UPDATE

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UNDERSTANDING QUALIFIED BUSINESS INCOME (PASS-THROUGH) DEDUCTION UNDER THE TAX CUTS AND JOBS ACT

Dawn Lopez

There is a significant new tax deduction taking effect in 2018 under the new tax law, the Tax Cuts and Jobs Act (the Act). It should provide a substantial tax benefit to individuals with "qualified business income" from a partnership, S corporation, LLC, or sole proprietorship. This income is sometimes referred to as "pass-through" income.

The deduction is generally equal to 20% of your "qualified business income" (QBI) from a partnership, S corporation, LLC, or sole proprietorship, defined as the net amount of items of income, gain, deduction, and loss with respect to your trade or business. The business must be conducted within the U.S. to qualify, and specified investment-related items are not included, e.g., capital gains or losses, dividends, and interest income (unless the interest is properly allocable to the business). QBI does not include reasonable compensation received from an S corporation, or a guaranteed payment received from a partnership for services provided to a partnership's business.

The deduction is taken "below the line," i.e., it reduces your taxable income but not your adjusted gross income. But it is available regardless of whether you itemize deductions or take the standard deduction. In general, the deduction cannot exceed 20% of the excess of your taxable income over net capital gain. If QBI is less than zero it is treated as a loss from a qualified business in the following year.

Rules are in place (discussed below) to deter high-income taxpayers from attempting to convert wages or other compensation for personal services into income eligible for the deduction.

These rules involve "thresholds," i.e. taxable income of over $157,500 ($315,000 for joint filers). If your taxable income is at least $50,000 above the threshold, i.e., it is at least $207,500 ($157,500 +$50,000), all of the net income from a specified service trade or business is excluded from QBI. (Joint filers would use an amount $100,000 above the $315,000 threshold, viz., $415,000.) For taxable incomes that are between the threshold amounts and the $207,500/$415,000 amounts, the exclusion from QBI of income from specified service trades or businesses is phased in. Specified service trades or businesses are trades or businesses involving the performance of services in the fields of health, law, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners.

Additionally, for taxpayers with taxable income more than the above thresholds, there is a limitation on the amount of the deduction that is based either on wages paid or wages paid plus a capital element. Here's how it works: If your taxable income is at least $207,500 ($415,000 for joint filers), your deduction for QBI cannot exceed the greater of (1) 50% of your allocable share of the W-2 wages paid with respect to the qualified trade or business, or (2) the sum of 25% of such wages plus 2.5% of the unadjusted basis immediately after acquisition of tangible depreciable property used in the business (including real estate). For taxable incomes that are between the threshold amounts and the$207,500/$415,000 amounts, a phase-in of the limitation applies.

Other limitations may apply in certain circumstances, e.g., for taxpayers with qualified cooperative dividends, qualified real estate investment trust (REIT) dividends, or income from publicly traded partnerships.

Obviously, the complexities surrounding this substantial new deduction can be formidable, especially if your taxable income exceeds the thresholds discussed above.

We are still working through the details of this complicated deduction so stay tuned for further updates.

CRYPTOCURRENCY USERS – MEET THE IRS

Bill McVicar

We have discussed cryptocurrencies in one of our former newsletters and would like to update you on some of the not so obvious tax implications involving this relatively new asset type.

2017 was viewed by many as the year of the crypto and many cryptocurrency investors are now finding themselves in the uncomfortable position of trying to determine what their tax liability is attributable to their 2017 cryptocurrency transactions.

But first, a little history lesson! All the way back in 2014 the Internal Revenue Service (IRS) was aware that “virtual currencies” existed and that they were a store of value, operating like a “real” currency, even though they did not have legal tender status in any jurisdiction (IRS Notice 2014-21).

The IRS stated these “convertible” virtual currencies, acting as a substitute for real currency, have tax consequences that could result in a tax liability when sold or exchanged or when used to pay for goods and services in the real-world economy. Also, these virtual currencies are not treated as currency that could generate foreign currency gain or loss for US federal tax purposes.

