The QBI Deduction
and
New “Qualified Opportunity Zone” Guidance

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QBI Deduction Issues for Professionals

By: Sidney Kess, CPA, J.D., LL.M.

Most attorneys, accountants, and other professionals operate as unincorporated sole practitioners, or through partnerships and limited liability partnerships (LLPs), making them owners of pass-through entities. Such professionals may be able to cut the effective tax rate on the income from their practices through the use of the qualified business income (QBI) deduction (Code Sec. 199A). This deduction, which was created by the Tax Cuts and Jobs Act of 2017, is up to 20% of QBI, but limitations and other rules can limit or prevent any write-off. Here are some key issues related to the QBI deduction for professionals in light of recently proposed regulations (REG-107892-18, released on 8/8/18 and published in the Federal Register on 8/16/18).

Overview

The deduction under Code Sec. 199A (QBI deduction) is a personal deduction claimed on an individual's federal income tax return. It is neither a deduction in computing an individual's adjusted gross income, nor is it an itemized deduction. The deduction does not reduce business income. Rules on the treatment of the QBI deduction for state income tax purposes depends on each state's tax conformity with federal income tax rules and special state-level rules. It appears that in New York and New York City, the QBI deduction is not allowed because income taxes here starts with federal adjusted gross income (which does not include the QBI deduction). However, future guidance from the New York Department of Taxation and Finance could allow the deduction to be treated as an itemized amount for state and city income tax purposes.

The QBI deduction is 20% of qualified business income for a professional with taxable income up to $315,000 on a joint return or $157,500 on any other type of return. For example, a sole practitioner who is single and has taxable income of $125,000 can claim the full 20% of QBI deduction.

When the professional's taxable income exceeds this threshold, then two limitations come into play:

General limitation. The deduction is the lesser of (1) 20% of QBI, or (2) the greater of (a) 50% of W-2 wages ("W-2 wages"), or (b) 25% of W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition ("UBIA") of qualified property.

Limitation for specified service trades or businesses (SSTBs) (defined below). The limitation under (b) for all types of businesses applies for married filing taxpayers filing joint returns whose taxable income is over $315,000, and other taxpayers whose taxable income is over $157,500. But for SSTBs, the amount of QBI that can be taken into account phases out over the next $100,000 for joint filers or $50,000 for other filers. In effect, a practitioner (and any other individual in an SSTB) with taxable income over $415,000 on a joint return or $207,500 on another type of return cannot take any QBI deduction; all of the QBI has been phased out.

For example, the partnership's taxable income is less than the threshold amount, but each of the partnership's individual partners have income that exceeds the threshold amount plus $50,000

($100,000 in the case of a joint return). As a result, none of the partners may claim a QBI deduction with respect to any income from the partnership's SSTB.

Guaranteed payments
Qualified business income means the net amount of items of income, gain, deduction and loss attributable to the practice. Not taken into account are capital gains and losses (including Section 1231 gains), dividends, and interest income on working capital, reserves, and similar accounts (i.e., investment-type interest). However, interest income on accounts or notes receivable received is part of QBI.

QBI does not include guaranteed payments received for services performed for the practice (Code Sec. 707(c)). However, the partnership's related expenses for making the guaranteed payments may nonetheless reduce QBI.

While guaranteed payments are not part of QBI, they do factor into the partners' taxable income. Because taxable income limits or bars the QBI deduction, the impact of guaranteed payments needs to be taken into account.

Specified service trades or businesses
A specified service trade or business (SSTB) includes any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, 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; engineering and architecture are not included. Proposed regulations help to clarify what constitutes an SSTB. Here are the rules for law and accounting:

Law. This includes the provision of services by lawyers, paralegals, legal arbitrators, mediators, and similar professionals. It does not include the provision of services that do not require skills unique to the field of law; for example, the provision of services in the field of law does not include the provision of services by printers, delivery services, or stenography services.

Accounting. This includes the provision of services by accountants, enrolled agents, return preparers, financial auditors, and similar professionals in their capacity as such. The provision of services in the field of accounting is not limited to services requiring state licensure as a certified public accountant (CPA). The field of accounting does not include payment processing and billing analysis.

