Estate and Trust Provisions of TCJA Including a Discussion of Section 199A (the QBI deduction)

Howard County Estate Planning Council

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About Jordon . . .

Jordon N. Rosen, CPA, MST, AEP® is a Director and shareholder in the Wilmington, Delaware CPA firm of Belfint, Lyons & Shuman, where he heads the firm's estate and trust practice. Jordon also provides tax consulting and compliance services to the firm's higher net worth clients and business owners. He is the Past President of the National Association of Estate Planners and Councils (NAEPC) and has served as president of the Delaware Estate Planning Council and the Chester County, PA Estate Planning Council. Mr. Rosen is also a member and past chair of the Delaware State Chamber of Commerce tax committee, is a member of the AICPA Trust, Estate and Gift Tax Technical Resource Panel, and is a member of the editorial board of Thomson Reuters Focus publication.

Jordon is a licensed CPA in Delaware and Pennsylvania and is a member of the Pennsylvania Institute of CPAs, Delaware Society of CPAs and the AICPA Tax Section. He also holds the designation of Accredited Estate Planner ® and has been recognized as a 5-Star Wealth Manager by Philadelphia Magazine and Delaware Today.

Mr. Rosen is a frequently sought out speaker both locally and nationally on tax planning and related issues and has published more than 100 articles. He has been a frequent television and radio guest and a past host of Money Talk on 1450-WILM. He received his undergraduate degree in Accounting from Temple University and his Master's degree in Taxation from Widener University.

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Tax Cuts and Jobs Act (H.R. 1)

- Official title- "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018"
- "AAPRPTZ5CRBFY18" too hard to say, so we use "TCJA"
- Will create a deficit of $1.456 trillion through 2027
- Most Corporate provisions are permanent
- Most individual provisions sunset after 2025

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Estate and Trust Provisions

Estate and Gift Taxes (2018 - 2025)

- Doubles the base exemption to $10 million per person
- Indexed for inflation after 2011
- Retains portability rules
- 2018 amount will be $11,180,000
- TCJA silent on GST Tax exemption - but assumed to increase based on basic exclusion rules
- Rate remains at 40%

Why Taxpayers Are Re-Thinking the Need for Planning

- Fewer are subject to the Federal Estate Tax since the exemption is so high
- Many states (i.e. Delaware) follow the Federal rules, thus eliminating any state death tax

However . . .

- Non-taxable estates today may become taxable in the future
  - o Assets grow (naturally or by inheritance)
  - o Laws change
  - o Some people actually win the lottery
- As time passes and life events occur, most estate plans become hopelessly out of date

Excuses We Hear Why Clients Don't Think They Need To Plan:

- If there are no taxes due, what is the need for planning?
- I'm too young
- All of my property is jointly held with my spouse
- Estate planning is only for the rich folks
- It's too expensive
- We had our wills drawn up when we were married (probably more than 15 or 20 years ago!)
- I don't want to think about it

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Reasons Why Estate Planning is Critical for the Modest Estate Owner

- Several States have estate exclusions well below the Federal level
- Several states (i.e. PA) impose a state inheritance tax
- Need to provide for surviving spouse
- Special needs family member
- Care for minor children
- Second (or third, or fourth) marriage
- Asset protection (predators and spend thrifts)
- Divorce planning

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Reasons Why Estate Planning is Critical for the Modest Estate Owner – Continued

- Closely held business/farming operations
- Provide for future education needs
- Charitable intent
- Family dynamics (potential divorce, drug addiction)
- Valuation issues
- Disposition of tangible personal property
- Dictate how YOU want to dispose of your estate
- Planning for pets

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Tax Rates for Estates and Trusts (2018 - 2025)

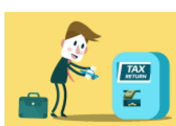
2017	2018-2025
15%	10%
25%	24%
28%	35%
33%	37% (T. I. > $12,500)
39.6%	

For Estates and Trusts

If taxable income is:	The tax is:
Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

Effect of Other Changes on Estates and Trusts

- State and local income tax deduction
- State and local real estate tax deduction
- 2% deductions
- Other deductions – Section 67(e)
  - Tax preparation
  - Attorney fees
  - Fiduciary fees
- Section 691(c) remains deductible
- ESBTs can utilize the QBI deduction



Effect of Other Changes on Estates and Trusts - Cont.

