

# Tax Update - Business Opportunities & Strategies December 11, 2019

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**Bauman Associates LTD**

Contact information: Chad C. Ryder, CPA

4229 Southtowne Dr, EC, WI 54701

715-834-2001

[www.baumancpa.com](http://www.baumancpa.com)



# Topics

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- Tax Reform – Impact on Business
- Sales Tax – Wayfair
- Payroll Issues
- Meals & Entertainment

# Tax Reform passed in late 2017 – Most provisions became effective in 2018

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- 2019 is very similar to 2018
- It's possible a Technical Corrections Bill could still pass before year end
  - Main issue is a depreciation provision, but other items could be added to get it passed

# Overview of Business Changes

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- C Corp rate reduction to flat 21%
- Repeal of C Corp AMT
- Special rules for pass-throughs (Sec. 199A)
- Loss limitation for other than C corps (Sec. 461)
- Repeal of Sec.199 (DPAD)
- Expensing of assets
  - increases to Sec.179 (\$1 million and threshold \$2.5 million – adj for inflation)
- Changes to various fringe benefits including treatment of meals and entertainment paid by employer
- Limit on use of and carryback of NOL
- Limitation on interest expense deduction for non-small businesses (over \$25 million receipts); limited exceptions

# C Corp Rate Changes

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- Flat rate of 21%
- Effective for years beginning after 12/31/17
  - Change is “permanent” – no sunset provision
- Personal service corporations taxed at same rate (no more surtax)
- Corporate AMT has been repealed

# 20% Pass-through Deduction

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- New deduction beginning in 2018
  - In effect until 2025, unless the tax laws change before that
- Section 199A
- 20% of Qualified Business Income (QBI)
- Deduction is claimed on 1040
  - Factors must be reported on K-1s from pass-through entities
- Form 8995 – new for 2019
  - Was calculated using worksheets in 2018

# 20% Pass-through Deduction

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- Who Qualifies?
  - Sole Proprietor or Pass-through Entity (C Corporations DO NOT qualify)
- Must be a Qualified Trade or Business
  - Wages don't count (including S Corp wages and Partnership Guaranteed Payments)
  - Hobbies don't count
  - Investment income doesn't count
  - Rentals
    - Not much guidance from IRS – facts and circumstances
    - Self-rentals qualify
    - Active participation in rental real estate probably qualifies
    - **Should issue 1099s (businesses are required to issue 1099s)**

# 20% Pass-through Deduction (Sec 199A)

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- Phase out Limits
  - Based on ***Taxable Income Before the QBI Deduction*** on 1040
  - If ***Less*** than \$315,000 (MFJ) / \$157,500 (Single/HOH/MFS)
    - There are no limits and the deduction is 20% of the lesser of:
      - QBI or Taxable Income before QBI
- **Note – these limits are adjusted for inflation each year**
  - **2019 is \$321,400 / \$160,700**



# 20% Pass-through Deduction (Sec 199A)

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- Phase out Limits
  - Based on ***Taxable Income Before the QBI Deduction*** on 1040
  - If ***More*** than \$315,000 (MFJ) / \$157,500 (Single/HOH/MFS)
    - There are limits based on Wages and Investment
    - Additional limits apply to ***Specified Service Trade or Businesses***
- **Note – these limits are adjusted for inflation each year**
  - **2019 is \$321,400 / \$160,700**

# 20% Pass-through Deduction (Sec 199A)

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- Specified Service Trade or Business
  - Health
  - Law
  - Accounting
  - Actuarial Science
  - Performing Arts
  - Consulting

# 20% Pass-through Deduction (Sec 199A)

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- Specified Service Trade or Business
  - Athletics
  - Financial Services
  - Brokerage Services
  - Investment and Investment Management
  - Trading
  - Dealing
  - Business whose principal asset is the reputation or skill of one of its owners or employees

# 20% Pass-through Deduction (Sec 199A)

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- Wage/Investment Limits

- If NOT an SSTB

- If taxable income before the QBI deduction is **greater than** the \$315,000 / \$157,500 inflation adjusted amounts, then the QBI deduction starts to be phased out (reduced) based on the amount of wages paid and investment (property).

