brackets and standard deduction would save approximately an additional $24,354 each year, assuming the grandchild has no other income.



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Limitation 2 - Aggregation of MSOs Providing Property or Services to Commonly Owned SSTBs

The Opportunity - MSO With Less Than 50% Common Ownership

Before the Proposed Regulations were published, many planners were expecting to be able to form MSO's like the ones described above, and to have these MSO's owned in whole or in large part by the high earner professional and his or her spouse as a non-Specified Service Trade or Business.

Unfortunately, the Proposed - and now Final - Regulations consider entities that have 50% or more common family ownership, and which perform services for each other as a Specified Service Trades or Businesses, even where the MSO entity does not provide any professional services directly to patients, clients or other third parties.

The Proposed Regulations provided that an MSO having at least 50% common ownership and which provided 80% or more of its property or services to the SSTB would be considered to be aggregated and a part of the SSTB, thus not eligible for the Section 199A deduction if the owner's taxable income exceeded the threshold amounts.

The Final Regulations simplify this by providing that an MSO entity that provides property or services to a SSTB with 50% or more common ownership will be treated as a separate SSTB, but only to the extent that such property or services are provided to the SSTB. If property or services are provided to entities that are less than 50% commonly owned, regardless of whether they are SSTBs or not, then the income attributable to such activities will not be treated as SSTB income.

As the result of this limitation, some Specified Service Trades or Businesses may contract to have MSO services provided by companies which are owned 49% or less by the family members of the Specified Service Trade or Business owners.

A possible arrangement would be to have a talented management person or entrepreneur own 2% or more of an MSO which is owned 49% or less by a group of doctors, lawyers, accountants or other professionals or family members thereof who own the professional practices that the MSO will manage and provide services for.

The income received by the high earner professional taxpayers and spouses, as well as other family members should not be considered to be SSTB income under the Final Regulations, so long as the substance of the MSO organization is at arm's-length.

There are limitations to having such service organization arrangements apply in professional service organizations. These are discussed in great depth in an article entitled *Using Multiple Entities to Reduce Income Taxes for Families Owning Personal Service Corporations Under Section 199A and Unique Concerns* that was written by the authors, and published in LISI Income Tax Planning Newsletter #136 (March 12, 2018).

It is important to note that the 50% common ownership test is measured based upon the common ownership between the two entities and is not simply a 50% test for one owner. For example, if three doctors equally own a medical practice and an MSO that provides services to the medical practice, then the common ownership test is satisfied, notwithstanding the fact that no doctor individually owns more than 50% of either entity, since the entities are 100% commonly owned.

However, if the three doctors each owned their own separate practice and established an MSO that was equally owned by the three doctors, then the common ownership would not exceed 50%, and the MSO would not be considered a SSTB. A reasonable management fee can then be paid to the MSO in exchange for the MSO managing the three doctor's practices and qualify for the Section 199A deduction.

Aggregation of SSTB & Non-SSTB Income Under Final Regulations

1. Small amount of specified service trade or business income will not taint a non-specified service trade or business.

The Final Regulations retained the ***de minimis* exception** that applies when income from a Specified Service Trade or Business is less than 10% of gross receipts, if the entity has $25,000,000 or less of annual receipts or 5% of gross receipts if annual receipts are greater than $25,000,000.

For example, a consultant could join an engineering firm with less than $25,000,000 in annual receipts, and qualify non-employment income for the exemption, if the consulting revenue is less than 10% of total revenue. A 5% threshold will apply if the engineering firm has more than $25,000,000 a year of revenues.

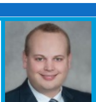
2. Incidental Trade or Business under common ownership with a SSTB removed from Final Regulations.

Under the Proposed Regulations, if a trade or business shares wage and overheard expenses with a SSTB and is more than 50% commonly owned by the owners of the SSTB, then such trade or business will be treated as incidental to and thus a part of the SSTB unless the gross receipts from the traded or business exceeds 5% of the combined gross receipts of the SSTB and the incidental trade or business.

The Proposed Regulations provided the example of a dermatologist selling skin care products at the dermatology office. The sales from the skin care products would not be considered to be separate from the dermatology practice unless the gross receipts from the sale of skin care products exceed 5% of the combined gross receipts from the sale of the skin care products and the dermatology practice.

<u>This was removed from the Final Regulations and presumably any incidental non-SSTB trade or business will be eligible for the Section 199A deduction regardless of gross receipts.</u>





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De Minimis Rule Examples in Final Regulations

Example One - Landscape LLC sells lawn care and landscaping equipment and also provides advice and counsel on landscape design for large office parks and residential buildings. The landscape design services include advice on the selection and placement of trees, shrubs, and flowers and are considered to be the performance of services in the field of consulting under paragraphs (b)(1)(vi) and (b)(2)(vii) of this section. Landscape LLC separately invoices for its landscape design services and does not sell the trees, shrubs, or flowers it recommends for use in the landscape design. Landscape LLC maintains one set of books and records and treats the equipment sales and design services as a single trade or business for purposes of sections 162 and 199A. Landscape LLC has gross receipts of $2 million.

$250,000 of the gross receipts is attributable to the landscape design services, an SSTB. Because the gross receipts from the consulting services exceed 10 percent of Landscape LLC's total gross receipts, the entirety of Landscape LLC's trade or business is considered an SSTB.

Example Two - Animal Care LLC provides veterinarian services performed by licensed staff and also develops and sells its own line of organic dog food at its veterinarian clinic and online. The veterinarian services are considered to be the performance of services in the field of health under paragraphs (b)(1)(i) and (b)(2)(ii) of this section. Animal Care LLC separately invoices for its veterinarian services and the sale of its organic dog food. Animal Care LLC maintains separate books and records for its veterinarian clinic and its development and sale of its dog food. Animal Care LLC also has separate employees who are unaffiliated with the veterinary clinic and who only work on the formulation, marketing, sales, and distribution of the organic dog food products. Animal Care LLC treats its veterinary practice and the dog food development and sales as separate trades or businesses for purposes of section 162 and 199A. Animal Care LLC has gross receipts of $3,000,000. $1,000,000 of the gross receipts is attributable to the veterinary services, an SSTB. Although the gross receipts from the services in the field of health exceed 10 percent of Animal Care LLC's total gross receipts, the dog food development and sales business is not considered an SSTB due to the fact that the veterinary practice and the dog food development and sales are separate trades or businesses under section 162.

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Best Ways to Separate Non-SSTB and SSTB Income

1. Maintain separate books and records.

2. Have separate employees in non-SSTB activity that are unaffiliated with SSTB.

3. Create a subsidiary for SSTB activity and a subsidiary for Non-SSTB activity.

4. Separate Non-SSTB into different taxable entity.

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Allocation of Items Among Multiple Trades or Businesses

The Final Regulations provide that if a taxpayer is operating multiple trades or businesses then the taxpayer must allocate wages, qualified property, and other items among the trades or businesses using a reasonable allocation method based on all facts and circumstances.

The allocation method chosen must be applied consistently from one tax year to the next.

<u>Different allocation methods may be used for different items of income, gain, deduction and loss so long as the chosen method clearly reflects the income and expenses of each trade or business.</u>

<u>If a method is no long reasonable or no longer clearly reflects the income and expenses of the trade or business, then the allocation method can be changed so long as the new method is reasonable and is applied consistently going forward.</u>

Limitation 3 - Anti-Abuse Regulations for Trusts

The Opportunity - Use of 678 Trusts

Certain trusts cannot be used to deflect income that would not be deductible by professionals or high income taxpayers.

Trusts which are separately taxed and held for the benefit of family members can be structured to receive income that is either accumulated or distributed, whereby the trust will pay tax on income accumulated, and the beneficiary or beneficiaries will pay tax to the extent of income distributed. When Section 199A was first passed, the estate planning community was ready to mobilize a great number of these trusts that would own interests in SSTBs, management companies and non-SSTB companies owned by high earner taxpayers, so that each separate trust could accumulate up to $157,500 of income and also spray out an amount sufficient so that each child and grandchild would have income of up to $157,500 (or $315,000 if married filing jointly), and articles describing this technique were published and mentioned in the Preamble to the Proposed Regulations.[1]

The Final Regulations carry forth the intention of the Proposed Regulations by providing that a separately taxed trust that is "formed or funded with a principal purpose of avoiding, or of using more than one, threshold amount for purposes of calculating the deduction under Section 199A" will be considered as aggregated with its contributor for Section 199A purposes.

The language of the Final Regulations was also changed from referencing "Trusts formed or funded..." under the Proposed Regulations to "A trust formed or funded..." under the Final Regulations, meaning that this not only applies to the creation of multiple trusts, but can also apply to the creation of a single trust as specifically stated in the Preamble to the Final Regulations.

For example, if a high earner married couple owning 50% of a manufacturing company that does not pay sufficient wages or have sufficient qualified property to allow them to receive a Section 199A deduction transfers part ownership of the S corporation to a trust for their daughter for no other purpose than to allow for the Section 199A deduction, then the income accumulated within the trust will not qualify for the Section 199A deduction as long as the father and the mother who fund the trust continue to be high income taxpayers, based upon their personal income and the income of the trust being aggregated.

The Proposed Regulations went even farther and provided that income distributed from the trust to a beneficiary of the trust would be considered to have stayed in the trust for the purposes of "disrespecting" the arrangement.
While the Final Regulations now allow for the taxable income of the "tax avoidance trust" to be determined after taking into account the DNI deduction for income distributed to a beneficiary, it is unclear if the net income that is transferred from a separately taxed trust to a beneficiary will be treated as having been received by the beneficiary and not subject to aggregation under the Anti-Abuse provisions of the Final Regulations.

The Final Regulations did not impose any limitation on the use of Section 678 Trusts, which are irrevocable trusts which are considered as owned by the beneficiary or beneficiaries thereof.

In fact, Final Regulations specifically state that trusts that are considered as owned by a specific individual or individuals under the "Grantor Trust Rules"[2] will be "treated as owned by the grantor or other person," and therefore appear to not be subject to these rules.

(Excerpt from a Forbes Blog article by Alan Gassman, published August 22, 2018)

678 Ways To Qualify For The 199A 20% Deduction

Alan Gassman Contributor

Retirement

I write about tax, estate and legal strategies and opportunities.

Special trusts that can be used for high earner taxpayers who might not otherwise qualify for the deduction. Photo Credit: Shutterstock

My recent blog post on the discriminatory nature of Section 199A makes mention of having high-income taxpayers falling under the SSTB (Specified Service Trade or Business) category consider the use of management, billing, marketing, and intellectual property entities held at arm's- length to reduce taxes, and discusses that if the proposed regulations that were issued on August 8, 2018 become final, then such entities will be aggregated with the affiliated SSTB and thus ineligible for the Section 199A deduction if the owner's taxable income exceeds the $207,500/$415,000 levels, or phased out ratable for income exceeding $157,500 for single filers and $315,000 for married filers. Therefore, taxpayers with income above these levels may shift ownership of such entities to trusts that can be held for descendants, parents, and other lower-bracket taxpayers (those with income below the $157,500/$315,000 levels).

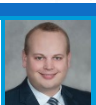
The same applies for high income taxpayers that have income from Specified Trades and Businesses that do not have sufficient wages or qualified property to allow for the full, if any Section 199A deduction.

For example, Joe Accountant owns an S corporation that operates his very successful accounting firm, and may wish to establish an arm's-length management company that provides billing, management, marketing, and other services for his accounting firm.

Joe's arm's-length management company may be owned one-third (33%) each, by separate trusts for his three children, who each earn less than $157,500 but then Joe loses control of the ownership interests and might not want the income to actually be paid to the children or they may give the interests to people Joe does not like or lose them in a divorce. Instead of using direct ownership or non-grantor trusts, which are taxed as separate entities that are disfavored under the new proposed regulations Joe may choose to use what are called "Section 678 Trusts", which are treated as being owned by one or more of the beneficiaries of the trust for income tax purposes, but allow a trustee selected by Joe to use the trust income and assets for such purposes and people as the trustee determines to be appropriate.