- Excess deductions in year of termination flow through as a miscellaneous I/D subject to 2% floor. New law would eliminate it. Need to plan for year of termination.
- Assume estates and trusts still entitled to “exemption” (personal exemptions suspended)

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Qualified Beneficiaries of an ESBT (after 2017)

- Existing Law - ESBT - Electing Small Business Trust - may be a shareholder in an S Corporation
- New law now allows a nonresident alien individual to be a potential current beneficiary of an ESBT (in addition to resident individuals, estates, and certain charitable organizations)

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Charitable Contribution Deduction for an ESBT (after 2017)

Deduction for charitable contributions will be determined using rules applicable to individuals (not trusts)

- Percentage limitation
- Carry forward provisions

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Section 199A : Qualified Business Income (QBI) Deduction

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Corporate Tax Rates Reduced (after 2017)

- Prior rates: 15%, 25%, 34%, and 35% (Personal Service Corps. paid at the 35% rate)
- For tax years beginning in 2018: Flat 21% (including Personal Service Corps.)

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Qualified Business Income Deduction: Section 199A

Overview

- Applies to non-corporate taxpayers-
  - Individuals (including children subject to the Kiddie tax)
  - Estates
  - Non-granter trusts
- Applies to tax years beginning 2018 → 2025
- Applies to income from an S Corp., Schedule E real estate rentals, partnerships or sole proprietors
- Applies only to QBI effectively connected with conduct of a trade or business within the U.S.
- QBI includes items of income, gain, deduction and loss
- No distinction between passive and active income
- Effectively reduces top rate of 37% to 29.6%

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QBI Does not include

Overview
- Certain investment income, including short-term and long-term capital gains
- Reasonable Compensation paid to the taxpayer
- Guaranteed payments paid to the taxpayer

Section 199A (QBI deduction) Does Not apply to

- Computation of Net Investment Income Tax (NIIT)
- Computation of SSA benefits
- Computation of S. E. Tax

The Big Question – currently the QBI deduction computation does not consider certain "adjustment to income", such as the SEP deduction, 50% of S.E. tax deduction and the deduction for S.E. health insurance. Will Congress change this?

Quick Reference Chart - The QBI Deduction

MFJ :

(Net) Taxable Income	Specified Services	Other Businesses
<$315,000	QBI x 20%	QBI x 20%
$315,000-$415,000	Phase-out of Deduction (W-2/ Asset Limitations Apply)	Phase-in of W-2/Asset Limitation Rule
>$415,000	No Deduction	Full W-2/Asset Limitation Rule APPLIES

Other than MFJ (Including Trusts and Estates) :

<$157,500	QBI x 20%	QBI x 20%
$157,500-$207,500	Phase-out of Deduction (W-2/ Asset Limitations Apply)	Phase-in of W-2/Asset Limitation Rule
>$207,500	No Deduction	Full W-2/Asset Limitation Rule APPLIES

QBI – Wage/Asset Limitation

- Wage Limitation does not apply if taxable income does not exceed $315,000
  - Limitation phases in when taxpayer's taxable income exceeds $315,000 for MFJ ($157,500 for others).
  - Phase-in is over the next $100,000 of taxable income for MFJ ($50,000 for others).
- If taxable income > $415,000 - MFJ ($207,500 for others) - the deduction cannot exceed the greater of:
  - 50% of (allocated share of) W-2 wages of the trade or business, or
  - 25% of (allocated share of) W-2 wages of the trade or business, **PLUS** 2.5% of the unadjusted basis of all qualified property held by and available for use in the T/B at the close of the year

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W-2 Wages

- Paid with respect to employment during the calendar year
- Limited to wages paid attributable to QBI
- Wages do not include any amount which is not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date for such return (including extensions)

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Qualified Property

- With respect to a qualified trade or business
- Tangible property (personal or real), subject to the allowance for depreciation under Section 167
  - Held for use in a qualified t/b at the close of the taxable year,
  - Used at any point during the taxable year in the production of qualified business income, and
  - the depreciation period has not ended before the close of the taxable year.

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Qualified Property Continued

- Depreciable period-
  - Beginning on the date placed in service by the taxpayer
  - Ending on the later of
    - Date which is 10 years after such date, or
    - the last day of full year in the applicable recovery period that would apply to the property under Section 168

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QBI Deduction for Specified Service Industry

- Generally does not apply
- Exception if taxable income of individual does not exceed $315,000 (MFJ), $157,500 (for others).
- Exception is phased-out over the next $100,000 (MFJ), $50,000 (for others)
- QBI deduction does not apply to the business of performing services as an employee.
- Specified services include any trade or business involving the performance of services in the field of health, law, accounting, actuarial sciences, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interest, or commodities (but not engineers and architects).