- 50% wages limit – QBI is lesser of 20% of QBI or 50% of wages paid

- If enough W2 wages are paid, then no limit

- 2.5% of property (land doesn't qualify) and 25% of wages

# 20% Pass-through Deduction (Sec 199A)

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- Wage/Investment Limits

- If NOT an SSTB

- Note – if taxable income before QBI deduction *exceeds* \$415,000 / \$207,500 amounts, the QBI deduction is fully limited based on wage/investment limits

- No QBI deduction allowed if no W2 wages or investment

- No limit on QBI deduction if enough wages are paid

- Important to review your situation before year-end

- Taxable income before QBI deduction limit

- Wages/Investment limits

- **2019 Inflation Adjusted Amounts \$421,400 / \$210,700**

# 20% Pass-through Deduction (Sec 199A)

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- Wage/Investment Limits

- If business is an SSTB

- If taxable income before the QBI deduction is **greater than** the inflation adjusted \$315,000 / \$157,500 amounts, then the QBI deduction starts to be phased out (reduced) based on income and on the amount of wages paid and investment (property).

- 50% wages limit

- Even if enough W2 wages are paid, there is a limit based on income

- 2.5% of property (land doesn't qualify) and 25% of wages

# 20% Pass-through Deduction (Sec 199A)

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- Wage/Investment Limits

- If business is an SSTB

- Note – if taxable income before QBI deduction **exceeds** the \$415,000 / \$207,500 inflation adjusted amounts, the QBI deduction is completely disallowed

- Important to review your situation before year-end

- Taxable income before QBI deduction limit

- Note for SSTB that if income exceeds amounts then no QBI deduction is allowed

- Wages/Investment limits apply over for the phase-out range

# 20% Pass-through Deduction (Sec 199A)

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- Planning Opportunities
- QBI can be limited based on Taxable Income before QBI deduction
  - Depreciation (note that depreciation reduces QBI but if needed to get below thresholds then it is important to do especially for SSTB amount)
  - Retirement plan contributions
  - HSA contributions
  - Donor advised funds (charitable donation if itemizing)



# 20% Pass-through Deduction (Sec 199A)

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- Planning Opportunities
- QBI can be limited based on W2 wages paid
  - Owner's compensation (S Corp)
  - Year end bonuses
  - Consider making independent contractors into employees (need to consider payroll tax costs and fringe benefit costs)

# Depreciation

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- Bonus depreciation
  - Additional first yr. 100% deduction for property acquired after 9/27/17
  - Bonus depreciation phase down schedule for years after 2022
  - **Now allowed for new and used property**
- Auto limits
  - Luxury auto 1<sup>st</sup> year additional \$8k depreciation has been extended
  - SUV Sec 179 limitation remains at \$25,000
- Qualified improvement property – new definition and recovery period
- Section 179
  - Increased to \$1M and threshold \$2.5M
    - **2019 inflation adjusted is \$1,020,000 / \$2,550,000**
  - Eligible property now includes nonresidential improvement real property (roofs, HVAC, and fire/security/alarm systems)
  - Eligible property also includes residential personal property (furniture, appliances, etc.)

**\*\*\*Remember De Minimis Election**



# Net operating loss provisions

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- No longer allowed to carryback NOLs
- Carried forward indefinitely
- 80% of taxable income may be reduced by NOL
  - For post 12/31/17 NOLs
  - Still 100% for pre-2018 NOLs

# Changes to Sec 1031 Exchanges

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- Only Real Property qualifies
- Personal Property (including vehicles) no longer qualify for gain deferral
  - Recognize gain on Trade-in
  - Basis in new asset is the purchase price – can claim Sec 179/Bonus

# Planning Opportunities

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- Take advantage of Depreciation
  - Section 179 and Bonus
- Know your tax bracket and do year-end planning for business income and expenses
- Set up a Retirement Plan
- Take advantage of QBI