For federal tax purposes, “virtual” or “crypto” currencies are treated as property and, as such, general tax principles applicable to property transactions apply. A taxpayer who receives virtual currency as payment for goods and services must, in computing gross income, include the fair market value of the virtual currency as of the date that the virtual currency was received. The fair market value is determined by converting the virtual currency into US dollars at the exchange rate, in a reasonable manner that is consistently applied. See Publication 551, Basis of Assets, for more information on the computation of basis when property is received for goods or services (see below for a discussion on whether to use the specific identification method or FIFO method for determining cost basis).

But what if the taxpayer is solely purchasing cryptocurrencies for personal or investment purposes? Since these cryptocurrencies, like Bitcoin and Ethereum, are treated as property per the IRS and are therefore treated as a capital asset subject to the capital gains tax rules, we have a few things to figure out before we can determine their taxability.

If the cryptocurrency was held for less than twelve months (short-term capital gains), then ordinary income tax rates would apply. Whereas, if the cryptocurrency was held for twelve months or more the favorable long-term capital gains rate would apply. The determination of a taxpayer’s overall net capital gain or loss is based on the netting formula involving all capital (cryptocurrency) transactions during the year, with the short-term gains netted against the short-term capital losses and the long-term gains netted against the long-term capital losses. Just be aware that if you wind up with a net capital loss for any given year greater than $3,000 you will have to carryover the remainder to future years.

Also, if a taxpayer was deemed to be in the business of trading or “mining” cryptocurrencies, they could be subject to the ordinary income tax rate.

Short-term capital gains are taxed at your maximum ordinary income tax rate, where the maximum tax rate was lowered to 37% under the new Tax Cuts & Jobs Act. Most long-term capital gains are taxed at either 0%, 15% or 20% and can be subject to the additional 3.8% net investment tax. A great tax planning tip for lower-bracket taxpayers, for which the long-term capital gains rate is 0%, is to accumulate qualified dividends and capital gains while you are taxed in those lower tax brackets.

Since the IRS has treated cryptocurrencies as property for tax purposes and the SEC has indicated they should be treated as a security, it is believed that an individual taxpayer can generally determine whether they will use the specific identification method, which lets one identify the specific cryptocurrency to be sold, or the first-in-first-out (FIFO) method for determining the cost basis of the cryptocurrency. The FIFO method is the default accounting method used by the IRS, unless one has records to support another method. The specific identification method is the method likely to give one the most flexibility and potentially the best tax result.

Historically, taxpayers could defer capital gains tax on the sale of appreciated property when they reinvested sale proceeds from one asset into a similar, like-kind property within a specific time period. Under Section 1031 of the Internal Revenue Code, this tax treatment was available to real estate investors as well as to collectors of art, jewelry and other highly appreciated assets. Investors in cryptocurrency have also assumed that Section 1031 treatment would apply to them when they trade one cryptocurrency for another.

While taxpayers can argue such a claim, in theory, they will be surprised to learn that Section 1031 treatment is not so easy to apply in reality. First, investors are required to track each Section 1031 exchange separately so if an investor had 50 such exchanges during the year they would have to file 50 separate tax forms.

Second, with the passage of the Tax Cuts and Jobs Act changing the US tax code, the government has made it clear the only asset that will qualify for tax-deferred Section 1031 exchange treatment beginning in 2018 is real estate. As a result, investors who traded Bitcoin for Litecoin or Ethereum for Ripple will need to report those trades to the IRS, even if they do not realize a gain or loss.

Any trades/exchanges that result in a loss may be, under certain circumstances, used to offset capital gains of the same type and potentially reduce your overall taxable income for the year.

Information contained in this article is subject to change based on further interpretation of tax laws and subsequent guidance issued by the Internal Revenue Service.

Notables

Announcing the John B. Brannan Accounting/Business Scholarship

The Board of Directors of the Hillsborough Education Foundation (HEF) has established the **John B. Brannan Accounting/Business Scholarship**, to honor our colleague John who served as Dwight Darby & Company's Managing Partner when he lost his valiant battle with Leukemia last year. Active in the community, John was passionate about youth and education and was a board member for HEF for close to 30 years, serving as its Board Treasurer for most of that time. This new scholarship will fund a full four-year scholarship to any state college or university in Florida to a worthwhile high school senior in need who wants to major in accounting or business.