Many advisors will recommend the use of "non-grantor" complex trusts which are taxed on their own retained income and can also provide significant tax savings, which include the ability to take the Section 199A deduction as a taxpayer with taxable income of less than $157,500, avoidance of approximately $2,000 a year in taxes on the first $12,500 of retained income that is taxed at lower brackets and immune from the 3.85 Medicare tax, the ability to have what is equivalent to a charitable deduction for amounts distributed to charities, the ability to deduct up to $10,000 of property taxes when personal use property or owned by the trust, and the ability to retain or pay moneys or investments as determined by the trustee each year.

Disadvantages of non-grantor trusts include the need to file an annual income tax return, the need to determine how much income to retain and how much to pay out, and that the proposed regulations that were released on August 8 provide that the Section 199A advantages will not apply for these trusts when they are used for the purpose of avoiding Section 199A taxes, although it is not clear whether the IRS has the authority to issue this type of rule. The proposed regulations also provide that multiple complex trusts will be aggregated into being considered to be only one trust when they are formed by one grantor or a grantor's spouse and each can benefit the same beneficiaries to avoid taxes. This rule can be avoided by simply having separate trusts established for the lifetime benefit of separate individuals even if common beneficiaries may benefit after the death of the lifetime beneficiaries.



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Therefore, in the example above, the mother and father could place part ownership of their S corporation stock into a trust that is considered as owned by their daughter for income tax purposes.

This is accomplished by special provisions in the trust that may give the daughter the right to withdraw the stock contributed to the trust within thirty days of when it is contributed thereto. After the thirty days lapses, the daughter will have no further withdrawal or control rights, and an Independent Trustee who is replaceable by the parents (which may be the daughter) can determine if and when the trust will make distributions to the daughter.

The K-1 income from the S corporation with respect to such stock will be reported on the daughter's personal income tax return, to qualify for the Section 199A deduction assuming that the daughter's income is below the threshold levels.

This will work just as well with a Specified Service Trade or Business, if state law allows this, or an MSO established to provide services to a Specified Service Trade or Business, if state law does not allow for ownership to be transferred.

CITE AS:

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CITATIONS:

1.Gassman and Ketron, *Demystifying the New Section 199A Deduction for Pass-Through Entities*, LISI Income Tax Planning Newsletter #125 (January 4, 2018).

2. Internal Revenue Code §§671-678.

COMMENT:

Advisors now have stable Final Regulations and multiple avenues to allow for the responsible structuring of business and professional arrangements to maximize tax deductions that may be received under Internal Revenue Code Section 199A.

Clients who would like to reduce family income tax burdens and enhance multiple generation and trust and estate planning stand ready to be helped and advisors should act with reasonable speed to make these structures available.

The authors believe that the decision of whether or not to aggregate and how to keep SSTB and Non-SSTBs separate when a taxpayer is involved in multiple trades or businesses is another important area in the Final Regulations. Stayed tuned for a future newsletter discussing this planning opportunity.

While the 247 pages of Final Regulations and their interaction with the inner workings of the Internal Revenue Code must be carefully studied and understood, seeing opportunities where they exist is an important function of tax advisors in the form of this special gift from the Treasury Department delivered just after the holiday season.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Alan Gassman

Brandon Ketron

John Beck

Leimberg Information Services, Inc.

Steve Leimberg's Income Tax Planning
Email Newsletter Archive Message #169

Date:21-Jan-19

Subject: Alan Gassman & Brandon Ketron - What the Final 199A Regulations Say Regarding Trust Planning

"These rules continue the position of the Proposed Regulations that complex trusts which are formed or funded for a primary purpose of avoiding income tax under Section 199A will be 'disrespected,' and confirm that this means that the $157,500 or $315,000 thresholds will be aggregated with the trust's grantor or grantors.

The Final Regulations also continued the IRS's decision to implement the multiple trust disallowance of multiple brackets under IRC Section 643(f), but took out much of the detail and the examples that had provided taxpayer guidance and some safe areas of practice that are no longer delineated, and further confirmed the Electing Small Business Trusts will have only one $157,500 amount for both the S corporation stock and non-S corporation stock portions thereto.

The trust rules leave many Section 199A and multiple trust planning avenues open, but a knowledge and understanding of the new rules is necessary to navigate these waters, and hopefully well explained in this newsletter."



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Here is their commentary:

EXECUTIVE SUMMARY:

On January 18, 2019, the Treasury released Final Regulations on Section 199A. The Final Regulations retain many of the limitations that were imposed by the Proposed Regulations, but many planning opportunities are still available.

These rules continue the position of the Proposed Regulations that complex trusts which are formed or funded for a primary purpose of avoiding income tax under Section 199A will be "disrespected," and confirm that this means that the $157,500 or $315,000 thresholds will be aggregated with the trust's grantor or grantors.

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The trust rules leave many Section 199A and multiple trust planning avenues open, but a knowledge and understanding of the new rules is necessary to navigate these waters, and hopefully well explained in this newsletter.



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FACTS:

A summary of the rules that apply to trusts and associated planning is summarized as follows, and can be used in conjunction with our **LISI** newsletter titled *Section 199A Final Regulations Leave Open Many Avenues for Tax Planning*.

Complex Trusts

Complex Trusts are trusts which pay income tax on "distributable net income" that is not distributed to beneficiaries. The Proposed Regulations had provided that the $157,500 threshold that applied to complex trusts would not be reduced by distributions made to beneficiaries that carry-out "distributable net income" for income tax purposes. For example, a complex trust with $300,000 of distributable net income that distributes $150,000 to a beneficiary having no other taxable income would not have been able to take a 199A deduction on its remaining $150,000 of income from an entity that pays no wages and has no qualified property under the Proposed Regulations, and the beneficiary of the trust would also not be able to take a Section 199A deduction on the income that was distributed from the trust to the beneficiary.

This provision of the Proposed Regulations was appropriately criticized, and the Final Regulations appropriately confirm that distributions that carry out distributable net income will reduce taxable income for purposes of determining to what extent, if any, the taxable income for a trust or estate exceeds the $157,500 threshold amount. In the example above, both the trust and the beneficiary would receive the full 20% deduction on the $150,000 respectively, assuming that the avoidance rules described below for trusts established or funded with a primary purpose of avoiding tax under Section 199A do not apply.

The Proposed Regulations relating to the allocation of depreciation deductions under a trust as between the trust itself and beneficiaries were criticized as being incorrect. The Final Regulations include a revised example to clarify the allocation of qualified business income and depreciation as between a trust and its beneficiaries, and continue to require that a trust or estate allocate qualified business income, including any negative losses, among the trust and its beneficiaries based on the relative portions of DNI distributed or retained.

Anti-Abuse Rules

The Proposed Regulations had unusual language which provided that certain trusts would be "disrespected" for Section 199A purposes if they were established for the purpose of avoiding tax under Section 199A. The Final Regulations clarify that the anti-abuse rule is designed to "thwart the creation of even one single trust with a principal purpose of avoiding, or using more than one, threshold amount."

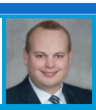
The Final Regulations indicate that if the trust creation is for a principal purpose of avoiding tax under Section 199A, then the trust will be aggregated with the grantor or other trusts from which it was funded for purposes of determining the threshold amount for calculating the Section 199A deduction.

Specifically, the Permanent Regulation provision for this reads as follows:

> Anti-abuse rule for creation of a trust to avoid exceeding the threshold amount. A trust formed or funded with a principal purpose of avoiding, or of using more than one, threshold amount for purposes of calculating the deduction under Section 199A will not be respected as a separate trust entity for purposes of determining the threshold amount for purposes of Section 199A.

The Final Regulations provide no examples to give any further guidance with respect to this.

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COMPLEX TRUST ADVANTAGES

Pages **157-160** of Section 199A (and 1202 Handbook

1. <u>Charitable Distributions</u>. If the Trust Agreement authorizes distributions to charity, then such distributions can carry otherwise taxable income out to the charity that is not taxed. The family therefore gets the equivalent of a charitable deduction that might not otherwise be available because of the high itemized deduction threshold that now applies to individuals ($12,200 for single individuals and $24,400 for married couples filing jointly). For example, a $20,000 charitable contribution made by a 37% tax bracket individual will commonly not result in any tax deduction whatsoever because of the $24,000 standard deduction that now applies. Using a complex trust that specifically allows for charitable payments could save 37% of $20,000 ($7,400) in taxes for a high-income bracket family that can place income producing property or S corporation or partnership interests under a complex trust.

   Charitable contributions can be made by the end of a calendar year and still count to reduce the income of the trust for the previous year, assuming an election to do so is filed on the trust's amended tax return for the previous year.261 For example, if a trust makes a charitable contribution in Year 2, it can elect to have the contribution treated as if it was made in Year 1 as long as the election is made on an amended tax return for Year 1, which can be filed as late as the deadline for Year 2's tax return on April 15 of Year 3, or October 15 if extended. The distribution can reduce the trust's taxable income for Year 1 or Year 2, as decided by the Trustee.

2. <u>State and Local Tax (SALT) Deduction</u>. Complex trusts can deduct up to $10,000 of state and local taxes each year, including real estate taxes, so that they can own personal use real estate and receive a tax deduction that the grantor and other family members may not be eligible for because of the $10,000 per year, per taxpayer limit on the deductibility of state and local taxes.

   For example, a vacation home that is subject to $30,000 a year in property taxes could be owned one-third each by three separate trusts for the primary benefit of each separate child of a married couple, to enable all of the property taxes to be deductible, assuming that each of the trusts has $10,000 or more of otherwise taxable income.



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Pages **157-160** of Section 199A (and 1202 Handbook

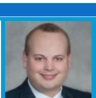
COMPLEX TRUST ADVANTAGES, continued

3. Spraying and Allocation Flexibility. The trustee can decide which beneficiaries receive how much each year. The trust may exert polite pressure on the beneficiaries or even pay beneficial expenses on their behalf instead of outright to them to influence behavior in a way that can be far superior to letting them have direct ownership in a management or intellectual property company. This provides significant flexibility that is not available for S corporations and partnerships because of the second class of stock and substantial economic effect rules.[262]

4. 65 Day Look Back. In addition, distributions made during the first 65 days of the calendar year can be considered to have been made in the previous calendar year for income distribution purposes. This allows the trustee and family members to confer with their tax advisors after December 31st to determine where income can best be allocated for the previous year.

5. Reduced Chance of Audit. Having income payable to a trust and distributed to low bracket taxpayers can reduce the chances of audit. Complex trusts file a Form 1041, and 1041 audits are very rare, if existent at all. Audits of low bracket taxpayers occur at a much lower frequency than the audits of high bracket taxpayers. This is certainly not a good sole reason to use irrevocable trusts, but it is an advantage.





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Pages **157-160** of Section 199A (and 1202 Handbook

COMPLEX TRUST ADVANTAGES, continued

6. Tax-Free Distributions of Appreciated Assets. Appreciated assets can be transferred out of a trust to beneficiaries without triggering income tax that would apply if a trust were taxed as a corporation, or as a partnership if certain "mixing bowl" and related rules apply.

7. New Fair Market Value Income Fair Market Value Tax Basis on Death of Power Holders. Assets held in a trust can receive a new income tax basis to avoid payment of capital gains tax on appreciation that occurs up through the date of the grantor's death, if the grantor has what is known as general Power of Appointment over trust assets. Court Orders or non-judicial reformation agreements may provide an individual with a short life expectancy with the right to direct how trust assets might pass within reasonable parameters, which can result in a new fair market value date of death income tax basis as if the Power Holder was the owner of the assets. This would include a power to appoint assets to creditors of the estate of the Power Holder, even if such Power is only exercisable with the consent of an independent party. This would be consistent with the intention of a grantor who set up a trust for estate tax purposes and now wants to assert a reasonable degree of control because estate tax is no longer an issue, and the situation among family members may have changed.



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Pages **157-160** of Section 199A (and 1202 Handbook

COMPLEX TRUST DISADVANTAGES:

1. <u>Formation and Annual Carrying Costs</u>. Costs and possible repercussions of forming or changing irrevocable trusts should of course be considered. This includes consideration of the cost of forming a trust or changing a disregarded trust to a complex trust, filing of income tax returns, and associated formalities.