# Sales Tax - Wayfair

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- Out of state sellers may now be required to collect and remit sales tax due to the Wayfair court case
- Various states are enacting at various times
- Most states have minimum thresholds
- See WI rules for a guideline but note that all states are different

# From WIDOR Website

## Wayfair Decision – Info for WI Sellers

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A Wisconsin business' in-state sales of products and services are not affected by the U.S. Supreme Court's decision in *South Dakota v. Wayfair, Inc.* The Court's decision provides that a state can require out-of-state sellers without a physical presence in that state (i.e., remote sellers) to collect and remit sales and use tax on sales delivered into that state. Therefore, if a Wisconsin business sells a taxable item that is delivered to a location in Wisconsin, the Wisconsin business will collect and remit the applicable taxes based on the delivery location in Wisconsin. This tax treatment was not changed by the Court's decision on June 21, 2018.

# From WIDOR Website Wayfair Decision – Info for WI Sellers

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However, Wisconsin businesses must determine if they are required to collect another state's sales or use tax on sales delivered outside Wisconsin. Each state's laws and rules are different and applying the Court's decision will vary by state. In addition, the implementation dates for states that are requiring remote sellers to collect their sales or use tax may be different. A Wisconsin business should contact each state it makes sales into to determine if the Wisconsin business is required to collect that state's tax.

January 16, 2019



# Sales Tax - Wayfair

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In general, most states have a small seller exception that must be met before sales tax is required to be collected and remitted.

The WI thresholds are:

\$100,000 in annual gross sales (includes both taxable and nontaxable sales) AND

Less than 200 separate sales transactions in WI in both the previous and current year

WI adopted as of October 1, 2018



# Sales Tax - Wayfair

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For WI, required to collect once meet the thresholds – see examples from WIDOR website

# Sales Tax – Wayfair

## Info from WIDOR website

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### Registration and Collection Dates for Remote Sellers

Beginning October 1, 2018, Wisconsin requires out-of-state retailers (i.e., remote sellers) to collect and remit sales or use tax on sales of taxable products and services in Wisconsin. A remote seller that has no activities in Wisconsin other than making sales is not required to register and collect Wisconsin sales or use tax if it qualifies for the small seller exception. The small seller exception is provided by rule and applies to remote sellers that have \$100,000 or less in annual gross sales and less than 200 separate sales transactions in Wisconsin in both the previous year and current year. Effective December 16, 2018, Wisconsin sales and use tax statutes were amended ([2017 Wis. Act 368](#)) to provide the small seller exception by law, consistent with the Court's decision in *Wayfair* and the rule.

# Sales Tax – Wayfair

## Info from WIDOR website

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### Registration and Collection Dates for Remote Sellers

A remote seller is required to collect and remit Wisconsin sales or use tax on sales of taxable products and services in Wisconsin if it does not qualify for the small seller exception. The following examples (not all-inclusive) illustrate when a remote seller is required to register and collect Wisconsin sales or use tax.

# Sales Tax – Wayfair

## Info from WIDOR website

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### Registration and Collection Dates for Remote Sellers

#### Index of examples

Example 1 – Remote seller exceeds annual gross sales threshold in 2017

Example 2 – Remote seller does not meet or exceed either threshold in 2017 and 2018

Example 3 – Remote seller exceeds separate sales transactions threshold prior to Oct 1, 2018

Example 4 – Remote seller exceeds annual gross sales threshold in 2018 after October 1, 2018

Example 5 – Remote seller reaches 200<sup>th</sup> separate sales transaction after October 1, 2018

Example 6 – Remote seller exceeds threshold in 2017 but not in 2018

# Sales Tax – Wayfair

## Info from WIDOR website

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**Example 1:** Remote Seller had \$300,000 annual gross sales and 175 separate sales transactions into Wisconsin in 2017. Since Remote Seller exceeded the annual gross sales threshold in 2017, it is required to register and collect Wisconsin sales or use tax beginning on October 1, 2018.