John's family has been extremely touched by those who have expressed an interest in contributing to help sustain the scholarship for future years, including those who have made a multi-year commitment. For those interested in supporting honoring John, donations may be made in two ways:

Donate by Check

Please make checks payable to the Education Foundation and mail the donation to:

Hillsborough Education Foundation

2306 N. Howard Ave.

Tampa, FL 33607

Attention: Cheryl Hedrick

Please write on the memo line: **John Brannan Legacy Scholarship**

Donate Online

Website: https://www.educationfoundation.com/donate-now. At the bottom of the page there is an area for you to recognize the gift "in honor" or "in memory" of John. Please put in the Additional Information box the following: **John Brannan Legacy Scholarship.** Please also note that if you donate via credit card you can sign up to make your contribution an annual one, helping ensure the scholarship for future years.

(TCJA) Continued from pg. 2

Under the pre-TCJA law, the threshold was generally 10% of adjusted gross income (AGI). But for tax years beginning after Dec. 31, 2012, and ending before Jan. 1, 2017, a 7.5%-of-AGI floor for medical expenses applied if a taxpayer or the taxpayer's spouse had reached age 65 before the close of the tax year. This temporary break for senior citizens expired at the end of 2016.

For tax years beginning after Dec. 31, 2016, and ending before Jan. 1, 2019, the TCJA provides that any taxpayer may deduct medical expenses to the extent they exceed 7.5% of the taxpayer's AGI. Therefore, for tax years ending after Dec. 31, 2018, medical expenses will be subject to the 10% floor unless it is further extended.

Personal casualty losses are nondeductible unless attributable to a federally declared disaster

The TCJA provides that, for tax years beginning after Dec. 31, 2017, and before Jan. 1, 2026, personal casualty and theft losses of an individual are deductible only to the extent they are attributable to a federally declared disaster. The loss deduction will be subject to the $100-per-casualty and 10%-of-AGI limitations. Therefore, losses of property as a result of fire, storm, shipwreck, or other casualty, or of theft are no longer deductible.

TCJA suspends overall limitation on itemized deductions

Under the pre-TCJA law, the overall limitation on itemized deductions (also called the "Pease limitation" or "3%/80% rule") limited the total amount of otherwise allowable itemized deductions paid during the tax year for certain higher-income taxpayers. The overall limitation was applied last, after application of any other limitations on itemized deductions. It didn't apply to medical expenses, investment interest, casualty, theft, or wagering losses, and charitable contributions.

Under the pre-TCJA overall limitation, the otherwise allowable total amount of itemized deductions was reduced by 3% of the amount by which the taxpayer's AGI exceeded a threshold amount. For 2017, this threshold amount was: (1) $261,500 for single individuals; (2) $313,800 for joint filers and surviving spouses; (3) $287,650 for heads of household; and (4) $156,900 for married taxpayers filing separately. But the overall limitation didn't reduce itemized deductions by more than 80%.

The TCJA suspends the overall limitation on itemized deductions for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026.

Impact of Tax Cuts and Jobs Act (TCJA) on Various Itemized Deductions

Dave Bove

TCJA lowers the maximum debt on which home mortgage interest is deductible, and limits the deduction for home equity loan interest

Under the pre-TCJA law, you could deduct interest of up to a total of $1 million of mortgage debt used to acquire your principal residence and a second home, i.e. acquisition debt. For a married taxpayer filing separately, the limit was $500,000. You could also deduct interest on home equity debt, i.e. debt secured by the qualifying homes. Qualifying home equity debt was limited to the lesser of $100,000 ($50,000 for married taxpayer filing separately), or the taxpayer's equity in the home or homes (the excess of the value of the home over the acquisition debt). The funds obtained via a home equity loan did not have to be used to acquire or improve the homes. So you could use home equity debt to pay for education, travel, health care, etc.