2. <u>Loss of 179 deductions</u>. Unlike a "special allocation partnership," depreciation and Section 179 deductions are not available for trusts, or for beneficiaries who receive trust distributions in the year that Section 179 property is acquired. Trusts may have to write off furniture, equipment, and other acquired business property under the Section 168 rules, which will, in many cases, give them the same deduction, but sometimes over a longer period of time.

   Fortunately, the Section 168(k) bonus depreciation will often be as good as the Section 179 deduction. The Tax Cut and Jobs Act expanded Section 168(k) to enable taxpayers to immediately expense 100% of qualified business property placed in service between September 27, 2017 and January 1, 2023.263 Although, the percentage of qualified business property that may be immediately expensed begins to decrease after 2023, and is eliminated after 2027, Section 168(k) bonus depreciation provides temporary relief from the inability of trusts to take a Section 179 deduction.

   For example, if a construction business purchases trucks for its workers to use, the company can choose to depreciate the property all at once (because it has a life of less than 20 years). A trust could have part-ownership in the company and be able to claim the deduction on its tax return, assuming the company is a flow-through entity. In addition to the instant deduction the company will get in the first year, the owners, including the trust, can continue to use the trucks as Qualified Property under Section 199A for at least10 years.



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COMPLEX TRUST DISADVANTAGES, continued:

3. Partnership Taxation May Apply. Trusts that engage in business may be taxed as partnerships instead of complex trusts if the case law that existed before the “check the box” regulations were issued in 1997 would have caused the trust to be considered to be an “association” under the Supreme Court decision of *Morrissey v. Commissioner*, and the subsequent Section 7701 Regulations. There are no known cases where this has occurred, and the result would be that the beneficiaries of the trust will be considered to be partners and thus taxable on the retained income of the trust that would have otherwise been taxed at the trust level.

4. Disclosure and Fiduciary Duty Differences. The Trustee of a trust normally has a duty to account annually, disclose trust actions, and to act for the best interest of the beneficiaries. These fiduciary duties will commonly exceed the duties that a general partner has under a partnership, or that a manager has under an LLC, but may be altered by agreement with adult beneficiaries, and selecting an appropriate situs (“state or country of formation”) for a given trust normally is a duty.

Clients with irrevocable trusts currently in place that are treated as disregarded for income tax purposes should review the situation and discuss with their advisors whether these structures should be altered in order to take advantage of the income tax planning opportunities that may exist for irrevocable trusts and the structures associated therewith.



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The only language in the Preamble to the Final Regulations which discusses this rule reads as follows:

Section 199A Anti-Abuse Rule

> One commenter requested clarification on whether a trust with a reasonable estate or business planning purpose would be respected. Another commenter argued that the rule is overbroad and lacks clarity as to what would be abusive and what the consequences would be of not respecting the trust for Section 199A purposes. The commenter also stated that the rule is not needed because of §1.643(f)-1 and if both rules are retained, they should use the same test (principal versus significant purpose).
>
> Finally, the commenter asked for clarification on whether the rule applies to a single trust and suggested it should apply on an annual basis. This last suggestion has not been adopted because the test goes to the creation of the trust, factors which would not change in later years. The final regulations clarify that the anti-abuse rule is designed to thwart the creation of even one single trust with a principal purpose of avoiding, or using more than one, threshold amount. If such trust creation violates the rule, the trust will be aggregated with the grantor or other trusts from which it was funded for purposes of determining the threshold amount for calculating the deduction under Section 199A.[Emphasis added].

Read literally, a separately taxed trust which has been formed and funded before enactment of Section 199A cannot have been "formed or funded with a principal purpose of avoiding, or of using more than one, threshold amount . . . under Section 199A," and should therefore not be subject to the anti-abuse rules.

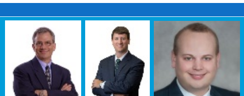
This means that taxpayers who have trusts that were in existence before the law was passed in December of 2017, and have not contributed to such trusts since then, could use their existing assets, or perhaps debt taken on at arm's-length, or purchase money debt, if sufficient net worth exists, to purchase ownership interests in SSTBs or entities that do not have sufficient wages or qualified property to allow the income to qualify for the Section 199A deduction. This can be accomplished by making capital contributions to the entity or purchasing interests owned by high income taxpayers who would not be eligible for the deduction.

In addition, trusts that are established under estate plans that were in place before Section 199A was enacted, and which will be funded under such plans without substantial change, should also be immune by the same rationale.

In many situations, trusts exist under state law that are disregarded for income tax purposes, with their assets considered to be owned by their grantors for income tax purposes. These trusts become complex trusts when the grantor dies or releases certain powers that exist over the trust. Time will tell whether such converted trusts may be considered to have been "formed or funded with a principal purpose of avoiding, or of using more than one, threshold amount for purposes of calculating the deduction under Section 199A" when they existed as grantor trusts before Section 199A was passed, but are voluntarily, or involuntarily, converted to complex trusts thereafter.

Further, many taxpayers have, and will, fund separately taxed trusts without having any knowledge, or any family situation, that would give rise to the avoidance of income tax under Section 199A at the time of formation and funding.

When subsequent Section 199A opportunities arise or become apparent, and the trust can purchase interests in a business or entity by making a capital contribution or buying an interest therein, the anti-abuse rule would not seem to apply.



199A Final Regulations

1.199A-5(d)(3)(vii) - Anti-abuse rule for creation of a trust to avoid exceeding the threshold amount.

A trust formed or funded with a principal purpose of avoiding, or of using more than one, threshold amount for purposes of calculating the deduction under section 199A will not be respected as a separate trust entity for purposes of determining the threshold amount for purposes of section 199A. See also §1.643(f)-1 of the regulations.

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It is noteworthy that the income tax benefits of being able to deduct up to $10,000 of trust income to pay for residential trust property taxes, and to make distributions to charity, if permitted in the trust agreement, being taxed at lower brackets of income tax and avoiding the 3.8% Medicare tax on up to $12,750 of income for 2019, and practical planning advantages make many separately taxed trusts worthwhile, regardless of whether a Section 199A deduction advantage applies.

It is also noteworthy that Section 678 Trusts are another variety of trusts that may allow for Section 199A and other tax advantages, which may be preferred over complex trusts, depending upon the circumstances.

Treatment of Multiple Trusts

Internal Revenue Code Section 643(f) was enacted in 1984 for the purpose of preventing multiple trusts funded by one grantor, or a married couple, from benefitting the same beneficiaries while having separate and multiple lower tax brackets.

It is the IRS's intention, as indicated in the Proposed Regulations, that multiple trusts that each can benefit the same multiple individuals at the same time would be considered as only one trust for purposes of the lower brackets that apply for the first $12,750 of income in 2019, and also with respect to the Section 199A $157,500 threshold amount.

The actual language of Section 643(f) is as follows:

> (f) Treatment of Multiple Trusts - For purposes of this subchapter, under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if–
>
> > (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and
> >
> > (2) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter. For purposes of the preceding sentence, a husband and wife shall be treated as 1 person.

While the IRS personnel have stated over the years that the statute is "self-implementing" even though it reads as if it was not to apply until Regulations were issued, commentators have not agreed as to whether this is accurate for multiple trusts have been established before the effective date of the Regulations.

The Proposed Regulations had extensive provisions which detailed when multiple trusts would be considered to be subject to the Section 643(f) rules, and had examples that demonstrated that multiple trusts that each benefitted only one of multiple siblings during their lifetimes would be considered as separate and not aggregated, even if they might be held for common multiple descendants after the death of the then living sibling and descendants thereof.

In one fact pattern, two separate trusts were established by parents, one for the benefit of their son, and the other for the benefit of their daughter. The trust for the son would pay income to him for his life, and after his death the remainder would be held for the daughter. The trust established for the grantors' daughter would pay her all income and principal in the discretion of the trustee for her education, support and maintenance, and further provided that distributions could be made during the daughter's life to provide medical expenses for the son, who would also receive the remainder of the trust upon the daughter's death. The Proposed Regulations concluded that the terms of these trusts contained significant non-tax differences and would not be presumed to be established for the principal purpose of avoiding income taxes, and thus would be permitted to be considered to have separate exemptions.

Many commentators criticized the Proposed Regulations, and as a result the IRS removed the presumption that a "principal purpose" for establishing or funding a trust would be presumed to be tax avoidance if it resulted in a significant income tax benefit, but also removed the examples illustrating the rule, including the example described above.

The IRS indicated that they are considering whether and how the questions posed should be addressed in future guidance, including whether the terms "principal purpose" and "identical grantors and beneficiaries" should be defined, and what examples might appropriately be provided.

199A Final Regulations

§1.643(f)-1 Treatment of Multiple Trusts.

(a) General rule. For purposes of subchapter J of chapter 1 of subtitle A of Title 26 of the United States Code, two or more trusts will be aggregated and treated as a single trust if such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and if a principal purpose for establishing one or more of such trusts or for contributing additional cash or other property to such trusts is the avoidance of Federal income tax. For purposes of applying this rule, spouses will be treated as one person.

(b) Effective/ applicability date. The provisions of this section apply to taxable years ending after August 16, 2018.

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The Preamble to the Final Regulations indicates that the following comments were received:

1. Requests for clarification of what it means to form or fund a trust with a significant purpose of receiving a Section 199A deduction, while stating that trusts should not be combined simply because the deduction is increased if there is a legitimate non-tax reason that led to the creation of the trusts.

2. Objections were received to the presumption of a tax avoidance purpose that would apply if there was a reduction of income tax under Section 199A, and arguing that the focus should be on whether there is a non-tax purpose for creating multiple trusts.

3. One commenter noted that the use of “substantial purpose” rather than “principal purpose” was inconsistent with the statutory language.

It is important to keep in mind that any single complex trust formed or funded for a primary purpose of avoiding income tax under Section 199A may be aggregated with its grantor or grantor under the anti-abuse rule described above, so that the Section 643(f) multiple trust rule may not be needed by the Service to disallow the Section 199A deduction in such circumstances.

The above multiple trust anti-abuse rule will apply only to tax years ending after December 22, 2017.




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Significant Changes in Final Regulations

The Final Regulations provide that a separately taxed trust that is "formed or funded with a principal purpose of avoiding, or of using more than one, threshold amount for purposes of calculating the deduction under Section 199A" will be considered as aggregated with its contributor for Section 199A purposes.

The Final Regulations was also changed from referencing "Trusts formed or funded..." under the Proposed Regulations to "A trust formed or funded..." under the Final Regulations, meaning that this not only applies to the creation of multiple trusts, but can also apply to the creation of a single trust.



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ESBTs ("Electing Small Business Trusts")

Under applicable tax laws, in order for a complex trust to be considered an eligible shareholder of S corporation stock, it must make an election to be treated as an Electing Small Business Trust ("ESBT"). Once an ESBT election is made, Treasury Regulation Section 1.641(c)-1 requires that it be treated as having two separate trusts, one consisting of the portion of the trust which holds the S corporation stock, and the other consisting of assets that are not S corporation stock. After the death of the grantor, the S portion of the trust is taxed at the highest trust bracket. The non-S portion is taxed under the traditional rules that apply to the taxation of complex trusts.

The Final Regulations clarified under the Proposed Regulations, many commentators thought that an ESBT would receive two thresholds – one for the S corporation portion of the trust, and another for the non-S corporation portion of the trust, however, the Final Regulations clarified that this is not the case – the S portion and non-S portion of an ESBT will be treated as a single trust for the purpose of determining the applicable threshold amount.

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Electing Small Business Trust (ESBT)

NOTE - - As written by the statute, any ESBT will not qualify for the 199A deduction, and although the Proposed Regulations say that it will, can regulations override an incorrect statute?

