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Certified Public Accountants and Business Advisors

July 2018

Inside this issue:

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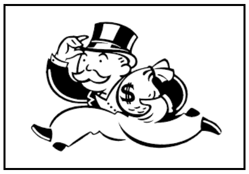
Qualified Business Income Deduction

One of the most heralded sections of the Tax Cuts and Jobs Act is the Qualified Business Income Deduction (QBI Deduction).



The QBI Deduction is a 20% deduction on most income from pass-through entities such as partnerships, S corporations, sole proprietorships and limited liability companies (LLC's) **not** treated as C corporations. Pass-through entities don't pay income taxes at the corporate level. Instead, income is allocated among the owners and taxes are collected from the individual.

With one exception, the deduction is limited to the greater of:

a. 50% of the W-2 wages with respect to the trade or business or
b. The sum of 25% of the W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition of the tangible property subject to depreciation.

The deduction also may not exceed the taxable income for the year over the net capital gain plus aggregate qualified cooperative dividends.

Qualified trades and businesses include all trades and businesses except the trade or business of performing services as an employee and "specified service" trades or businesses. A specified service business is a business involving the performance of services in law, accounting, financial services and other specified fields, or where the business's principal asset is the reputation or skill of one or more owners or employees.

Qualified business income is the net amount of qualified items of income, gain, deduction, and loss with respect to a qualified trade or business.

The W-2 wage limitation does not apply to taxpayers with **taxable** income of less than $157,500 ($315,000 married filing joint) for the year. It is phased out for taxpayers with income over those thresholds. Income from specified service businesses is not excluded from QBI for taxpayers with taxable income under those same thresholds.

This section of the Tax Cuts and Jobs Act is very complex, with many areas requiring clarification from the IRS. Please contact us if you'd like to arrange a consultation specific to your facts and circumstances.

Sales Tax Changes

On June 21, 2018, the U.S. Supreme Court handed down its decision in *South Dakota v. Wayfair*. The Court's decision in favor of South Dakota's enforcement of its sales tax to out of state businesses who sell into South Dakota but have no property or employees in the state significantly expands which businesses will be subject to collecting and remitting sales tax in South Dakota and other states. A key element in ruling favorably for the expansion of State's rights in enforcing sales tax requirements, was that South Dakota's law was determined not to be an undue burden to interstate commerce. As Justice Kennedy's majority opinion states:

South Dakota's tax system includes several features that appear designed to prevent discrimination against or undue burdens upon interstate commerce:

- First, the Act applies a safe harbor to those who transact only limited business in South Dakota. (No collection/reporting requirement if business activity in South Dakota is less than 200 transactions or $100,000 revenue annually);
- Second, the Act ensures that no obligation to remit the sales tax may be applied retroactively. S. B. 106, §5;
- Third, South Dakota is one of more than 20 states that have adopted the Streamlined Sales and Use Tax Agreement. This system standardizes taxes to reduce administrative and compliance costs.

Of the forty-five states that currently have sales tax laws, thirty-one states have laws which will allow them to expand their tax collection beyond the historical physical presence standard (begin enforcing sales tax collection responsibilities on more out of state businesses). Sixteen of these states have laws very similar to South Dakota. Of the others, state legislators are already beginning to look at introducing bills in their legislature based on the *Wayfair* decision. For example, Texas legislative leaders have already stated that they are going to act quickly in passing legislation that is similar to South Dakota's sales tax laws.

The Wayfair decision changes the sales tax collection responsibility landscape significantly across the U.S. and adds sales tax collection and reporting exposure to multi-state businesses who may now exceed new minimal economic thresholds in each state.

Contact us at Lima & Associates if you'd like us to consult with you regarding your specific facts and circumstances to assist in determining your exposure and preparing for the new "Wayfair" state sales tax requirements for states in which you're selling into.

Watch out for refund scams. Refunds scams are common tactics used by cybercriminals to trick people into opening a link or attachment. This link takes people to a fake page where thieves try to steal information like Social Security numbers.

IRS Debuts New Postcard 1040 Return

At the end of June, the IRS unveiled a new draft version of the 2018 Form 1040, Individual Income Tax Return. The proposed postcard-size Form 1040 form replaces the prior version of the form as well as the Forms 1040EZ and 1040A. While some are celebrating the design as a simpler way to file, a closer look may tell a different story.

What is changing?

- There will be fewer lines as the new form has only 23 lines – that's 50 fewer lines than the 2017 Form 1040.
- There are six new schedules (Schedules 1 – 6) which replace many of the 50 lines reduced on the Form 1040.
- There are many new lines incorporated into the Form 1040 and it's six schedules to accommodate changes under the Tax Cuts and Jobs Act.

How does this affect you?