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QBI Examples: Example #1

- Basic Rule: Combined QBI deduction cannot exceed taxable income (net of capital gains) x 20%
- John is a married accountant with business income of $150,000
  - QBI Deduction: $150,000 x .20 = $30,000
  - Net Taxable Income: $200,000
  - $200,000 x .20 = $40,000
  - QBI deduction is not limited
- Mary is a married accountant with business income of $250,000
  - QBI Deduction: $250,000 x .20 = $50,000
  - Net Taxable Income: $200,000
  - $200,000 x .20 = $40,000
  - QBI deduction is limited to $40,000

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QBI Examples: Example #2

For Non-Specified Service Businesses:

- When taxable income exceeds $415,000 (MFJ), the QBI deduction is limited to the greater of:
  - 50% of Wages or
  - 25% of Wages **PLUS** 2.5% of unadjusted basis of property
- Bruce is married and has a yard cleaning company and has taxable income of $600,000 and the QBI amount from the company is $100,000. The company pays wages of $50,000 and has nominal assets
- Lesser of:
  - $100,000 x .20 = $20,000
  - Limited to: $50,000 (wages) x .50% = $25,000
  - Bruce's QBI deduction is not limited

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QBI Examples: Example #3

- Bruce also owns a commercial rental property that generates $8,000 of QBI. Assume the property is fully depreciated and there are no employees.
- The QBI deduction is $0

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QBI Examples: Example #4

- Same as EXAMPLE #3 except the building is not fully depreciated and was purchased for $250,000, which includes land cost of $50,000.
  - QBI deduction is $8,000 x .20 = $1,600
  - ($0 wages x .25) **PLUS** $200,000 (net of land) x .025 = $5,000
  - QBI deduction of $1,600 is not limited

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QBI Examples: Example #5

- Jordon is married and has a widget producing business that generates $100,000 of QBI. His taxable income is over $415,000. In addition, he paid wages of $30,000 and has qualified property of $50,000.
  - $100,000 x .20 = $20,000
  - Wage Test 1: $30,000 x .50 = $15,000
  - Wage Test 2: ($30,000 x .25) + ($50,000 x .025) = $8,750
  - QBI deduction is limited to $15,000 (the greater of $15,000 or $8,750)

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Section 199A Application to trusts, estates and beneficiaries

- A trust or estate is treated as a passthrough entity to the extent it allocates QBI and other items to its beneficiaries and is treated as an individual to the extent it retains the QBI and other items.

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Section 199A – Grantor Trusts

- To the extent 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 that person.

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Section 199A – Non - grantor trusts and estates

- Trust or estate must allocate qualified items of deduction in computing QBI.
- Depletion, amortization and depreciation that are otherwise properly included in the computation of QBI are included in such computation, regardless of how they may otherwise be allocated between the trust or estate and its beneficiaries
- QBI is to be allocated to each beneficiary and to the trust or estate based on relative proportion of DNI for the taxable year, or is to be retained by the trust or estate.
- If no DNI for the taxable year, all items are allocated to the trust or estate.

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ESBTs

- S portion
- Grantor portion
- Non- S portion

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Threshold and Anti-Abuse rule

- \$157,500 → \$207,500 in 2018
- Increased by COLA 2019 → 2025
- Taxable income of estate/trust is determined before taking into account any distribution deduction under section 651 or 661
- Trusts formed or funded with significant purpose of receiving a deduction under Section 199A will not be respected.
- Two or more trusts will be aggregated and treated as a single trust if such trusts have substantially the same grantor(s), beneficiaries and if the principal purpose* for establishing such trusts or for contributing additional cash or other property, is the avoidance of Federal income tax. Spouses will be treated as one person. Reg. Section 1.643 (f)-1.

  *significant non-tax purpose

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Planning For Trusts

- If holding fully depreciated real property that has no basis, consider transferring business interest to a CRT
- Making a Section 645 election may hurt the estate/trust's QBI deduction

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C Corporation Planning

- Generally not as tax favorable
  - Double taxation of profits
  - No QBI deduction (assuming QBI deduction is available to other entity)
- Even if corporation did not pay a current dividend:
  - Accumulated earnings tax potential
  - Personal holding company tax potential

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COMPARISON

C Corporation	LLC/Sole Prop.
1st level tax = 21%	1st level tax = 0
QBI Deduction = 0	QBI Deduction = 20%
2ND Level tax= 15 %	1st level tax = 0
NIIT= 3.8%	NIIT= 0
Net to Owner=64%	Net to Owner=81%
Net Text Rate= 36%	Net Tax Rate=19%
No S.E. tax	S.E. Tax applies

- $1,000 business profit of C corporation would yield $640 to owner, assuming dividend is currently paid
- $1,000 business profit to LLC/Sole Prop. would yield $810 to owner

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Conversion to S Corporation

- Reasonable compensation needs to be paid to owner/employees
- BIG tax
- All shareholders have to be qualified to own S corporation stock
- Cannot have more than one class of stock
- Outstanding loans to business
- Passive investment income exceeding 25% of gross receipts for 3 consecutive years and the S corporation has accumulated E&P will void the S election

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Planning for Specified Service Businesses

- Need to keep taxable income below $315,000/ $157,500
  - D.C. plan
  - D.B./cash balance plan
  - Bonus depreciation/Section 179
  - But, maybe regular depreciation which is taken each year will keep T. I. below threshold EACH YEAR.

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Questions

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