If the Grantor is Living:	After the Grantor's Death:
If disregarded (Grantor Trust) - Income is taxed at Grantor's individual income bracket	S-Corporation income taxed a highest bracket
If Complex: 1. S-Corporation income is taxed at highest income tax bracket 2. Other income taxed at beneficiary's bracket if distributed; if not income is taxed at compressed trust brackets	Other income taxed at beneficiary's bracket if distributed; if not income is taxed at compressed trust brackets

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Grantor Trusts

The Final Regulations fortunately were unchanged from the Proposed Regulations in indicating the trusts that are considered as owned by the grantor or a beneficiary of the trust will be treated as such. As indicated in other LISI Newsletters and Alan Gassman's Forbes Blog entitled *678 Ways To Qualify for the 199A 20% Deduction*, 678 Trusts can be used very effectively under the Section 199A rules to allow income to be considered as having been paid to low income bracket trust beneficiaries without having to give the income or other amounts to such beneficiaries. Any planner who is not yet using Section 678 Trusts owes it to him or herself and his or her clients to begin to do so, especially in Section 678 planning.

199A Final Regulations

§1.199A-6(d)(2) Grantor Trusts. To the extent that the grantor or another person is treated as owning all or part of a trust under sections 671 through 679, such person computes its section 199A deduction as if that person directly conducted the activities of the trust with respect to the portion of the trust treated as owned by the grantor or other person.

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Unrelated Business Income

Section 501(a) "Tax Exempt Entities," including charitable trusts and 501(c)(3) charitable corporations, are subject to income tax on income that is not related to their charitable or tax exempt functions. This is known as "Unrelated Business Taxable Income." The Preamble to the Final Regulations indicates that eligibility to receive a Section 199A deduction by tax exempt companies and trusts are beyond the scope of the Final Regulations, and that the IRS will study the issue and request comments on the interaction of Sections 199A and 512.

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Conclusion

The IRS giveth and the IRS Taketh Away. While the Final Regulations retain a number of the limitations that the Proposed Regulations announced regarding trust planning, multiple avenues remain open to allow for the possible restructuring of businesses and professional arrangements in order to maximize the Section 199A deduction and associated income and Medicare tax planning. Tax planners and advisors that have a thorough understanding of these rules can use them to their advantage in order to maximize clients' abilities to take a Section 199A deduction.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Alan Gassman

Brandon Ketron

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EXCERPT FROM:

Leimberg Information Services, Inc.

Steve Leimberg's Income Tax Planning
Email Newsletter Archive Message #168

Date:21-Jan-19

Subject: Alan Gassman, John Beck & Brandon Ketron - How the Final 199A Regulations Changed the Definition of Performance of Services in the Field of Health

"On January 18, 2019, the Final Regulations changed the definition of 'performance of services in the field of health' and will likely have the result of including many more medical professions in that definition. Unfortunately, the new definition and related examples leave much of what may be considered 'performance of services in the field of health' open to interpretation and do not provide the level of guidance many may have hoped for.

This newsletter analyzes the new language of the definition of 'services in the field of health' and some of the potential consequences of the updated language and the new ball park we find ourselves in."

(For a copy of the entire article, email agassman@gassmanpa.com)

EXCERPT FROM:

Leimberg Information Services, Inc.

Steve Leimberg's Income Tax Planning
Email Newsletter Archive Message #170

Date:21-Jan-19

Subject: Alan Gassman, John Beck & Brandon Ketron - One Particular Harbor, New Regulatory Guidance on If and When a Rental Real Estate Activity Can Qualify for the 20% Section 199A Deduction

"The time is now to reach out to clients who have rental properties, convert triple net leases to be able to qualify under the statute, and make sure that clients, or their employees and agents, are spending at least 250 hours a year doing the right things. While at it, we can explain what entities clients should have their real estate in, determine if they have sufficient unadjusted basis immediately after acquisition (UBIA) of their qualified properties, and talk to them about other planning opportunities."

(For a copy of the entire article, email agassman@gassmanpa.com)

Significant Limitations Apply With Respect to Income Received from Specified Trades or Businesses

For taxpayers with less than $157,500, or $315,000 of taxable income, if married, income from a Specified Trade or Business qualifies for the deduction.

Taxpayers with income above those levels have a phase out or complete elimination of the deduction, as described in the next slide.

The Specified Trades and Businesses are as follows:

1. health
2. law
3. accounting
4. actuarial services
5. performing arts
6. consulting
7. athletics
8. financial services
9. brokerage services
10. investing, trading, or dealing in securities, partnership interest or commodities
11. any business where the principal asset is the reputation or skill of one or more of its employees or owners

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Health Services SSTB Under Final Regulations

The Proposed Regulations defined health services as:

- "the field of health means the provision of medical services by individuals such as physicians......and other similar healthcare professionals performing services in their capacity as such **who provide medical services directly to a patient (service recipient)**."

The Final Regulations removed the bolded words above, which may have the effect of treating many more healthcare professionals as SSTBs.

- The Treasury and the IRS agreed that proximity to patients is not a necessary component to providing services in the field of health.

- The final regulations also provided a number of examples which are included on the following slides. The Treasury and the IRS have provided the following examples in an attempt to clarify what is a health service although some of the examples may not be realistic due to applicable healthcare laws.

Final Regulations still exempt the following from health services:

- "the performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers, payment processing, or the research, testing or manufacture and/or sales of pharmaceuticals or medical devices."

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Health Services Example 1

Under the first new example, a board certified pharmacist has a full-time job but also works part-time as needed as an independent contractor to a small medical facility in a rural area. The part-time pharmacist works at the facility and receives and reviews orders from physicians who are providing medical care at the facility, makes recommendations on dosing and alternative medications, performs inoculations, checks for drug interactions, and fills pharmaceutical orders for patients receiving care at the facility. The example concludes that this part-time pharmacist is engaged in the field of health.

- The Preamble to the Final Regulations indicate that this example was provided in response to commentator requesting clarification on whether a retail pharmacy selling pharmaceuticals or medical devices is engaged in a health service trade or business.

- This indicates that "the sale of pharmaceuticals and medical devices by a retail pharmacy is not by itself a trade or business performing services in the field of health, but some services provided by a retail pharmacy through a pharmacist are in the field of health."

  - It seems like filling prescriptions is not a healthcare function but discussing a prescription with a doctor or patient does. It is unclear how a pharmacist could fill prescriptions without talking to a patient or doctor.

- It would also seem that the pharmacist in the above scenario would be an employee and not an independent contractor.

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Health Services Example 2

A second new example involves an entity that operates a residential facility for the elderly that provides not only the housing facility, but also meals, laundry and entertainment. The facility entity also contracts with local professional health care organizations to provide residents with a range of medical and health services at the facility, including skilled nursing, physical and occupational therapy, speech pathology, medical social services, medications, medical supplies and equipment used in the facility, ambulance transportation and dietary counseling.

The facility receives all of its income from residents for residential services, and any health and medical services are billed directly by the health care providers. The example concludes that the facility does not perform services in the field of health.
Treas. Reg. 1.199A-5(b)(3)(ii)

- Many similarly situated facilities have directly employed nurses, whether skilled or not, who are available to help assure that residents take their medications daily and may check the residents' vitals. This would most likely be considered incidental.

- Overall, this example should prove to be a victory for residential facilities that do not provide a significant amount of services that involve skilled nursing.

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Health Services Example 3

The third new example provides that a company that operates day surgery centers and does not employ physicians, nurses or medical assistants, does not perform services in the field of health, even though it presumably provides medical equipment, medical supplies and support staff other than physicians, nurses and medical assistants.

The surgery center in the example enters into agreements with other professional medical organizations or directly with individual medical professionals to perform the procedures and provide all medical care.

- The commentary to the Final Regulations indicate that several commentators asked for clarification regarding when two separate activities would generally be viewed separately in the healthcare field and this was given as a “fact pattern that the Treasury Department and the IRS do not believe is a trade or business providing services in the field of health.”

- As a practical matter, the vast majority of ambulatory surgery centers (“ASC”’s) simply allow doctors to bring their patients in for procedures, and then charge a separate procedure fee, with the doctor charging a “procedure fee” and taking care of all physician services before and after the procedure at the doctor’s own office.

- The restructuring of surgery centers as the result of the Final Regulations may involve establishing nursing and personal care service companies that would hire the patient management staff of the ambulatory surgical center, and any anesthesiologists or nurse anesthetists who have been performing services at the center.

- There would likely be violations of the Federal and some state anti-kickback statutes when surgery centers are paid directly or indirectly by anesthesiologists, anesthetists or anesthesia entities for the right to perform anesthesia services at the facility.



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Health Services Example 4

The fourth new example involves the "only provider" of a patented test that is used to detect a particular medical condition. This entity accepts test orders only from health care professionals, and does not have contact with patients. Its employees do not diagnose, treat or manage any aspect of medical care. Only the manager of the testing operations has an advanced medical degree and no other employees are health care professionals, although they are well-educated technical professionals who each received more than a year of a specialized training in what the company does. The company analyzes results from testing and provides its clients, the medical professionals, with a report summarizing the findings. It does not discuss results or the patient's diagnosis or treatment with any health care provider or patient, and is not informed as to the resulting diagnosis or treatment. The company is found not to be providing services in the field of health.

- This example provides very clear guidance for the majority of testing and similar operations, which will typically include a statistical or charted summary with the test results for each patient to indicate whether the test findings are within normal and abnormal ranges.

- It appears, as discussed in Example 1, that there may be issues if the testing facility consults directly with the physician regarding recommended courses of treatment or assistance that extends beyond providing the report generated by the testing.

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Health Services – Miscellaneous

- **<u>Stem Cell and PRP Injection Therapies</u> –** One commentator argued that gene therapy and stem cell therapy should be treated the same as pharmaceuticals so that their manufacture and production is not considered to be a health service. Due to the fact that these therapies are generally provided by a physician who examines the patient, handles or oversees the extraction, and handles or oversees the re-injection, which is often done with ultrasound or other x-ray style guidance, these treatments will likely be treated as health services.

- **<u>Veterinarian Services</u> –** There is a lengthy discussion of veterinary medicine and animal health in the history of the characterization thereof as being a health service. Apparently, veterinarians lobbied hard to be excluded, and this was not successful.

- **<u>Physical Therapists</u> -** One commentator requested a dividing line between physical therapists and other health-related occupations, noting that physical therapists are paid less than doctors and that Congress initially attempted to exclude physical therapists from being reimbursed Medicare and Medicaid. The Treasury Department and the IRS declined to exclude physical therapists from being health care professionals.

- **<u>Remote Radiologists and Non-Patient Contact Professionals</u> -** One commenter suggested that services are not performed in the field of health unless "performed directly to a patient." The Treasury Department and the IRS agreed that proximity to patients is not a necessary component of providing services in the field of health, so the Final Regulations removed the requirement that <u>medical services be provided directly to a patient.</u>

(Excerpt from recent Forbes Blog article by Alan Gassman, published November 1, 2018)

Does Rental Income Qualify For The New 20% Section 199A Deduction?

Alan Gassman Contributor
Retirement
I write about tax, estate and legal strategies and opportunities.

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Why Landlords With Triple Net Leases Are Likely Punished Under The New Tax Law

Section 199A was added to the Internal Revenue Code under the Tax Cuts and Jobs Act of 2017 to provide taxpayers with a 20% deduction from income attributable to qualifying trades or businesses.

One immediate question under the new law was whether the definition of a "trade or business" would include a landlord who is in the business of collecting rent and performing only incidental duties under a Lease Agreement.

This will make a big difference for landlords who have a net profit because rent income exceeds depreciation, interest and operating deductions.

New Proposed Regulations were issued on August 8th which provide some degree of guidance, but also confusion.

The new Proposed Regulations indicate that if a taxpayer has an active business, like a factory or an engineering firm, and directly or indirectly leases property to the firm, then the net income from the leasing arrangement will be considered to be an active trade or business for Section 199A purposes.

On the other hand, where the tenant under an arrangement is not an active business that is affiliated by at least 50% ownership with the landlord, then by the terms of the Proposed Regulations a definition of "trade or business" which comes from Internal Revenue Code Section 162 will be used. Section 162 dates back to 1926, and controls when a taxpayer can take deductions for expenses incurred in an "active trade or business."

The court cases interpreting Section 162 have not always been kind to landlords. In particular, there needs to be something more than a long-term triple net lease where a landlord just collects rent and does very little else in order to qualify as being a trade or business.