Multiple activities
If professionals derive income from rentals of property to their partnerships, proposed regulations help to clarify when the income is or is not treated as an SSTB. In general, an SSBT includes any trade or business that provides 80% or more of its property or services to an SSBT if there is 50% or more common ownership (determined under Code Secs. 267(b) and 707(b)). If less than 80% is provided but there is that 50% common ownership, then that portion of the trade or business providing property or services to the commonly-owned SSTB is treated as part of the SSTB.

For example, a law firm that's a partnership providing services to clients owns its own office building and employs administrative staff. The firm divides into three partnerships: Partnership 1 performs legal services to clients, Partnership 2 owns the building and rents it to the firm, and Partnership 3 employees the administrative staff through a contract with Partnership 1. All three partnerships are owned by the same individuals (the original firm partners). Because the common ownership test is met, all three partnerships are treated as one SSBT.

Figuring the QBI deduction

Again, the QBI deduction is applied at the professional's level; it does not impact the practice's income that is passed through to the owners. Thus, as stated earlier, it is the professional's taxable income that determines the amount of the deduction.

However, Schedule K-1 must report items needed by professionals to compute their deduction. More specifically, on Schedule K-1 of Form 1065, "other information" must include:

- Section 199A income (code Z)
- Section 199A W-2 wages (code AA)
- Section 199A unadjusted basis (code AB)
- Section 199A REIT dividends (code AC)
- Section 199A PTP income (code AD)

Special basis adjustments

Partnerships may make special basis adjustments under Code Sections 734(b) or 743(b). Proposed regulations provide that partnership special basis adjustments are not treated as separate qualified property (Reg. Sec. 1.199A-2(c)(1)(iii)). If the IRS had allowed the special basis adjustments to be treated as separate qualified property, then it could result in a duplication of UBIA if, for example, the fair market value of the property has not increased and its depreciable period has not ended.

Impact on self-employment tax

The QBI deduction does not reduce net earnings from self-employment for purposes of figuring self-employment tax. In effect, self-employment tax is figured as though there were no QBI deduction.

Conclusion

Some of the guidance from the proposed regulations may be changed when final regulations are released. Comments to the proposed regulations are being accepted no later than October 1, 2018. In the meantime, FAQs posted by the IRS (https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-provision-11011-section-199a-deduction-for-qualified-business-income-faqs) help to clarify some of the rules for this important tax deduction.

Executive Editor Sidney Kess is CPA-attorney, speaker and author of hundreds of tax books. The AICPA established the Sidney Kess Award for Excellence in Continuing Education in his honor, best-known for lecturing to over 700,000 practitioners on tax. Kess is senior consultant for Citrin Cooperman, consulting editor to CCH and Of Counsel to Kostelanetz & Fink.

Non-Grantor Trust Planning Tips Benefit Many Clients

By: Martin M. Shenkman, CPA, MBA, PFS, AEP, JD

Why You Must Understand the New Planning Benefits of Non-Grantor Trusts

The 2017 Tax Act dramatically changed tax planning. In the new tax environment, there are a number of significant income tax saving you can advise clients on how to realize. But for many of these planning ideas you need to understand and use non-grantor trusts. This article will provide background on non-grantor trusts, some of the new complexities and issues introduced by the new 199A Proposed Regulations, and more. You need to understand many of these concepts or your clients could lose out on substantial tax benefits, including:

• 199A benefits by splitting qualified business income (QBI) to avoid the taxable income limitation and the impact of the phase-outs (yes, even with the new Proposed Regs).

• Charitable contribution benefits with a dollar for dollar benefit without regard to the new doubled standard deduction.

• Property tax deduction up to at least another $10,000 despite the tough state and local tax (SALT) limitations imposed by the 2017 Tax Act.

• State income tax savings which are more valuable and important to planning given the tough new restrictions on SALT deductions.

While there are other potential benefits (e.g. net investment income tax savings) this article will focus on just the primary ones above. If you are able to identify further savings using non-grantor trusts for your, all the better.

What is a Non-Grantor Trust

A non-grantor trust is a trust that is treated as a separate taxpayer and which pays its own income tax. Although a non-grantor trust pays its own income tax it has a deduction for distributions made to beneficiaries thereby shifting the income tax burden on income distributed, in simple terms, to the recipient beneficiary. Thus, it is not merely enough to know for planning purposes whether a trust is a non-grantor trust, but also the amount of distributions it makes and other factors. After the 2017 Tax Act the use of non-grantor trusts has been greatly enhanced because of the possibility of such trusts enhancing the income tax benefits above in comparison to the income tax results that would be realized if the taxpayer himself or herself instead reported the tax item directly on his or her own personal return.