# Sales Tax – Wayfair

## Info from WIDOR website

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**Example 2:** Remote Seller has \$45,000 annual gross sales and 95 separate sales transactions into Wisconsin in 2017. From January 1, 2018 through September 30, 2018, Remote Seller has \$65,000 gross sales and 120 separate sales transactions into Wisconsin. Remote seller is not required to register and collect Wisconsin sales or use tax on October 1, 2018. From October 1, 2018 through December 31, 2018, Remote Seller had an additional \$10,000 gross sales and 10 separate sales transactions into Wisconsin, bringing the total in 2018 to \$75,000 gross sales and 130 separate sales transactions. Since Remote Seller qualifies for the small seller exception, it is not required to register and collect Wisconsin sales or use tax until it meets or exceeds one of the thresholds in 2019.

# Sales Tax – Wayfair

## Info from WIDOR website

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**Example 3:** Remote Seller has \$90,000 annual gross sales and 155 separate sales transactions into Wisconsin in 2017. From January 1, 2018 through September 30, 2018, Remote seller has \$75,000 gross sales and 220 separate sales transactions into Wisconsin. Since Remote Seller exceeded the separate sales transactions threshold during 2018, Remote Seller is required to register and collect Wisconsin sales or use tax beginning on October 1, 2018. In addition, Remote Seller is required to collect Wisconsin sales or use tax in 2019 because it exceeded the threshold in 2018.



# Sales Tax – Wayfair

## Info from WIDOR website

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**Example 4:** Same as *Example 3*, except from January 1, 2018 through September 30, 2018, Remote Seller has \$95,000 gross sales and 185 separate sales transactions into Wisconsin. On October 19, 2018, Remote Seller has a \$6,000 Wisconsin sale, which brings its annual gross sales in 2018 to \$101,000. Remote Seller is required to register and collect Wisconsin sales or use tax beginning with its next sales transaction in 2018. In addition, Remote Seller is required to collect Wisconsin sales or use tax in 2019 because it exceeded the threshold in 2018.

# Sales Tax – Wayfair

## Info from WIDOR website

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**Example 5:** Same as *Example 3*, except from January 1, 2018 through September 30, 2018, Remote Seller has \$65,000 gross sales and 199 separate sales transactions into Wisconsin. On October 15, 2018, remote seller has a \$1,000 Wisconsin sale, which brings its number of separate sales transactions in 2018 to 200. Remote Seller is required to register and collect Wisconsin sales or use tax beginning with the \$1,000 sale on October 15, 2018. Remote Seller is also required to collect Wisconsin sales or use tax in 2019 because it met or exceeded the sales transaction threshold in 2018.

# Sales Tax – Wayfair

## Info from WIDOR website

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**Example 6:** Remote Seller has \$140,000 annual gross sales and 245 separate sales transactions into Wisconsin in 2017. Remote Seller is required to register and collect Wisconsin sales and use tax beginning on October 1, 2018. During 2018, Remote Seller has annual gross sales of \$68,000 and 160 separate sales transactions into Wisconsin. Remote Seller is not required to collect Wisconsin sales or use tax in 2019, unless it meets or exceeds one of the thresholds in 2019. Since Remote Seller qualifies for the small seller exception, it may deactivate its use tax registration certificate effective January 1, 2019. Remote Seller is required to collect Wisconsin sales and use tax in 2019 if it does not deactivate its use tax registration certificate.

December 17, 2018

# Sales Tax - Wayfair

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What to do?