A landlord that provides active management relating to a particular building, or at least administers common area expenses, should probably be able to take the Section 199A deduction, but someone who simply bought a building that is triple net leased to a large company where the large company does everything and simply sends a check to the property owner will probably not qualify, although this is not clear.

One example in the Proposed Regulations provides that an individual who manages and leases vacant property to an airport is able to take the deduction.

The primary focus of this example was not whether this landowner was in a "trade or business," but it seems like the only reason the IRS would have had to mention that the landlord manages the airport property would be to show that it must be an active trade or business.

A second example in the Proposed Regulations provides the same language for a parking garage rental.

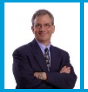
Based upon these examples, it appears that taxpayers who have passive triple net leases and are not otherwise active in the leasing business will not qualify for this 20% deduction, although landlords under triple net lease arrangements might be engaged in continuous due diligence, negotiating, and buying and selling properties that are triple net leased and therefore be considered to be in an active trade or business for the purposes of this deduction.

Employee Census

Name of Employer:

Provide complete information for all employees employed during the year, even if they have terminated.

Employee Name	Date of Birth	Date of Hire	Date of Termination	Annualized W-2 Compensation	Hours per Week	Ownership %



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Definition of Wages

For taxpayers with more than $157,500 of taxable income (or $315,000, if married), the full deduction (or any deduction whatsoever if over $217,500/$415,000) is lost, if the Qualified Business Income entity has not paid sufficient wages and/or does not have sufficient "Unified Basis Immediately After Acquisition ("UBIA") " basis.

Assuming no Qualified Property, the 199A deduction from any given entity or activity is limited to 50% of the wages allocated to the taxpayer.

Example - If the taxpayer's share of Qualified Business Income is $100,000, the maximum deduction would be $20,000, and wages paid by the entity would need to be at least $40,000 ($20,000 x 2 = $40,000). $40,000 divided by $140,000 is 28.7%.

Therefore, a client that has not paid wages and would otherwise have $100,000 of income, and is a high earner, will need to pay $28,700 in wages to have $71,300 in 199A Qualified Business Income to deduct.

Note - that certain separate trades or businesses can be aggregated for Wage and Qualified Property testing purposes



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Definition of Wages, continued

Wages include all W-2 payments made by a Schedule C, E or F business, an S corporation or a partnership, except as follows:

(a) Compensation paid by a partnership to a partner will not qualify and is instead called a "Guaranteed Payment"

Note While the definition of "guaranteed payments" in the partnership tax includes payments for the use of capital, the IRS concluded that an individual or entity taxed as an S corporation or partnership that receives guaranteed payments for having provided capital to a partnership cannot characterize such income as trade or business income that will qualify for the Section 199A deduction.

For example, an S corporation or partnership that provides capital to a separate LLC taxed as a partnership and receives payments based upon 15% of such capital contribution amount each year for 10 years will not be able to receive a 20% income tax deduction on such income.

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Definition of Wages, continued

Wages include all W-2 payments made by a Schedule C, E or F business, an S corporation or a partnership, except as follows:

(b) An individual Schedule C, E, or F owner cannot pay herself wages (but can pay wages to her spouse).

Note that wages include most pension contributions, health plan expenses and many other employment expenses.

Note that S corporations are required to pay reasonable wages to shareholders/owners who render valuable services. Several comments were received by the IRS in response to the Proposed Regulations requesting some sort of safe harbor so that tax return preparers would not be subject to possible penalties if they signed off on tax returns where there was unreasonably low compensation paid to an S corporation shareholder. The Service concluded that providing additional guidance with respect to this was beyond the scope of the Final Regulations.

The Final Regulations retain the provisions related to employee leasing, professional employer organizations (PEOs) and common paymaster arrangements – for one company to pay wages for another under a common paymaster arrangement the employee must do some work for the common paymaster.

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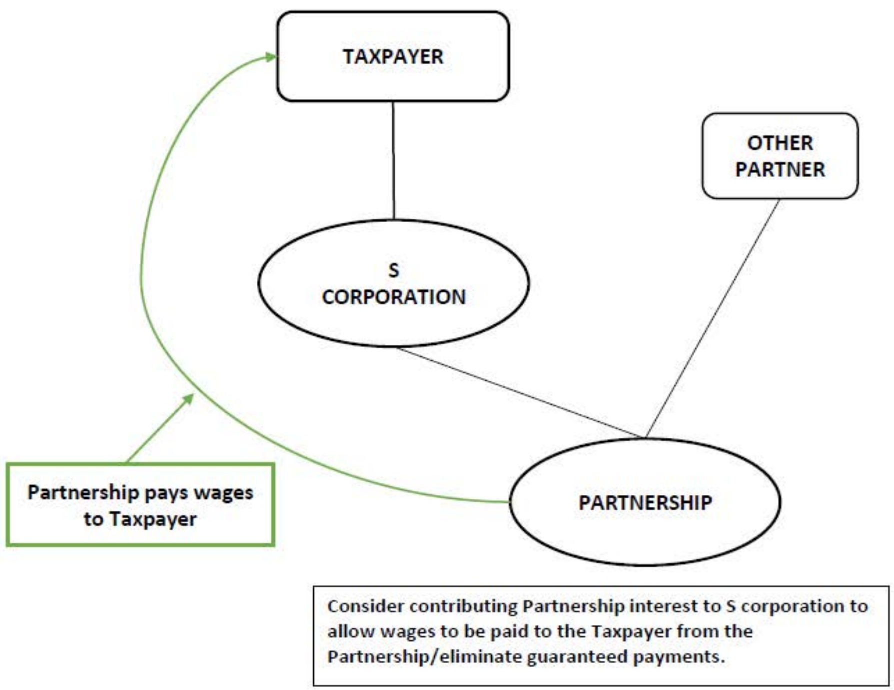
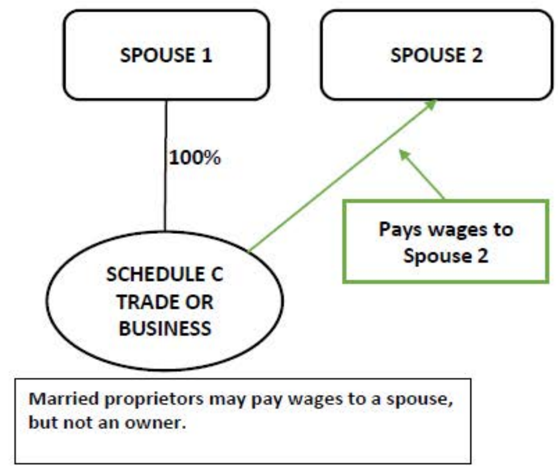
Chart 2 – W-2 WAGES BY ENTITY CHART. This chart simplifies who can be paid W-2 wages for the purposes of maximizing a Section 199A deduction from the standpoint of the flow-through entity:

Which employees below can be paid W-2 wages by the business structures listed on the right?	Sole Proprietorship	Partnership	S Corporation
Owners/employees with ownership interest	No	No	Yes
Non-owner employees	Yes	Yes	Yes
Spouses (with no ownership interest)	Yes	Yes	Yes
Independent contractors	No	No	No





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Some Employees Should Become Independent Contractors and Some Independent Contractors Should Become Employees

Some employees should become independent contractors and some independent contractors should become employees.

An employee may prefer to be an independent contractor to qualify for the 20% deduction, but is it worth it after paying employment taxes, or will the employer pay extra in recognition of saving employment taxes?

An independent contractor may need to become an employee to allow the employer to have sufficient wages.

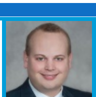
The statute indicates that income from services rendered "in the nature of an employee" will not qualify for the deduction.

The Final Regulations indicate that a person who was an employee will be presumed to be an employee for a period of three years even after restructuring to be an independent contractor or going to work for a separate entity that is an independent contractor to the original employer.

The Final Regulations fortunately provide that an individual may rebut the presumption by providing records that are sufficient to corroborate the individual's status as a non-employee for federal employment tax purposes. Records can include contracts and partnership or shareholder agreements.

Also, the Final Regulations contain an additional example in which an employee has materially modified his relationship with an employer to successfully rebut the presumption.





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(Excerpt from recent Forbes Blog article by Alan Gassman, published October 5, 2018)

What Is An Independent Contractor? Here's Why It Matters Under The Trump Tax Law

Alan Gassman Contributor
Retirement
I write about tax, estate and legal strategies and opportunities.

Photo Credit: Getty

Harsh consequences may befall those who mis-categorize themselves or others.

Individuals who work for themselves are treated differently than employees, but the distinction is sometimes very hard to make.

The IRS leans towards having individuals, in the interest of making sure that everyone is on the tax system with withholding and for the sake of watching out for the benefit of individual workers who have employment tax contributions, workers' compensation, unemployment, and other benefits required by law.

The 2017 Tax Act includes new Internal Revenue Code § 199A, which provides that individuals who are independent contractors can qualify for a 20 percent tax deduction on their independent contractor income without further requirements being met as long as they are engaged in a trade or business and make less than $315,000.00 in taxable income with their spouse if they are married filing jointly, or $157,500.00 of taxable income if filing a single return. Individuals with higher incomes may still be able to take the deduction, in whole or in part, based upon whether they pay wages, and what trade or business they are in. This is covered very well in Tony Nitti's article "IRS Provides Guidance on 20% Pass-Through Deduction, But Questions Remain" published on August 9th, 2018.

The IRS will be on the lookout for individuals who change from employee to independent contractor status to the extent that they can. In fact, new proposed regulations released on August 8th indicate that the IRS will presume that an individual who was an employee and changed to an independent contractor will continue to be treated as an employee and therefore deprived of a Section 199A 20 percent deduction, unless it can be proven that he or she is truly an independent contractor. Employee relationships will thus be viewed as "sticky" and not easy or safe to change or adapt.

Given the many factors that are taken into account in making a determination, and the significant latitude that courts have in determining what factors apply, even individuals with the best of intentions who restructure their relationships to meet the requirements of being an independent contractor cannot be absolutely sure how the IRS will treat them.

Chart 4 – EMPLOYMENT TAX RATES SUMMARY CHART. This chart gives the rates for the above employment taxes. For this chart, assume the employer is in the highest tax bracket, so that an employer in the 37% tax bracket will pay 63% of the employment tax rate (after taking into account that the payments are tax deductible), which will be $6,189 on the first $128,400 of income ($128,400 x 4.82% is $6,189). Also, if the employee is married the additional Medicare tax threshold will be $250,000, or $200,000 if the employee is single.

	Employed			**Independent Contractor**
Income	**Employer (Deductible)**	**Employee**	**Combined**	**Self Employed***
$100,000	(63% x 7.65%) = 4.82% **Cumulative Cost: $4,820**	7.65% **Cumulative Cost: $7,650**	12.47% **Cumulative Total: $12,470**	12.47% **Cumulative Total: $12,470**
$128,400	(63% x 7.65%) = 4.82% **Cumulative Cost: $6,189**	7.65% **Cumulative Cost: $9,823**	12.47% **Cumulative Total: $16,012**	12.47% **Cumulative Total: $16,012**
$200,000	(63% x 1.45%) = 0.914% **Cumulative Cost: $6,843**	1.45% **Cumulative Cost: $10,861**	2.34% **Cumulative Total: $17,684**	2.34% **Cumulative Total: $17,684**
$250,000	(63% x 1.45%) = 0.914% **Cost: $7,300**	1.45% **Cumulative Cost: $11,586**	2.34% **Cumulative Total: $18,856**	2.34% **Cumulative Total: $18,856**

*	Self-employed taxpayers act as employer and employee, and can deduct one-half of their employment tax against their income tax.

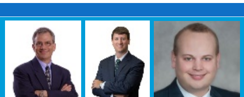

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CHART 18 - 3 FACTORS/20 FACTORS COMBINATION CHART.