How Non-Grantor Trusts can Provide Charitable Deductions Taxpayers Otherwise Could Not Realize

Creative uses of non-grantor trust planning can salvage a charitable contribution deduction for moderate wealth clients who have no particularly need for estate planning in its traditional sense. Practitioners should be alert to educate clients that “estate planning” can be valuable even for those who do not view themselves as wealthy.

Example: Taxpayer is married and makes a $10,000 charitable contribution for the year. Because her standard deduction is $24,000 she realizes no tax benefit from the deduction. Instead she creates a simple non-grantor trust in her state naming her sister as trustee. The trust lists charities and descendants as beneficiaries. The taxpayer gifts $200,000 to the trust which hears 5% or $10,000 which her sister the Trustee donates to charity. The trust realizes $10,000 of income and $10,000 of contribution deduction since as a non-grantor trust it is treated as a separate taxpayer. Trusts do not receive a standard deduction so the full donation is deductible. The taxpayer still benefits from her entire $24,000 standard deduction.

Compare Non-Grantor to Grantor Trusts

It is also important to understand the different between a non-grantor trust and a grantor trust. This is crucial for practitioners not only because of the different tax compliance implications, but because of several important tax and other ramifications. Grantor trusts can have in the trust document a swap or substitution power. In fact, that is the mechanism many grantor trusts use to characterize the trust as a grantor trust. This power enables the settlor who created the trust to swap appreciated assets from the back into his or her name to achieve a basis step-up on death. That is a potentially valuable benefit that may be lost with the use of a non-grantor trust that practitioners should weigh. But that loss is not assured as it may be possible to modify even an irrevocable trust in the future and add to it a swap power, thereby changing its status from non-grantor to grantor. But this is just one of the factors that must be weighed in helping clients assess the potential benefits of using non-grantor trusts.

Grantor trusts also can permit the tax-free sale of assets.

Example: Taxpayer owns a valuable closely held business she started a decade ago in her garage. She sells a minority interest in the business to a trust for a note. One goal is to lock in valuation discounts and another is to freeze future appreciation outside her estate. If that sale were made to a non-grantor trust income tax would be triggered. If made to a grantor trust it would not be.

Grantor trusts can own stock in S corporations. However, if a non-grantor trust holds stock in an S corporation that trust will have to qualify as either an Electing Small Business Trust (ESBT) or Qualified Subchapter S Trust (QSST). The latter present compliance and other complications practitioners should be aware of. If the trust involved does not have the appropriate ESBT or QSST provisions the trust will have to be modified (which will itself present costs and complexities) in order to hold S corporation stock.

Life insurance generally may only be held in a grantor trust. This is because if a trust can use trust income to pay insurance premiums on policies insuring the settlor's life the trust will be characterized as a grantor trust for income tax purposes.

Non-Grantor Trusts May Permit Saving Property Tax Deductions

This is another potentially valuable planning idea that, just like the charitable planning idea above, can benefit moderate wealth clients. Again, that is a critical point for all practitioners to understand as too often clients and practitioners alike dismiss the importance of "estate" planning without first understanding the valuable income tax benefits the process can provide to clients who are not "wealthy." To understand how non-grantor trusts might save clients property tax deductions, the limitations of the 2017 Tax Act must first be understood.

The 2017 Tax Act severely restricted the Code Section 164 tax deduction for non-business state and local income, sales and property taxes to $10,000 annually. Both individual and married couples filing jointly get the same $10,000 limit. Married couples filing separately are limited to only $5,000 a year. Also, this $10,000 cap is not indexed for inflation. The bottom line is that many clients will lose most of their property tax deduction. Can practitioners help? In many instances yes. The answer is in the creative application of non-grantor trust planning.

Although some might express concern about the impact of the multiple trust rule in the new 199A Proposed Regulations (discussed below) neither those Proposed Regulations or any other law in any way prevents the use of one non-grantor trust for this purpose. For many clients, salvaging an additional $10,000 of property tax deduction per year will alone justify the planning.