If your business has out of state sales, contact those states to determine if they adopted Wayfair and what their requirements are for out of state sellers

**Can use WI rules as a general guide but note that each state has its own set of rules and requirements**

# Payroll Updates

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- S Corp Health Insurance/HSA
- 1099/W9
- Spousal Travel
- Accountable / Nonaccountable Plans

# S Corp Health Ins/HSA for 2% Owners

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- Need to add to W2
  - Box 1 but not subject to Soc Sec/Medicare
  - Box 14 description so can deduct on 1040

# 1099/W9 Reminder

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- Be sure to determine if a W2 or 1099 should be issued (Employee vs Independent Contractor)
- If a Form 1099 should be issued, make sure you get a W9 from the contractor
  - Best practice is to get the W9 up front before you pay them

# Spousal Travel

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- IRC Sec 274(m)(3)

## **(3) Travel expenses of spouse, dependent, or others.**

No deduction shall be allowed under this chapter (other than section 217 ) for travel expenses paid or incurred with respect to a spouse, dependent, or other individual accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel, unless—

(A) the spouse, dependent, or other individual is an **employee** of the taxpayer,

(B) the travel of the spouse, dependent, or other individual is for a bona fide business purpose, and

(C) such expenses would otherwise be deductible by the spouse, dependent, or other individual.





# Spousal Travel

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If the spouses are **not employees**, the taxpayer must be able to show that the spouse is accompanying the taxpayer for a bona fide business purpose, which is a facts and circumstances decision. The Bank of Stockton court case was a win for the taxpayer as they were able to show that the spouses attended the events for a bona fide business reason.

If the spousal travel is shown to be for a bona fide business purpose, then the employer's payments are tax free to the employee. ***Please note that the employer is not allowed to deduct the spousal travel costs as a tax deduction, if the spouse is not an employee.***

If the spousal travel doesn't meet the bona fide business purpose test, then the amounts paid are treated as compensation to the employee and is subject to income and payroll taxes just like any other taxable compensation. The payments would be deductible to the employer since they would be treated as compensation.



# Spousal Travel

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Note that the employer should pay the travel costs directly as opposed to reimbursing the employee for the costs. This is done to preserve the tax free treatment to the employee assuming there is a bona fide business reason for the spouse to attend. The IRS could argue that any reimbursements for spousal travel are made under a nonaccountable plan which would then be treated as compensation to the employee. To be safe, the employer should pay the travel costs directly to avoid the IRS being able to bring up this issue.

# Accountable vs Nonaccountable Plans

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## Reimbursements

When an employer reimburses an employee for travel, meals or entertainment expenses, the reimbursement is excluded from the employee's income if the reimbursement arrangement is an accountable plan. Similar rules apply to independent contractors. [Reg. §1.274-5T(h)(2)].

Employees cannot deduct meals and entertainment expenses if the employer reimburses the expenses under an accountable plan and does not treat the reimbursement as wages.

- **Unreimbursed Employee Business Expenses are now N/D on Sch A**

Independent contractors cannot deduct meals and entertainment expenses if the customer or client makes direct reimbursement for the expenses and adequate records are submitted to the customer or client.



# Accountable vs Nonaccountable Plans

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## **Accountable Plan:**

Reimbursements made to an employee under an accountable plan are not included in the employee's income, and the employee does not take a deduction for the expenses.

## **Nonaccountable Plan:**

Reimbursements made to an employee under a nonaccountable plan are treated as taxable wages and reported in box 1 of Form W-2.

The employee is ***no longer allowed*** to take a deduction for the expenses on Form 2106, subject to the 2%-of-AGI limitation due to the Tax Reform Act.



# Accountable vs Nonaccountable Plans

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## **NOTE:**

**An employee who receives payments under a nonaccountable plan cannot convert the payments to an accountable plan by voluntarily accounting to the employer or returning excess payment.**

# Accountable vs Nonaccountable Plans

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## **Accountable Plan Requirements [IRC Sec 62(c)]:**

### ***Business Connection.***

The reimbursement must be for job related expenses the employee would reasonably be expected to incur. A plan that reimburses personal expenses does not qualify as an accountable plan.

### ***Substantiation.***

The employee must substantiate the expense by providing receipts or other documentation to the employer within a reasonable period of time.

### ***Return of Excess Reimbursement.***

The employee must return any excess reimbursement to the employer within a reasonable period of time.