Under the TCJA law, starting in 2018, the limit on qualifying acquisition debt is reduced to $750,000 ($375,000 for a married taxpayer filing separately). However, for acquisition debt incurred before December 15, 2017, the higher pre-TCJA limit applies. The higher pre-TCJA limit also applies to debt arising from refinancing pre-December 15, 2017 acquisition debt, to the extent the debt resulting from the refinancing does not exceed the original debt amount. This means you can refinance up to $1 million of pre-December 15, 2017 acquisition debt in the future and not be subject to the reduced limitation.

And, importantly, starting in 2018, there is no longer a deduction for interest on home equity debt unless the loan is used to "buy, build or substantially improve" the home that secures the loan. This applies regardless of when the home equity debt was incurred. If you take out the loan to pay for things like an addition, a new roof or a kitchen renovation, you can still deduct the interest. But if you use the money to pay off credit card debt or student loans, or take a vacation then the interest is no longer deductible. Accordingly, if you are considering incurring home equity debt in the future, you should take this factor into consideration. And if you currently have outstanding home equity debt that does not meet the criteria discussed above, be prepared to lose the interest deduction for it, starting in 2018.

TCJA puts $10,000 aggregate limit on state and local tax deduction

The TCJA has placed limits on various kinds of nonbusiness taxes effective beginning with the 2018 tax year.

Before the changes were effective, individuals were permitted to claim the following types of taxes as itemized deductions, even if they were not business related:

1. State, local, and foreign real property taxes;
2. State and local personal property taxes; and
3. State, local, and foreign income, war profits, and excess profits taxes.

Taxpayers could elect to deduct state and local general sales taxes in lieu of the itemized deduction for state and local income taxes.

Tax deduction cuts. For tax years 2018 through 2025, TCJA limits deductions for taxes paid by individual taxpayers in the following ways:

It limits the aggregate deduction for state and local real property taxes; state and local personal property taxes; state, local, and foreign, income, war profits, and excess profits taxes; and general sales taxes (if elected) for any tax year to $10,000 ($5,000 for married taxpayers filing separately). The $10,000 limit doesn't apply if those taxes are paid or accrued in carrying on a trade or business or in an activity engaged in for the production of income.

It completely eliminates the deduction for foreign real property taxes unless they are paid or accrued in carrying on a trade or business or in an activity engaged in for profit.

TCJA disallows miscellaneous itemized deductions

Under the pre-TCJA law, individuals who itemized their deductions could deduct certain miscellaneous itemized deductions to the extent that the aggregate of those deductions exceeded 2% of adjusted gross income (AGI).

The miscellaneous itemized deductions to which the 2%-of-AGI floor applied included the following:

1. Unreimbursed employee business expenses;
2. Unreimbursed vehicle expenses of rural mail carriers;
3. Investment expenses and expenses for the production or collection of income;
4. Tax determination expenses;
5. Expenses allowed under the "hobby loss" rules.

Miscellaneous itemized deductions aren't allowed under the TCJA for any tax year beginning after Dec. 31, 2017, and before Jan. 1, 2026. The disallowance of miscellaneous itemized deductions won't apply in tax years beginning after Dec. 31, 2025.

TCJA retroactively extends 7.5%-of-AGI floor for medical expense deduction through 2018 and applies to all taxpayers

A deduction is allowed for the expenses paid during the tax year for the medical care of the taxpayer, the taxpayer's spouse, and the taxpayer's dependents to the extent the expenses exceed a threshold amount.

SUMMER TRAVEL TIPS FOR FAMILIES

Rick Vernal

Summer is the time for family vacations. Hitting the road as a family can create some lasting memories and funny situations that will be talked about for years. However, being with family in close quarters for long hours can also create some horror stories, that will also be talked about for years. The best way to prevent the latter is to follow the tips below.