- Nearly everyone will need to file schedules with their Form 1040, even those who previously used the simple 1040EZ. The IRS website states that only "taxpayers with straightforward tax situations" will be able to skip the new schedules.
- The postcard goal is met, however there will be a lot of training and software reprogramming required.
- The postcard 1040 is still in draft form.

The proposed 2018 Form 1040 can be viewed on the IRS website at https://www.irs.gov/pub/irs-dft/f1040--dft.pdf.

Paycheck Checkup

The Tax Cuts and Jobs Act, the tax reform legislation passed in December, made major changes to the tax law, including increasing the standard deduction, removing personal exemptions, increasing the Child Tax Credit, limiting or discontinuing certain deductions and changing tax rates and brackets.

These far reaching changes could have a big impact on the tax refund or balance due on the tax return people file for 2018. The IRS encourages every employee to do a "paycheck checkup" soon to ensure they have the correct amount of tax taken out of their pay.

Checking and adjusting withholding now can prevent an unexpected tax bill and penalties next year at tax time. The IRS Withholding Calculator and Publication 505, Tax Withholding and Estimated Tax, can help.

You can find these resources at www.irs.gov or contact our office for assistance with determining the correct withholdings.

Reminder of New 2018 Business Tax Provisions

The C Corporation tax rate is reduced to 21% and corporate AMT has been repealed.

After 2017 NOL Carryforwards may offset only 80% of future taxable income and you may no longer carry losses back.

More C corporations and partnerships with a C corporation partner will be able to use the cash method of accounting under new accounting method provisions. Returns for 2018 will include an automatic change in accounting method for taxpayers electing the cash method under the expanded $25 million gross receipts test.

For accrual method taxpayers, income must be included in taxable income no later than it is included for financial accounting purposes. An election is available for advance payments. Any required change in accounting method is treated as an automatic change.

After 2017, there will be no deduction for entertainment expenses. This will disallow greens fees, event tickets and other items of client and customer entertainment. Meals will continue to be deductible at 50%.

The transportation fringe benefit has been suspended in most circumstances.

An employer credit is provided for paid family and medical leave when a written policy is in place. The credit will be 12.5% - 25% of wages paid to qualifying employees. The maximum amount of leave subject to the credit is 12 weeks.

The Domestic Production Activities Deduction (DPAD) is repealed.

Rehabilitation credits have been limited to certified historic structures with a transition rule for existing projects.

100% Bonus depreciation on qualifying post 9/27/2017 asset acquisitions. Bonus depreciation has been expanded to include used assets as well with related party rules to prevent churning.

Like-kind exchanges continue to be available for real estate but have been suspended for personal property (such as vehicles).

The 100% Bonus depreciation comes at a cost. There is now a limitation on the deductibility of interest expense for businesses with average gross receipts of $25 million over the past 3 years. Interest expense deductions will be limited to 30% of adjusted taxable income plus business interest income.

A real property trade or business can elect out of the limitation on interest expense deductibility, but in doing so loses the 100% bonus depreciation. A real property trade or business means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing or brokerage trade or business.

The interest expense provisions are applied at the partnership and S corporation level with excess interest carryforwards allocated to the partners and shareholders.

The Section 179 deduction has been increased to $1 million and the phase-out to $2.5 million.

The definition of qualified real property as Section 179 property has been expanded to include roofs, heating, ventilation, air-conditioning (HVAC) property, fire protection and alarm systems and security systems in non-residential property. These provisions are effective 1/1/2018 and the property cannot be expensed using bonus depreciation.

Further, depreciation limits on luxury automobiles have been increased. First year depreciation is increased from $2,560 to $10,000.

Employer paid tuition reimbursements will become taxable if the employer does not have a Section 127 plan in effect. A Section 127 plan is a separate written plan of an employer for the exclusive benefit of his employees to provide such employees with educational assistance.

There will no longer be a deduction for local lobbying, effective after the date of enactment (12/22/2017).

Contributions of capital by a customer, potential customer, governmental entity or civic group are no longer tax free.

There are also other tax provisions that may affect you. Please contact our office with any questions you may have or to schedule a consultation.

For those of you considering converting from a partnership or S corporation to a C corporation, please schedule a planning meeting with our office first. There are other considerations and this may not be the best option for you in the long-term.

Standard Mileage Rate - The standard mileage rate for business is $0.545 per mile for 2018. The rate for medical and moving is $0.18 and $0.14 for charity per mile.

Retirement - For 2018, the elective deferral (contribution) limit for employees who participate in 401(k), 403(b), most 457 plans and the federal government's Thrift Savings Plan is $18,500. For persons age 50 or older in 2018, the limit is $24,500 ($6,000 catch-up contribution).

Contribution limits for SIMPLE plans remain at $12,500 for persons under 50 and $15,500 for anyone age 50 or older in 2018. The maximum compensation used to determine contributions is $275,000 in 2018.