	Common Law Test Factor	Behavioral Control	Financial Control	Relationship of the Parties
1	Compliance with instructions	X		
2	Training	X		
3	Integration	X		
4	Services rendered personally	X		
5	Hiring, supervision, and paying assistants	X		
6	Set hours to work	X		
7	Full time required	X		
8	Doing work on employer's premises	X		X
9	Order or sequence test	X		
10	Oral or written reports	X		
11	Payment by the hour, week, or month		X	
12	Payment of business and/or traveling expenses		X	
13	Furnishing tools and materials		X	
14	Significant investment		X	
15	Realization of profit or loss		X	
16	Making services available to the general public		X	
17	Continuing relationship			X
18	Working for more than one firm at a time			X
19	Right to discharge			X
20	Right to terminate			X



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Significant Changes in Final Regulations

1. The new definition for performances of services in the field of health is no longer limited to those who provide medical services directly to a patient, which significantly broadens this definition.

2. Architects and engineers were specifically excluded from the definition of performance of services in the field of consulting.

3. Life insurance excluded as an SSTB.

4. The Final Regulations eliminated the incidental SSTB limitation whereby SSTB's providing products and/or services that were incidental to their SSTB trade or business would need to exceed 5% of the total combined gross receipts of the trade or business in order to be considered a separate trade or business and not aggregated as part of the SSTB.

5. The Final Regulations do clarify that the S portion and non-S portion of an ESBT will be treated as a single trust for the purpose of determining the applicable threshold amount.

6. The Final Regulations confirm that the SSTB limitation and the W-2 and wage/property limitation also applies to publicly traded partnerships.



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Significant Changes in Final Regulations

7. The Final Regulations allows a partnership to take into account basis adjustments using a modified version of Section 743(b) when a Section 754 election is in place.

8. The Final Regulations corrected the taxpayer unfriendly position under the Proposed Regulations that the UBIA of property contributed to a S-Corporation or Partnership would be based upon the basis of the property on the date of contribution, which could result in a step-down in basis if property was depreciable.

   The Final Regulations provide that the UBIA of contributed property will retain the basis of the property when it was first placed into service by the contributing partner or shareholder.

9. The Final Regulations confirm that qualified property that is eligible to receive a new fair market value income tax basis under IRC Section 1014 will be considered to have been placed in service at the date of death fair market value with a new depreciation period having started.

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Expenses Deductible in Determining Qualified Business Income

The Preamble to the Final Regulations recognized that any expense that is deductible for federal income tax purposes will be considered as an expense in the determination of Qualified Business Income under Section 199A, including the deductible portion (50%) of employment taxes on self-employment income under Section 164(f), the self-employed health insurance deduction under Section 162(l) and the deduction for contributions to qualified retirement plans under Section 404.

The Treasury Department and the IRS declined to address whether deductions for unreimbursed partnership expenses, the interest expensed to acquire partnership and S corporation interest, and state and local taxes are attributable to a trade or business, stating that “such guidance is beyond the scope of such regulations.” – WHAT A COP-OUT!



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The Qualified Property Test

The Qualified Property Test is that the 20% Qualified Business Income deduction for a high earner taxpayer cannot exceed 2.5% of the Unadjusted Basis Immediately After Acquisition ("UBIA").

The Unadjusted Basis Immediately After Acquisition is the original cost of depreciable assets. The Proposed Regulations provide that improvements are considered as separate assets with separate tracked lifetimes under the statute.

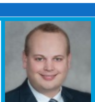
The Unadjusted Basis Immediately After Acquisition disappears completely at the later of (1) 10 years after acquisition and placement into service; or (2) when the depreciation period for the particular asset ends.

Therefore, a building depreciated over 39 years will have its Unadjusted Basis Immediately After Acquisition amount for the full 39 years.

An air conditioning system with a five or seven year life will have its Unadjusted Basis Immediately After Acquisition for ten years.

HYBRID METHOD - use 50% of wages or the sum of 2.5% of Qualified Property plus 25% of wages.





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Section 199A Strategies

Let’s talk now about strategies as opposed to the 199 technical points that we could spend the rest of our time reviewing.

These strategies may not mean a lot as I review, but these are the “take it back to the office and apply it” items that can save solid tax dollars for your clients, and give you a useful checklist for what your law firm or CPA firm can do to help clients qualify for the strategy.

Taking into account that single taxpayers with under $157,500 in taxable income and married under $315,000 can take the deduction for any specified trade or business, and without reference to whether wages or qualified property levels apply:

a. **<u>Don’t Use S Corporations for Low Income Taxpayers</u>**.

Do not use an S-Corporation for these clients, unless you have to have wages to justify a pension plan or can put part ownership under someone other than the taxpayer or the taxpayer's spouse that files a joint return with the taxpayer.

If there is no significant pension plan, and a married contractor can earn $315,000, as a Schedule C taxpayer, do so without going into an S-Corporation, so that she does not have to pay herself reasonable wages under Revenue Ruling 74-44 and the long line of case law requiring S-Corporation shareholders to pay themselves reasonable compensation if rules because the wages do not qualify for the Section 199A deduction.



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Section 199A Strategies, continued

b. **<u>Use S Corporations for High Income Taxpayers</u>**.

If your client is well over the $217,500, or $415,000 if married, threshold, then the business is probably best suited to be an S-Corporation, to avoid employment taxes and to enable the person to pay himself or herself sufficient wages to qualify.

c. **<u>Minimize or Eliminate Guaranteed Payments From Partnerships</u>**.

Your clients who derive income from entities taxed as partnerships should minimize guaranteed payments that they receive, because this income does not qualify for the Section 199A deduction.

If your client is receiving a guaranteed payment that needs to be wages, then convey the partnership interest to the S-Corporation if debt does not exceed basis, and the compensation paid to the individual owner of the S-Corporation does not have to be classified as a guaranteed payment.

Remember that hot assets (ordinary income assets) from the sale of a partnership interest qualify for the 199A deduction.

d. **<u>Asset Sales Yielding Ordinary Income Can Qualify Under Section 199A</u>**.

The Proposed Regulations specifically confirm this for situations where a partner’s sale of a partnership interest triggers “hot asset” income (from accounts receivable and appreciable items).

This should also apply where there is a sale of assets and ordinary income form the sale of accounts receivable, and depreciation recapture.



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Section 199A Strategies, continued

e. **Reduce Income**.

Do whatever you can to get the individual or married couple income below the $315,000/ $157,500 levels if this will save considerable taxes:

1. Defined benefit or cash balance pension planning.

2. 199A asset acquisitions.

3. Shelter capital gains in Charitable Remainder Uni-Trusts or by using deferred exchanges under 1031, which now only applies to investment or business real estate.

4. Oil and gas investments (100% deduction for individual’s intangible drilling costs (IDC).

5. Conservation easements.

6. Put other family members to work and on the payroll to reduce taxpayer’s income and increase wages.

7. Pay past due and prior earned amounts to others in 2018.

8. Defer sale of capital gain asset to next year if sale will increase income above the threshold levels.

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Section 199A Strategies, continued

f. **Establish Arm's-Length Compensation and Sales Arrangements**.

A specified trade or business owned by a high-earner taxpayer may pay arms length management, marketing, billing and factoring fees to a separate company whose income will not be Specified Trade or Service Business income until the final regulations come out.

When the final regulations come out, the separate company can be owned by children and/or 678 Trusts which are considered as owned by the beneficiary who had to withdrawal right over all assets. Google Gassman Forbes 678 to see article on this.

The ownership can be under complex trusts, which should receive a $157,500 threshold at both the trust level and at the level of each beneficiary until the final regulations come out.

If the final regulations restrict use of complex trusts convert the complex trust into a 678 trust, so for each young child, you will have $157,500 times 7% savings.

g. **Plan for Wages**.

Remember that the wages need to be 28.57% of what the income without wages would otherwise be, and include not only wages themselves, but also pension contributions and employer paid health benefits.

You may, therefore, already have significant "wages" but may not know it.



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Section 199A Strategies, continued

h. Decide **what income to aggregate** between related companies and what you can do to prevent aggregation in later years. Remember you can't aggregate SSTBs.

i. **Separate life insurance agency** income from investment advisory and annuity sales income.

j. **Restructure celebrities and well known professionals s**o that their earnings come from business operations and not from royalties or endorsements.

k. Make **real estate rentals and other "passive" activities** active in order to qualify such activities for the Section 199A deduction.

l. **Pay off loans** to eliminate interest expenses to qualify for a larger deduction, or maintain debt if interest expense will reduce income below the high earner thresholds.

m. Remember that **1231 property income** – capital gains income from the sale of business property – will not qualify, but losses will reduce 199A income. (See Section 1231 Summary Chart on next slide.)

The Section 1239 rules also apply.

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<u>Chart 9 - SECTION 1231 SUMMARY CHART.</u> Below is a chart that demonstrates how the netting system under Section 1231 works:

Net Gain of 1231 Property:		Net Loss of 1231 Property:	
Property:	Gain/Loss:	Property:	Gain/Loss:
Property 1	$5,000	Property 1	$ (5,000)
Property 2	$ (5,000)	Property 2	$5,000
Property 3	$5,000	Property 3	$ (5,000)
Net Gain:	$5,000	Net Loss:	$ (5,000)
Taxed as Long-Term Capital Gain		Treated as Ordinary Loss	

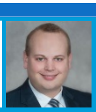
The characterization of gain of or losses from Section 1231 property applies in a consistent manner for purposes of Section 199A. Section 1231 property is defined as property used in a trade or business that (1) is subject to Section 167 depreciation held for more than one year, and (2) real property used in the trade or business held for one year.

All Section 1231 property gains and losses are netted. If the result is a net gain, then such gain is taxed as a long-term capital gain, and if the result is a net loss, then such loss is treated as an ordinary loss.

QBI does not include any "item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss." Section 1231 property is considered Qualified Property, which can be used to help eliminate limitations on the Section 199A deduction. Section 1231 Property sold for a net gain will not be considered QBI, but will be taxed at the more favorable capital gains rates, which peak at 20%.

Section 1231 is not to be confused with Section 1239 which converts capital gains into ordinary income if depreciable property is sold to a related party.





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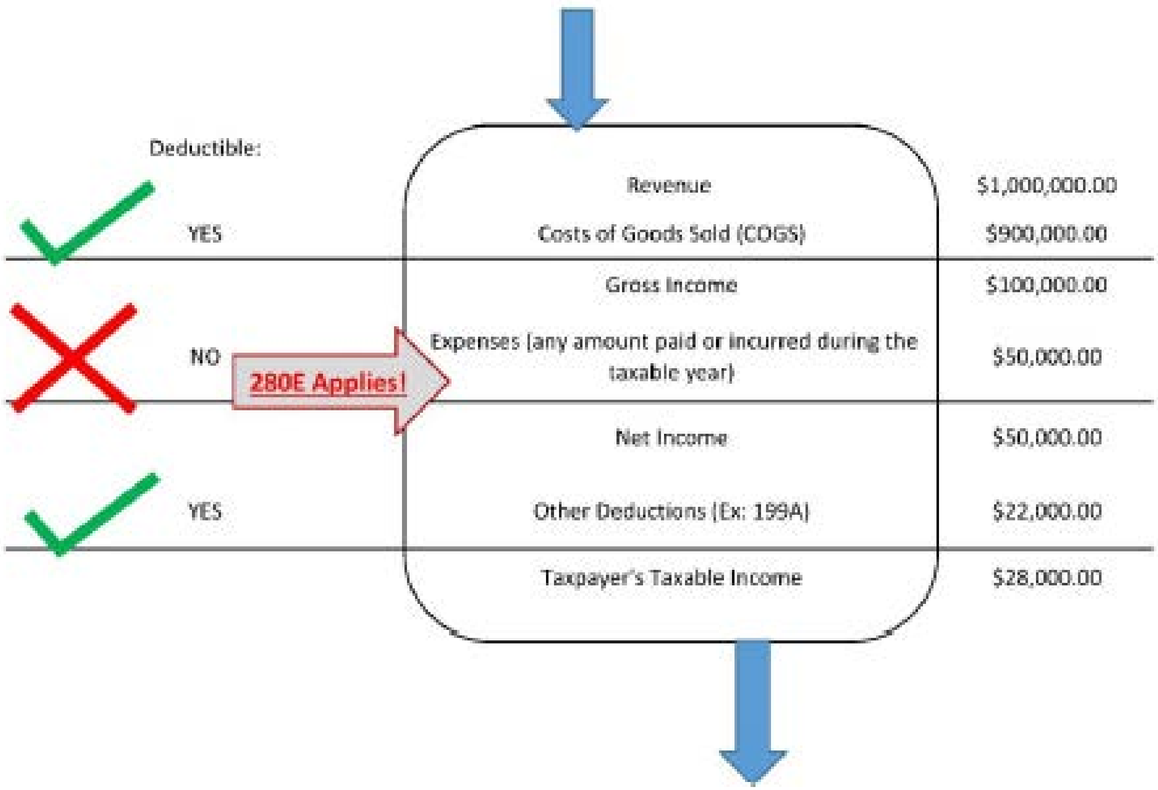
Section 199A Strategies, continued

n. Have **marijuana-related businesses** in flow through entities that have plenty of wages or qualified property to receive the 20% deduction.