If a portion of the taxpayer's house is transferred to a non-grantor trust, that trust should be treated as a separate taxpayer and will be permitted to deduct up to $10,000 annually for state and local taxes, e.g. property tax on the home it pays. For this deduction to be realized the trust must earn income at least equal to the property taxes it pays. The trust realizes the property deduction. The individual taxpayer will still have their own $10,000 state and local tax (SALT) benefit and will qualify for his or her full standard deduction. Thus, just as illustrated for the charitable contribution deduction above, this planning idea can provide an additional $10,000 tax benefit each year. If combined with the charitable contribution deduction planning illustrated above, a single non-grantor trust can provide valuable benefits many clients will have lost under the new law.

But just as with so many creative planning ideas there are wrinkles practitioners will need to address. For example, no home sale exclusion under Code Section 121 is available. This might be mitigated by selling the house to the non-grantor trust at inception and obtaining a tax-free step up in basis up to the amount of the exclusion. Alternatively, the trust could in a future year, at least two years before sale, be converted to a grantor trust so that the gain will be included in the taxpayer's return.

How A Non-Grantor Can Increase 199A Benefits

Practitioners are no doubt by now well familiar with the general concepts contained in Code Section 199A. This new tax benefit enacted as part of the 2017 Tax Act can provide a deduction of up to 20% of income from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust, or estate. The income must be qualified business income (QBI). The activity must be a trade or business as defined under Code Section 162. If that business is a Specified Service Trade or Business (SSTB) further restrictions apply. One of the key limitations on the new 199A deduction is the taxable income threshold. If married taxpayers have taxable income above $315,000 for a non-SSTB then a wage or wage and tangible property limitation may apply to reduce the amount of QBI that can qualify for the 20% deduction. If the business involved is tainted as an SSTB then the 20% deduction is phased out ratably from $315,000 to $415,000 at which point no deduction is available.

After enactment of the law, many commentators speculated that the taxable income threshold could be circumvented in some instances by transferring equity in the business to non-grantor trusts. The basis for this planning idea, which in part or whole still is viable, is that a non-grantor trust is its own taxpayer and as an independent taxpayer would be subject to its own taxable income threshold of $157,500 as if a single taxpayer.

Example: Taxpayer has an SSTB that might qualify for the 199A 20% deduction but her taxable income is over $500,000 so she cannot realize any benefit. The SSTB generates $400,000/year in income. She gifts 30% of the SSTB to three different non-grantor trusts, one for the benefit of each of her children. Each non-grantor trust realizes 30% x $400,000 = $120,000 of income which is under each trust's $157,500 taxable income threshold for 199A phase out purposes. Each trust might qualify for a full 20% 199A deduction.

The IRS, aware of the planning ideas practitioners were considering, endeavored to attack the above planning with non-grantor trusts in the Proposed Regulations.

How the New Proposed Regs May Inhibit Non-Grantor Trust 199A Planning
On first blush the Proposed Regulations appear to eliminate this planning with non-grantor trusts by promulgating anti-abuse rules attacking the use of multiple trusts. Before examining those rules consider:

• Nothing in the Proposed Regulations suggests that use of a single non-grantor trust is problematic. However, practitioners will have to consider the aggregation and control tests that apply to SSTBs which may restrict splintering an SSTB into SSTB and non-SSTB components, and perhaps gifting part to a non-grantor trust. Thus, the above planning seems to be viable if only one non-grantor trust is created. That could be beneficial to a client. Also, in evaluating the benefits versus costs of such planning consider how many different uses a particular non-grantor trust might provide a particular client (home property tax, charitable contribution, 199A, etc.).

• The Proposed Regulations are merely proposed at the present time and may well change before finalized.

• Many commentators have attacked the Proposed Regulations as exceeding the authority granted to Treasury and also, especially with respect to the multiple trust rules they contain, contradicting the specific provisions of Code Section 643(f) for which they are providing rules.

• Depending on the reading of the Proposed Regulations by some commentators, the planning in the above example, if done properly, may still be viable.

Again, each practitioner should help each client weigh the pros and cons of this planning with each individual client and also caution clients about the potential for an audit, which certainly cannot be quantified.