# Accountable vs Nonaccountable Plans

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## Reasonable Period of Time

The following situations will be considered within a reasonable period of time for purposes of accountable plans.

- Employee receives an advance within 30 days of the time the expense is incurred.
- Employee adequately accounts for the expense within 60 days of the time the expense was paid or incurred.
- Any excess reimbursement is returned to Employer within 120 days after the expense was paid or incurred.
- Employer provides a statement to Employee (at least quarterly) asking the employee to either return or adequately account for outstanding advances, and Employee complies within 120 days of the statement.

***IF THESE REQUIREMENTS ARE NOT MET THE PLAN IS CONSIDERED  
NONACCOUNTABLE***



# Accountable vs Nonaccountable Plans

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## **Part Accountable Plan or Part Nonaccountable Plan**

If an employer makes reimbursements to an employee under an accountable plan, but some reimbursements do not qualify under accountable plan rules, only the reimbursements falling under the nonaccountable plan are considered taxable wages

Each plan is viewed separately, and the employer treats the employee as having received reimbursements under two different plans.





# Meals and Entertainment

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- The final item to discuss today is the changes to the Meals and Entertainment rules
- There has been a lot of confusion about this and what is still deductible and what isn't deductible

# Meals and Entertainment

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**Entertainment expenses that are no longer deductible for tax purposes include:**

Cost of tickets to sporting events;

License fees for stadium or arena seating rights;

Private boxes at sporting events;

Theater tickets;

Golf club dues;

Golf outings for customers;

Hunting, fishing, and sailing outings for customers/clients

# Meals and Entertainment

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## Entertainment – not deductible

Cost of tickets to fundraising charitable sporting events (example – charity golf outings)

- A “meals only” option might qualify for a 50% deduction under the general meals & entertainment deduction rules.

*NOTE:* Prior to 2018, these expenses were at least 50% deductible if a taxpayer could show the expense was related to or associated with the conduct of a business or income producing activity

These new rules regarding entertainment expenses should **not** affect the deductibility of the costs of sponsorships that can be classified as advertising or promotion

# Meals and Entertainment

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## Meals & Entertainment – Still 100% Deductible

- Food, beverage, and entertainment expenses incurred for recreational, social, or similar activities primarily for the benefit of employees other than certain highly-compensated employees
  - For example, a company picnic or holiday party.
- Food, beverages, and entertainment that are made available to the general public
  - For example, free snacks at a car dealership or free food and music at an event open to the public.
- Meal and entertainment expenses that are reported as taxable compensation to recipient employees.
- NOTE: An employer can deduct 80% of the cost of meals provided to employees whose work is subject to U.S. Department of Transportation hours-of-service limitations
  - For example, interstate truck drivers and airline pilots.

# Meals and Entertainment

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## Meals & Entertainment – 50% Deductible

- Business meals with clients and potential clients (the business discussed at a meal should be documented on the back of the receipt or in some other manner.)
- Meals while travelling out of town on business
- Food and beverage expenses incurred at entertainment events (even though the expenses of the entertainment events themselves are no longer deductible), but only if business was discussed during the event or immediately before or after.
  - Example: Tailgating food and beverages before or after a football game attended by clients or beverages and food purchased during a sporting event where business is discussed
  - *NOTE: This is a current interpretation of the new law; the IRS may issue future guidance on this matter*

# Meals and Entertainment

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## Meals & Entertainment – 50% Deductible

Occasional meals for employees (not reportable as income to employee as a “de minimis” fringe benefit.) ***Under prior law, these were 100% deductible; now they are 50% deductible.***

For example, occasional meals for employees working overtime or occasional donuts/bagels in the morning qualifies for this exception.

Meals furnished to an employee for the convenience of the employer. ***Under prior law, these were 100% deductible; now they are 50% deductible.***

Examples here would include working lunches (i.e., committee meetings, training during lunch, etc.) or offsite executive retreats.

# Thank You!

[chadryder@baumancpa.com](mailto:chadryder@baumancpa.com)

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