Chart 11 – SECTION 280E EFFECT CHART. This chart displays the effect of Section 280E on business deductions.



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Section 199A Strategies, continued

o. **<u>Get Married or Divorced</u>**, depending upon the circumstances.

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<u>Chart 17 – MARITAL CONSIDERATIONS CHART.</u>

Consideration	Single Status	Married Status
Sale of a primary residence (Section 121(b))	Capital gain is excluded up to $250,000	Capital gain is excluded up to $500,000
Federal estate tax exemption	Can only shield assets up to $11.2 million from estate, gift, and generation-skipping tax	Can shield assets up to $22.4 million from estate, gift, and generation-skipping tax
Marital Tax Penalty and Bonuses	High-earning individuals may be better separate from a financial standpoint	Two high-earning individuals who get married may be subject to an increase in tax; one high-earner and one low-earner getting hitched may create tax savings
Medicare surtax threshold (additional 0.9% tax above the threshold)	$200,000 per person threshold	$250,000 per married couple threshold (a $150,000 threshold loss)
Tax on Social Security benefits	Can earn up to $25,000 and not be taxed on Social Security benefits	Can earn up to $32,000 and not be taxed on Social Security benefits
Transferability of assets upon death	Subject to estate tax if decedent is over $11,180,000 exemption amount on death	Surviving spouse can receive assets tax-free upon the death of the first spouse
Social Security survivorship benefits	Unmarried children under 18 can receive benefits;	Spouses can receive partial benefits if they are under

Chart 17, Marital Considerations Chart, continued

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Consideration	Single Status	Married Status
	possibly parents where the deceased provided at least half of their parent's support	retirement age, and may be eligible for 100% of the deceased's benefit if they have reached retirement age
Government and Employer Pension Plan survivorship benefits	No surviving spouse benefits if not married	Potentially eligible for survivorship benefits
Transferability of assets upon divorce	N/A	Tax-free passing of assets upon divorce
Ability to roll over an IRA on the death of a spouse	Cannot treat it as one's own IRA; cannot make continued contributions to the IRA	Allowed to roll over the IRA upon death without a tax hit; can treat the IRA as the surviving spouse's own; can continue to make contributions to the IRA
Net operating losses (NOL)	Cannot transfer to others	If losses are accumulated during marriage, they can be used against the joint income of the couple. If they are accumulated while single, it may be possible for one spouse to hire the NOL spouse and pay them a wage, which would be deductible depending on how large the NOLs are
Related Party Losses (Section 167(e))	Can take the losses on the sale to another individual	Can take the losses on the sale to his spouse
Medical and Nursing Expenses (to the extent they exceed 10% of Adjusted Gross Income)	May not be able to be claimed because of too high income (where the expenses fall under 10% of adjusted	Large medical expenses are more likely to impact the marital income, and may save thousands in taxes[212]

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Chart 17, Marital Considerations Chart, continued

Consideration	Single Status	Married Status
	gross income) or too low, where much of a potential deduction is wasted	
Sharing Capital Loss Carryforward (the excess of $3,000 is carried forward into future years)	N/A	An unmarried individual with loss carryforward from capital losses can marry someone with capital gains, and use the loss carryforward to reduce their capital gains liability
Tax Brackets	Enters the highest bracket of 37% at $500,000 of taxable income	Enters the highest bracket of 37% at $600,000 of taxable income
Standard deduction	Able to claim a $12,000 standard deduction	Able to claim a $24,000 standard deduction or two $12,000 standard deductions if filing separately



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Section 199A Strategies, continued

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p. **Warn about Substantial Understatement Test and Paid Preparer Penalties** – a single dollar of Section 199A eligible deduction causes the substantial understatement test to go from the greater of $5,000 or 10%of the tax required to be shown, to 5% of the tax, for no apparent reason.

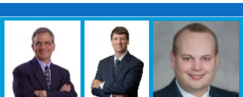
q. **If W-2 Wages and UBIA of Qualified Property is not reported, then the taxpayer's share of such items will be presumed to be zero!**

The Final Regulations clarified that if one item is not reported then it will not result in other items being presumed to be zero.

The Final Regulations also added a provision that would allow unreported items to be reported on an amended or late filed return for any open tax year.

r. **Reconsider Entity Selection**, based on Section 199A Factors.

(See chart on next slide.)



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Issue/Factor	Sole Proprietorship	Partnership	S Corporation	C Corporation
Tax Rates	Owners are taxed at individual rates for salary and income of the company	Owners are taxed at individual rates for salary and income of the company	Owners are taxed at individual rates for salary and income of the company	Entity taxed for income at 21%; shareholders taxed for dividends and distributions
Double Taxation	Not subject	Not subject	Not subject	Dividends or distributions taxed separately
Issue/Factor	Sole Proprietorship	Partnership	S Corporation	C Corporation
Availability of Section 199A deduction	Available (depending on limitations)	Available (depending on limitations)	Available (depending on limitations)	Cannot qualify for Section 199A
Accumulated Earnings	Taxed to owner as reported on their Form K-1, regardless of whether distributions are made	Taxed to owner as reported on their Form K-1, regardless of whether distributions are made	Taxed to owner as reported on their Form K-1, regardless of whether distributions are made	Taxed at 21% corporate rate; beware of accumulated earning tax issues
Guaranteed payments	N/A	Excluded from QBI; Not considered to be W-2 wages	N/A	N/A
Owner provides services (reasonable compensation issues)	Self-Employed (no W-2 wages); currently not subject to reasonable compensation	Self-Employed (no W-2 wages); currently not subject to reasonable compensation rules	W-2 Wages; excluded from QBI and subject to reasonable compensation rules	W-2 Wages; subject to reasonable compensation rules
Business is a Specified Service Trade or Business	Eligible if owner's taxable income is under lower-income thresholds; Limited if in between lower- and higher-income thresholds; Lost if taxable income is greater than higher-income thresholds	Eligible if owner's taxable income is under lower-income thresholds; Limited if in between lower- and higher-income thresholds; Lost if taxable income is greater than higher-income thresholds	Eligible if owner's taxable income is under lower-income thresholds; Limited if in between lower- and higher-income thresholds; Lost if taxable income is greater than higher-income thresholds	N/A
High Income earner as owner	May be limited if Wage/Property Hurdle is not met	May be limited if Wage/Property Hurdle is not met	May be limited if Wage/Property Hurdle is not met	N/A
Employees (W-2 Wages)	Consider impact on Wage/Property Limitation, adjust if necessary	Consider impact on Wage/Property Limitation, adjust if necessary	Consider impact on Wage/Property Limitation, adjust if necessary	N/A
Issue/Factor	Sole Proprietorship	Partnership	S Corporation	C Corporation
Independent contractors	Hurts in application of Wage/Property Hurdle; Compensation not considered W-2 wages	Hurts in application of Wage/Property Hurdle; Compensation not considered W-2 wages	Hurts in application of Wage/Property Hurdle; Compensation not considered W-2 wages	N/A
Qualified property basis	Consider impact on Wage/Property Hurdle, adjust if necessary	Consider impact on Wage/Property Hurdle, adjust if necessary	Consider impact on Wage/Property Hurdle, adjust if necessary	N/A
State and local tax deductions	Deduction Limited	Deduction Limited	Deduction Limited	Fully Deductible
Medical expenses and plans deductions	N/A	N/A	N/A	Premiums and medical reimbursement plans are deductible

Section 199A Strategies, continued

s. **Recharacterize and change entities or even professions** for services and businesses that will not be considered to be Specified Trades or Businesses.

Beautiful Losers: The Discriminatory Nature Of The 199A Proposed Regulations

Alan Gassman Contributor
Retirement
I write about tax, estate and legal strategies and opportunities.

The IRS's new Proposed Regulations push tax discrimination between professions to new heights.

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The lyrics of Bob Seger's hit "Beautiful Loser" ring true when reading the Proposed Regulations under Section 199A, which are riddled with disparities that push the envelope of the IRS's regulatory authority.

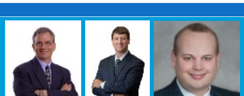
In May 2018, the IRS promised that the Proposed Regulations regarding the pass-through deduction would be issued in mid-June, however, they were only issued on August 8th. The IRS's new Proposed Regulations push tax discrimination between professions to new heights under tax and regulatory law that we have not seen since the Windfall Profits Taxes that were imposed on oil companies in the 1980's. The chart at the end of the article summarizes the Winners and Losers in each of the 11 categories of the statute, and a new 12^{th} category called "In the Trade Or Business of Being an Employee" that was introduced by the Proposed Regulations.

The crux of the discrimination is whether the trade or business meets the definition of a Specified Service Trade and Business, also known as an "SSTB".

For example, engineers, architects, bankers, property and casualty insurance agencies, hash bars, tattoo shops, brothels in Nevada and e-smoking dens can receive a 20% income tax deduction if they are S-corporations, partnerships, or individual Schedule C businesses and satisfy certain wage or qualified property requirements regardless of how high their income might be.

On the other hand, the professions of medicine, law, accounting, consulting, athletes, performers, and financial service companies are not able to take the 199A deduction if their personal income exceeds $207,500 if they are single, or $415,000 if they are married filing jointly.

See Forbes blog by Alan Gassman entitled "Beautiful Losers: The Discriminatory Nature of the 199A Proposed Regulations" for full article



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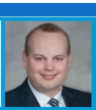
ALTERNATIVE MINIMUM TAX

The Section 199A deduction is not a preference item for AMT tax purposes.

Item Included in Taxable Income	Included in Alternative Minimum Taxable Income?
Standard Deduction	Not Allowed
State and Local Taxes	Not Allowed
Depreciation Deductions	Allowed (Some Restrictions Apply/Subject to Different calculation Method)
Itemized Medical Expenses	Allowed (To the extent exceeding 10% of Adjusted Gross Income)
Intangible Drilling Costs	Allowed (Some Restrictions Apply)*
Gain/Loss From Sale or Exchange of Property	Allowed
Section 199A Deduction	Allowed
Mortgage Interest Payment Deduction	Allowed (Except upon home equity loans)
Net Operating Losses	Allowed (but may not exceed 90% of AMTI)

Pages **82-83** of Section 199A (and 1202 Handbook





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ACTIVITY CHART		
Activity	**Includes**	**Does Not Include**
Where the Principal Asset of The Trade or Business is the Reputation or Skill of One or More Employees or Owners	**SEE DISCUSSION BELOW**	

14. The final category of a Specified Service Trade or Business involves a situation where the principal asset of the trade or business is the reputation or skill of one or more employees or owners. Many advisors were concerned with the potential breadth of this "catch all" provision. This was one of the few leniencies provided for in the Regulations.

Fortunately, under the Regulations, the Treasury choose to narrowly construe this category, and it will not apply unless one of the following three items exists:

(A) Fees or other compensation is received for endorsement of products or services;

(B) License or fees are received for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated therewith; or

(C) Compensation is received for appearing at an event or on radio, television, or other media.



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I feel disrespected

Chart 20 – TYPES OF TRUSTS CHART.

Complex Electing Small Business Trust "ESBT"

1. Can be owner of an S Corporation.
2. Can allow a non-resident alien beneficiary to effectively be a member of an S Corporation.
3. S Corporation income taxed at the highest rate bracket, regardless of whether income is distributed to beneficiaries.
4. ESBTs may have multiple beneficiaries, and mandatory distributions of income are not required.
5. Distributions made to charity will be subject to the same rules that apply to individuals.
6. 3.8% Medicare tax begins to apply at $12,500+ of AGI.