Saver's Credit - In 2018, the adjusted gross income limit for the saver's credit (also known as the retirement savings contribution credit) for low and moderate income workers is $63,000 for married filing joint, $47,250 for head of household and $31,500 for single and married filing separate taxpayers. The credit is 50%, 20% or 10% of retirement contributions up to $2,000 ($4,000 MFJ).

Reminder of New 2018 Individual Income Tax Provisions

Personal Exemptions – The personal and dependent exemption for tax year 2018 is suspended.

Standard Deduction – The 2018 standard deduction for married filing joint is $24,000. For single and married filing separate it is $12,000 and for head of household the deduction is $18,000. Additional standard deductions are also available for the aged or the blind.

State and Local Taxes Deduction – Under the new rules, individuals can deduct up to $10,000 ($5,000 for married filing separate) in state and local income taxes or property tax.

Mortgage Interest Deduction – The new law reduces the ceiling of acquisition indebtedness to $750,000, unless the indebtedness was incurred before December 15, 2017, where the limitation is still $1 million.

Home Equity Interest Deduction – The home equity interest deduction was repealed through December 31, 2025. However, home equity interest that qualifies as acquisition debt (secured by the principle residence and incurred in acquiring, constructing or substantially improving the home) and is less than the $750,000 limit noted previously would still be deductible. Please note the $750,000 limit applies to combined debt not individual loans.

Miscellaneous Itemized Deductions – The new law suspends all deductions that were subject to the 2% adjusted gross income (AGI) limitation (e.g.., tax preparation fees, safe deposit box, unreimbursed employee business expenses, etc.).

Pease Limitations – The Pease limitations (itemized deduction phase-out) for high-income taxpayers who itemize their deductions is suspended through December 31, 2025 as well.

Alimony – For divorce decrees executed after December 31, 2018, alimony will no longer be deductible by the payor nor taxable to the recipient.

Moving Expenses – The moving expense deduction has been suspended for all except members of the Armed Forces.

Shared Responsibility Penalty – The shared responsibility penalty for not maintained minimal essential health care coverage is reduced to zero for tax years starting January 1, **2019**.

Child and Dependent Care Credit – The child and dependent care tax credit was permanently extended for taxable years starting in 2013. If you pay someone to care for your dependent (under age 13 or incapable of self-care) in order for you to work or look for work, you may qualify for a credit of up to $1,050 or 35% of up to $3,000 per dependent of eligible expenses. For higher income earners, the credit is limited to 20%.

Adoption Credit – In 2018 a nonrefundable (i.e. only those with a tax liability will benefit) credit of up to $13,570 is available for qualified adoption expenses for each eligible child.

Child Tax Credit – For tax year 2018, the child tax credit is $2,000 per eligible dependent. The threshold at which the credit begins to phase out is increased to $400,000 for married filing joint and $200,000 for other taxpayers. The new rules include a $1,400 refundable child tax credit for those who qualify.

Family Tax Credit – The family tax credit is $500 per non-child dependent when you provide more than 50% of their support.

Coverdell Education Savings Account – You can contribute up to $2,000 a year to Coverdell savings accounts in 2018. These accounts can be used to offset the cost of elementary and secondary education as well as post-secondary education. The allowable contributions phases out for married filing joint taxpayers with modified adjusted gross income from $190,000 - $220,000 ($95,000 - $110,000 for single filers).

American Opportunity Tax Credit – For 2018, the maximum American Opportunity Tax Credit that can be used to offset certain higher education expenses is $2,500 per student, although it is phased out beginning at $160,000 adjusted gross income for joint filers and $80,000 for other filers.

Lifetime Learning Credit – A credit of up to $2,000 is available for an unlimited number of years for certain costs of post-secondary or graduate courses or courses to acquire or improve your job skills. For 2017, the modified adjusted gross income threshold at which the lifetime learning credit begins to phase out is $114,000 for joint filers and $57,000 for single filers and heads of household.

Employer-Provided Educational Assistance – In 2018, as an employee, you can exclude up to $5,250 of qualifying post-secondary and graduate education expenses that are reimbursed by your employer.

Student Loan Interest – In 2018 you can deduct up to $2,500 in student loan interest as long as your modified adjusted gross income is less than $80,000 (single) or $165,000 (married filing joint). The deduction is phased out at higher income levels. In addition, the deduction is claimed as an adjustment to income so you do not need to itemize deductions.

Charitable Contribution Planning

Charitable contributions are deducted as a part of itemized deductions. With the changes to the standard deduction (almost doubling it) and itemized deductions (creating new limits and elimination miscellaneous itemized deductions and casualty losses with the exception of federally declared disasters) many taxpayers will find that the standard deduction is usually the best option. So how will you be able to deduct your charitable contributions in the future?

One strategy is to "bunch" your donations to charities in specific years, while limiting donations in other years. When you contribute by bunching your donations, you combine multiple years of "normal" annual charitable contributions into a single year.