1. Give your car a check-up – nothing wrecks an enjoyable road trip faster than car trouble. Before the trip, change the oil, check tire pressure, have brakes inspected, replace wiper blades, and have any other needed maintenance completed by a reputable mechanic.
2. Provide itinerary and emergency information to a family member or friend – also remember to take a list of emergency information, such as contacts, medical requirements, and other important information that may be needed.
3. Set realistic driving distances – it is best to break up long driving trips into multiple days to help avoid both driver and passenger fatigue. It is best to stop every couple of hours, even if for just a few minutes or bathroom break, so everyone can stretch and move a little to get the blood flowing and muscles loosened up.
4. Avoid being distracted while driving – distractions while driving can include cell phone use, texting, eating, drinking, or even talking with passengers. The driver should focus on driving at all times.
5. Bring activities – be realistic about how much travel time children, and family members can handle. Depending on age, have children bring books, games, and electronic devices to listen to music or watch movies. Other items to bring include pillows and blankets so family members can catch a nap on longer trips.
6. Bring a travel emergency kit – be prepared to handle any unforeseen situations that may arise while on the road. Have these essentials in your vehicle at all times: cell phone charger, water, nonperishable food, medicines such as pain relievers, antihistamines and anti-nausea medicine, sunscreen, flashlight, lighter, jumper cables, pocket knife, first aid kit, hand cleaner and paper towels.

Time Saving Tips For Your Month End Close

Sharon Sibilia

The Journal of Accountancy has delivered some tips to help business owners streamline their month end process so that accountants can spend less time collecting numbers and more time analyzing them for the organization's benefit.

Despite improvements in efficiency from modern accounting systems, the month-end close process still causes considerable stress. A recent survey reported that 88% of accounting and finance professionals were negatively impacted by the pressure to close quickly.

Obstacles preventing a faster close process abound. Among them are the complexity of accounting standards and tax regulations; difficulty obtaining information from outside the accounting department; and working across incompatible legacy software platforms. Understaffed accounting teams, meanwhile, face a lack of time to design and implement new processes. And let's not forget potential foot-dragging.

Here are some best practices to smooth the process:

Develop standard procedures and checklists for speed and accuracy. Determine an order of procedures and keep these procedures fluid to keep with the availability of information.

Keep improving your processes. Take one process per month and break it into steps to find ways to improve the accuracy of estimates and to save time.

Examine processes with the end in mind. A tweak to a report generated at the first step can simplify later steps or provide a more accurate final number.

Cross-train the critical steps. Documented standard procedures and cross-training mean there's no holdup in the process if a key employee is out sick or if that employee leaves the company.

Spread out the work. Many routine journal entries can be prepared well in advance. Some accrual or impairment calculations can be started midperiod and fine-tuned at the end of the period. Frequent reconciliations of key accounts — such as cash — reduce the work needed to close the books.

Consider materiality for estimates. In calculating accruals and estimates, keep materiality in mind. Finding a simple method for estimating accruals can save time if there's no material difference from the exact amount.

Communicate the importance of a speedy close to the entire company. Getting information from those outside of accounting can often be the biggest impediment to a speedy close. So developing relationships outside the finance and accounting departments is critical.

Automate as much as possible. Data integrity and speed improve as manual processes such as spreadsheets are replaced with automation. While spreadsheets are a useful tool, they can be prone to errors and have no means to track changes made to them.

While these steps may and retraining can require additional time and resources, this investment can pay off by retaining the knowledge of those employees in the company, and will reduce the time needed for month end close in years to come.

Closing Entries

ANNIVERSARIES

The following Dwight Darby & Company employment anniversaries will be occurring this summer:

Dawn Lopez – 25 years in August

Tara Nichols – 6 years in August

Just for fun.....

DDCo loves MARGARITAS! Try this great recipe for your next gathering or pour yourself one of these whenever you're in the mood for a margarita that's a cut above ordinary.

Recipe

1 1⁄2 ounces lime juice (about 2 limes)	2 ounces tequila (top shelf)
1 ounce Grand Marnier or Patron Citronge	1 1⁄2 cup ice cubes
Lime slice	Coarse kosher salt
Optional: simple syrup to taste	

Run a lime slice around the rim of a margarita glass and then press the rim into a saucer of kosher salt to create the salt rim. Put the ice in a cocktail shaker along with all other ingredients. Shake until beads form on the outside of the shaker. Strain the mixture into the glass, garnish with a lime wedge and serve.

This newsletter is published for our clients and other interested persons. Since this information may be of a technical nature, no final decision should be made without first consulting our office.

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