Grantor Trust

Grantor treated as the owner for federal income tax purposes.

Beneficiary Defective Trust (aka BDIT or 678 Trust)

Beneficiary treated as owner for federal income tax purposes.

Qualified Subchapter S Trust "QSST"

1. Can be owner of an S corporation.
2. Can have only one named beneficiary.
3. Must pay all "fiduciary accounting income" to trust beneficiary each year.
4. All S corporation K-1 income taxed to beneficiary of trust.

Complex Trust

1. Taxed as a separate entity to the extent that income is not distributed.
2. "Distributable Net Income" paid out can carry the income to lower bracket taxpayers.
3. The trust has an effective tax rate of 24.1% on the first $12,500 of income and 37% above that.
4. Distributions made within 65 days of the next tax year can be considered to have been made in the previous tax year.
5. Distributions made to charity can carry income to the charity to in effect give a tax deduction without a 60% adjusted gross income limitation or itemized deduction considerations.
6. 3.8% Medicare tax begins to apply at $12,500+ of AGI.
7. Unlike a C corporation - No tax upon liquidation of the trust.
8. Can shield trustee and beneficiaries from operational liability similar to a corporation depending upon state law.

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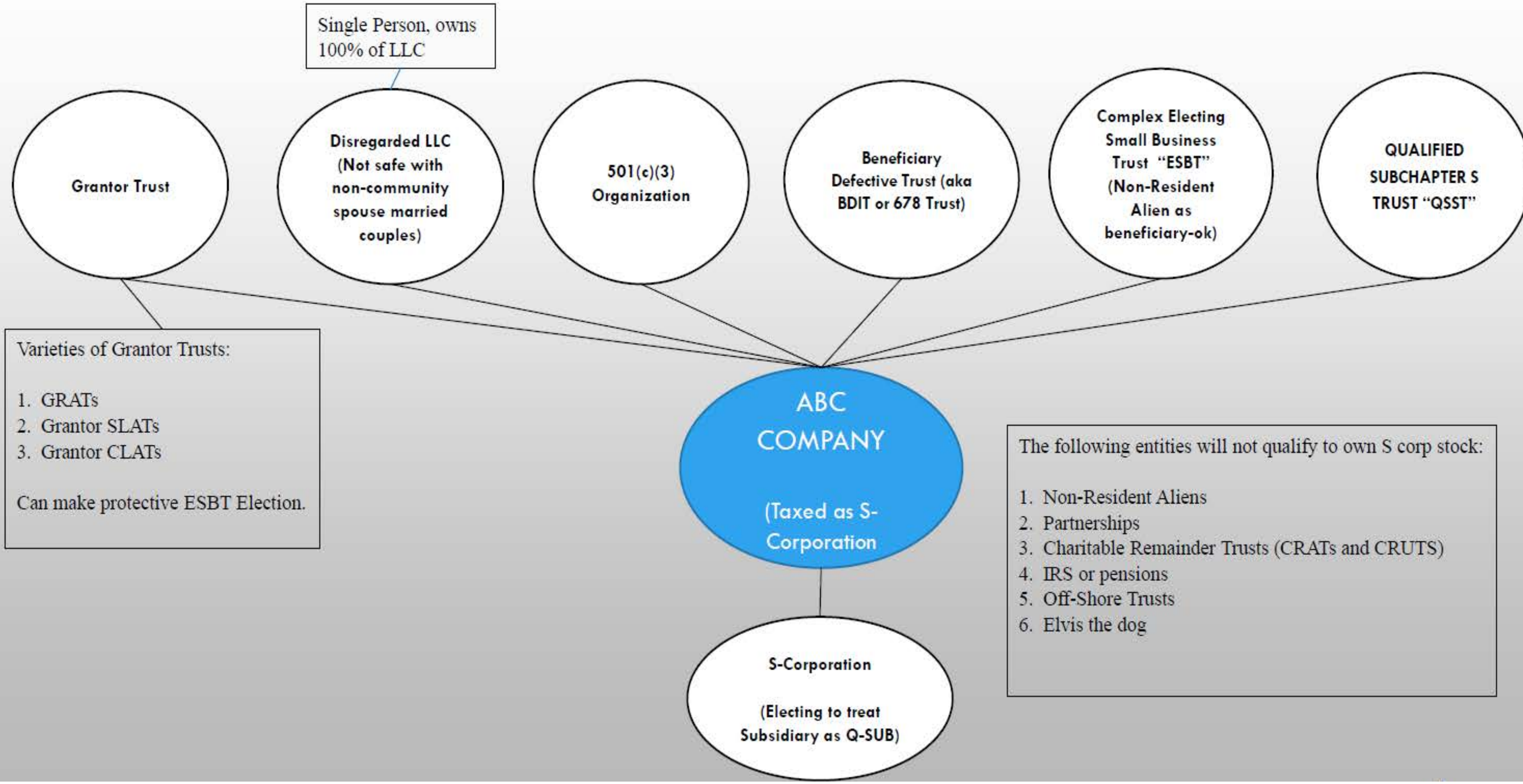
Refresher on Types of Entities That Can Hold S-Corporation Stock



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CALCULATING PHASE-OUT SITUATIONS WHEN THEY APPLY

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Chart 16 – SECTION 199A PHASE-OUT CALCULATIONS CHART. For this chart, assume the taxpayer is a joint filer who owns an S corporation. The taxpayer's taxable income is listed at the top of the chart and the left column shows if the business is a Specified Service, the flow-through income derived from the business, the W-2 wages paid by the business and the Qualified Property owned by the business. If Qualified Property is not listed in the left column, assume it is $0. The resulting percentage in the right five columns is what remains of the 20% Section 199A deduction. A full deduction is 20%, and the deduction reduced by half would be 10%.

Scenario:	$315,000	$340,000	$365,000	$390,000	$415,000
Specified Service Income - $100,000 Wages - $60,000	20%	15%	10%	5%	0%
Specified Service Income - $100,000 Wages - $0	20%	11.25%	5%	1.25%	0%
Non-Specified Service Income - $100,000 Wages - $60,000	20%	20%	20%	20%	20%
Non-Specified Service Income - $100,000 Wages - $0	20%	15%	10%	5%	0%
Non-Specified Service Income - $100,000 Wages - $20,000 Property - $600,000	20%	20%	20%	20%	20%
Non-Specified Service Income - $100,000 Wages - $10,000 Property - $200,000	20%	17.5%	15%	12.5%	10%



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EVENT	DATE/TIME	LOCATION	DESC.	REGISTRATION
Maui Mastermind Scale and Grow Rich	January 25-27, 2019	Hilton Irvine-Orange County Airport	Preparing Your Company for Sale and Why	Please Click HERE.
American Bar Association Presentation	Tuesday, January 29, 2:00 PM – Join Alan for his presentation, *Lesser Known Traps and Strategies for the Well Versed Creditor Protection Planner, Including What You Really Must Know About Bankruptcy.*			Please Click HERE.
Dentists are Different Webinar	February 4, 2019	Gotowebinar	With Martin Shenkman	Please Click HERE.
Leimberg Services Webinar	January 30, 2019, 3:00 PM	Gotowebinar	With Martin Shenkman and Jonathan Blattmachr, "Planning Strategies Under the New Section 199A Final Regulations"	Please Click HERE.
Johns Hopkins All Children's Foundation 2019 Estate, Tax, Legal and Financial Planning Seminar **February 7, 2019**	**Resurgence of a Forgotten Problem for Family Limited Partnerships: Section 2036 (A)(2) and the *Powell* Case Panel Discussion with Paul Lee, Jerry Hesch, Jonathan Blattmachr and Moderater, Alan Gassman, Esq.** **Alan will be presenting a stand alone presentation, "Creative Planning with Section 199A After the New Regulations".**			Contact: Agassman@gassmanpa.com
Pinellas County Medical Association "What You Need to Know About" Webinar Series	February 12, 2019, 12:00 PM	Gotowebinar	Limiting Liability by Using Medical Practice Companies and Other Entities	Please Click HERE

Special Presentation Webinar	February 13, 12:00 PM – 1:00 PM	gotowebinar	Special presentation with Roger McEowen - QBID Final Regulations on Aggregation and Rents – The Meaning For Farm and Ranch Businesses	Email Agassman@gassmanpa.com
Pinellas County Medical Association "What You Need to Know About" Webinar Series	February 19, 2019, 12:00 PM	Gotowebinar	Employee Practices, Exposures and Insurances with Chuck Wasson.	Please Click HERE
University of Florida Tax Law Institute Conference	March 2, 2019,	University of Florida, Gainesville, FL	Professional Acceleration for Tax and Estate Planning Lawyer Workshop	Email Alan at Gassman@gassmanpa.com
New Jersey Bar Association Presentations	March 11, 2019, 9:00am and 1:00PM New Jersey Law Center, New Brunswick, NJ	**Alan will be speaking on two separate topics:** **What to Do for Clients Who No Longer Have to Worry About Federal Estate Tax with Deirdre Wheatley** **and** ***What New Jersey Lawyers Need to Know About Florida Law***		To Register click HERE
Special webinar presentation with Holly Kerr	March 5, 2019	**Insurance Coverage with Holly Kerr and Alan Gassman**		Email Alan at Gassman@gassmanpa.com
Special webinar presentation with John McDonald	March 6, 2019	**"Selling Your Business: Advanced Planning Considerations with Chris Denicolo and John McDonald"**		Email Alan at Gassman@gassmanpa.com

Pinellas County Medical Association "What You Need to Know About" Webinar Series	March 12, 2019, 12:00 PM	Gotowebinar	**Anti-Kickback and Related Laws with Renee Kelly**	Please Click HERE
9th Annual Pinellas County Medical Association Continuing Medical Education Cruise	March 14-18, 2019 	Port of Tampa	**Biggest Mistakes Physicians Make in Medical Practice**	FOR INFORMATION AND RESERVATIONS CONTACT JEN BOLL 727-526-1571 / 1-800-422-0711
Pinellas County Medical Association "What You Need to Know About" Webinar Series	April 9, 2019, 12:00 PM	Gotowebinar	**Cornflakes and Estate Planning Mistakes with Mike Jensen**	Please Click HERE
Florida Bar Association	April 18, 2019, 10:00 am – 2:00 PM	Stetson Tampa Law Center ***Primary Florida and Federal Creditor Protection Laws, A Closer Look at Florida and Federal Creditor Exemption Laws and Planning*** And ***Putting it All Together with Leslie Share***		Contact: Agassman@gassmanpa.com
University of North Carolina Tax Institute	April 25-26, 2019	Creative Planning with Section 199A After the New Regulations		Contact: Agassman@gassmanpa.com
Maui Mastermind Financial Pillar Super Course	June 22-23, 2019	Hilton-Atlanta Airport	**Crucial Legal and Tax Principals for Accumulating Wealth**	Please Click HERE
45th Annual Notre Dame Tax Institute	October 26-27, 2019	South Bend, Indiana	**TBD**	Contact: Agassman@gassmanpa.com
Maui Mastermind Wealth Summit	November 3-8, 2019	Wailea Beach Resort, Maui	**Essential Aspects and Decisions for Your Remarkable Financial Future**	Please Click HERE

199A Updated

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What do the New 199A Regulations Say?

The New 199A Regulations were released today and Gassman, Crotty & Denicolo, P.A. have you covered. Join us for four special 30 minute complimentary presentations explaining the differences, implications, and new ways of thinking about this important topic.

Special 50 Minute Session for CPAs and Tax Advisors with CPE Credit*

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*CPE Credit Available within 30 Days

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We thank co-authors Martin M. Shenkman (Shenkman@shenkmanlaw.com) and Jonathan Blattmachr (Jblattmachr@hotmail.com) for their wisdom that make these webinars possible.

We wrote the book on 199A.
Please Contact us at 727-442-1200 with any questions

To register, click **HERE**.
(https://attendee.gotowebinar.com/register/8343072637662526721)

199A Planning for Real Estate Investors and Professionals

Thursday, January 24, 2019

Free Webinar – Presented By:

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