The preamble to the Proposed Regulations provides: "Section 643(f) grants the Secretary authority to treat two or more trusts as a single trust for purposes of subchapter J if (1) the trusts have substantially the same grantors and substantially the same primary beneficiaries and (2) a principal purpose of such trusts is the avoidance of the tax imposed by chapter 1 of the Code [highlights added]." That language comports with the statute which has a conjunctive three prong test requiring substantially the same grantors and primary beneficiaries and a principal purpose of tax avoidance. Note that as for the tax avoidance being a "principal purpose" if the trust also provides estate tax benefits by using an exemption that is scheduled to sunset, provides important asset protection benefits, etc. will the income tax avoidance be a "principal purpose?"

The last example in the Proposed Regulations deals with the multiple trust rule. After illustrating how trusts can in fact surmount the requirements to avoid having substantially the same primary beneficiary, and thus be respected under the newly formulated multiple trust regulations, the following language appears: "Under these facts, there are significant non-tax differences between the substantive terms of the two trusts, so tax avoidance will not be presumed to be a principal purpose for the establishment or funding of the separate trusts. Accordingly, in the absence of other facts or circumstances that would indicate that a principal purpose for creating the two separate trusts was income tax avoidance, the two trusts will not be aggregated and treated as a single trust for Federal income tax purposes under this section [highlight added]." Thus, the Treasury/IRS are suggesting that if there is a "principal purpose" of income tax avoidance the trusts can be aggregated even if the other two conjunctive requirements of the statute are complied with. That interpretation is clearly contrary to the statute and it is not clear that it could be upheld.

Conclusion

Although grantor trusts have been the default planning tool for wealthy clients, in the current tax environment, many clients, even those that may not be "wealthy" may realize income tax benefits from creative uses of non-grantor trusts. Practitioners, especially those who have believed that they did not have to get involved with "estate planning" or who viewed their clients as not being sufficiently wealthy to benefit from estate planning, need to reconsider how important non-grantor trust planning is for their clients.

Martin M. Shenkman is the author of 35 books and 700 tax related articles. He has been quoted in The Wall Street Journal, Fortune, and The New York Times. He received his BS from the Wharton School of Pennsylvania, his MBA from the University of Michigan, and his law degree from Fordham University.

Tax News Update

IRS Provides Guidance On 20% Pass-Through Deduction
August 9
By: Tony Nitti for Forbes

The Tax Cuts and Jobs Act -- signed into law on December 22, 2017 — gave birth to a brand new provision: Section 199A, which permits owners of sole proprietorships, S corporations, or partnerships to deduct up to 20% of the income earned by the business. While the provision has the potential to bestow a tremendous benefit upon owners of these pass-through businesses, since its enactment, no one has been able to, well... *figure out how the whole thing work*s. Quite truthfully, the statutory language of Section 199A created more questions than answers, with those queries ranging from the seemingly simple -- what do we do about a fiscal year business that crosses over January 1, 2018? -- to the much more complex -- what exactly is a "specified service business" for which a deduction is generally prohibited?

<u>Go to the link listed below for the rest of the article…</u>
https://www.forbes.com/sites/anthonynitti/2018/08/09/irs-provides-guidance-on-20-pass-through-deduction-but-questions-remain/#420a22aa2ff8

Sale of Improved Land: Capital or Ordinary Gain?
October 1
By: Brenda M. Graat, CPA, MBA, Milwaukee

When real property is subdivided into lots and actively sold, the common result is that the gain on sale of the property is subject to ordinary income tax treatment. However, this may not always be the case under Sec. 1237. In certain situations, a taxpayer still may be able to claim capital gain treatment under the five- or 10-year rule, even if the taxpayer subdivides the real property into lots and actively tries to sell the parcels.

Five-year rule
To take advantage of this exception, the taxpayer must meet the following conditions (Sec. 1237(a)):

• No portion of the tract has ever been held for sale in the ordinary course of the taxpayer's business;
• No other real estate was held for sale to customers in the year of sale;
• No substantial improvements have been made on the tract that materially increased the value of the lot sold; and
• The property must have been owned by the taxpayer for five years, unless the taxpayer inherited it.