Another strategy for IRA owner's age 70 ½ or over is to directly transfer, tax-free, up to $100,000 per year to an eligible charity. The IRA excludes the distribution from income and does not include the donation on Schedule A. The transfer must be made directly from the IRA to the charity to qualify.

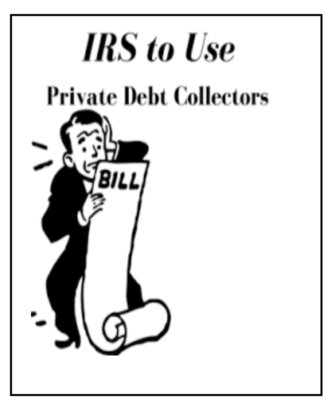
Business Identity Theft on the Rise

The IRS notes that the tax industry has made significant progress in the past two years against tax-related identity theft aimed at individuals but warns that business identity theft is on the upswing. Beginning in 2017, tax preparation software for business related returns will ask additional questions to assist government agencies in identifying suspicious returns as follows:

- The name and social security number of the company executive authorized to sign the corporate tax return.
- Estimated tax payment history including when, how and how much (mostly relates to C corporations.
- Is there a parent company, and if so, the identifying information.
- Were other business related tax forms filed, and if so, which ones.

All of this information will assist in identifying that the proper taxpayer is submitting the returns.

IRS Private Debt Collection Program Kicks Off



This past spring, the IRS began sending letters to notify "a relatively small group of individuals" with overdue federal income tax that their accounts had been assigned to one of four private collection agencies (PCAs). The assignments were authorized by legislation enacted in 2015. PCAs are authorized to discuss payment options, including setting up payment agreements with taxpayers. But, as with cases assigned to IRS employees, any tax payment must be made, either electronically or by check, to the IRS. The IRS also warned taxpayers to be wary of scammers posing as PCAs and to keep in mind that a legitimate PCA will only be calling about a tax debt that the person has had, and has been aware of, for years and had been contacted about previously by the IRS.

Virtual Currency Tax Ramifications

What is virtual currency? In simple terms, currency is anything that has an attributed value and is commonly accepted as a medium of exchange in an economy. Traditional currencies such as the US dollar and the euro have a physical component, i.e. paper or coin. Virtual currency is an entirely digital representation that functions as a medium of exchange, a unit of account, and/or a store of value. Bitcoin (BTC), Ethereum (ETH) and Litecoin (LTC) are the most commonly known of the nearly 2,000 virtual currencies currently in existence, with more being created.

What are the tax consequences of using virtual currencies? The IRS has not issued comprehensive guidance on reporting requirements, however general guidance was provided in March 2014 in Notice 2014-21 and the application of general tax rules.

Blockchain technology, the underlying platform for virtual currencies, facilitates their creation and is a system of worldwide distributed ledgers that record all cryptocurrency transactions in a series of cryptographically sealed blocks verified by a network of computers, or nodes. The currencies can then be stored in digital wallets for appreciation or they can be traded on third party exchanges similar to stocks. The virtual currency can also be used to pay for products and services or they can be loaned to others to earn interest.

Virtual currencies are treated as property for US federal tax purposes and governed by the same principles that apply to property transactions. Gain or loss may be recognized under the general rules applying to the exchange of capital assets when digital currency is used to pay for goods or when one type of digital currency is exchanged for another.

When virtual currency is used to pay employee compensation, the fair market value of the virtual currency at the time it is paid must be included in the employee's W-2 wages, and the employer must withhold income and employment taxes. Similar rules apply when virtual currency is paid for services provided by an independent contractor.

When held in a foreign account, virtual currency is likely reportable under FBAR (FinCEN Form 114, Report of Foreign Bank and Financial Accounts) and income attributable to the currency subject to FATCA (Foreign Account Tax Compliance Act) rules, although Treasury and the IRS have not issued specific guidance.

As mentioned above, virtual currency received as a method of payment or by mining or borrowing is stored in digital wallets. Digital wallets are susceptible to hacking. In several recent incidents, millions of bitcoins were stolen from digital wallets. Further, individual theft losses not incurred in a trade or business or attributable to a federally declared disaster are not deductible as they have been suspended in the Tax Cuts and Jobs Act of 2017.

Mark your Calendar

- September 15, 2018 – 3rd Quarter Estimates are due to be paid.
- September 15, 2018 – Extended partnership, S corporation and calendar year C corporation returns are due.
- October 15, 2018 – Extended individual and employee benefit plan returns and FinCEN Report are due.
- November 15, 2018 – Extended exempt organization returns are due.
- January 15, 2019 – 4th Quarter 2018 Estimates are due to be paid.
- January 31, 2019 – Forms W-2 and 1099 are due.

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