<u>Go to the link listed below for the rest of the article…</u>
https://www.thetaxadviser.com/issues/2018/oct/sale-improved-land-capital-ordinary-gain.html?utm_source=mnl:cpald&utm_medium=email&utm_campaign=10Oct2018

The New "Qualified Opportunity Zone" Guidance

By: Micah W. Bloomfield, Mayer Greenberg, Michelle M. Jewett, Kevin Matz, Brian J. Senie, and Jeffrey D. Uffner at Stroock & Stroock & Lavan LLP in New York

The Internal Revenue Service recently released the first set of proposed regulations[1] (the Proposed Regulations) and a revenue ruling (the Revenue Ruling) clarifying certain aspects of the Qualified Opportunity Zone (QOZ) provisions added by the tax reform legislation enacted in December 2017. The IRS indicated that it expects to issue additional guidance before the end of 2018,[3] and the IRS has requested comments on a number of provisions in the Proposed Regulations. The Proposed Regulations state that they may apply to transactions occurring before the finalization of such regulations, provided they are applied consistently. We are preparing a more detailed bulletin to provide further comments, but want to highlight some of the key aspects of the Proposed Regulations in this Stroock Special Bulletin:

Only Capital Gains Eligible for Reinvestment

The Proposed Regulations provide that only capital gains may be "rolled over" into a QOZ investment. This would preclude ordinary income from the sale of inventory (and possibly would preclude gain recharacterized as ordinary income under certain "recapture" rules).

Partners in Pass-Through Entities May Reinvest Share of Entity's Gains From Asset Sales

The Proposed Regulations include special provisions by which gain recognized by a partnership may (except to the extent the partnership elects to rollover the gain itself) flow through to the partners and be reinvested by such partners into qualified opportunity funds (QOFs). It was previously unclear whether the partner or the partnership had to make such reinvestment.

Additionally, there is the potential for such partners to have an increased period during which to reinvest gain into a QOF. The partnership's 180-day period begins on the date of its sale, but if the gain flows through to the partners, the partners' 180-day period begins on the last day of the partnership's taxable year. Partners may instead elect to use the partnership's 180-day period if they so desire (e.g. if the desired investment is already lined up).

Qualified Opportunity Funds Always Tested at End of Calendar Year

The Proposed Regulations clarify that, while the initial testing date for a QOF (for purposes of the 90% asset test, discussed below) may be as long as six months after the QOF's start date, there is always a testing date on the last day of the calendar year. Accordingly, QOFs that are formed near the end of a calendar year may need to meet the 90% asset test sooner than expected.[4]

The Proposed Regulations do, however, provide flexibility for QOFs to select the date on which they begin to qualify (although QOFs must qualify as such prior to receiving investments for such investments to qualify under the QOZ provisions), and for taxpayers to use pre-existing entities as QOFs.

LLCs Likely Permitted

The Proposed Regulations state that QOFs may include entities treated as partnerships for federal income tax purposes, which would presumably permit the use of limited liability companies.

Investors May Hold Investments Past Expiration of QOZ Designation
Although the statute provides that the QOZ designations expire after 10 years, the Proposed Regulations permit investors seeking to take advantage of the 10-year rule to hold their investments for an additional 20-year period — until December 31, 2047 — and still receive the benefit of the exclusion from income of all post-acquisition appreciation.[5]

Treatment of Land
The Proposed Regulations and Revenue Ruling provide that land is treated separately from the improvements thereon for purposes of the substantial improvement test, and provide several important clarifications regarding the treatment of land.

The Revenue Ruling provides that land, given its permanence, may never be treated as originally used by a QOF in a QOZ. However, the examples in the Revenue Ruling indicate that the land may qualify as QOZ Business Property if the improvements thereon qualify, even if such land is not improved. Accordingly, for the substantial improvement test, a QOF need only substantially improve the building on a parcel of acquired land in order for the entire parcel to qualify for the 90% asset test.

Additionally, the example in the Revenue Ruling involves the conversion of a factory building into residential real property. As the building was already in existence and is being modified (rather than a new one being constructed), it must meet the substantial improvement test rather than the original use test. The example also seems to confirm that residential real property does indeed qualify as potential QOZ property.[6]

Working Capital Safe Harbor
The Proposed Regulations provide certain safe harbors relating to working capital and asset composition of a QOF. Specifically, the "reasonable working capital" safe harbor of Section 1397C(e)(1) of the Internal Revenue Code now also extends to QOFs for a period of 31 months.

QOZ Business "Substantially All" Requirement to Mean at Least 70%
QOFs may own QOZ businesses (rather than directly owning qualified opportunity zone property), with the requirement that a QOZ business have "substantially all" of its assets be qualified opportunity zone property. The Proposed Regulations provide that, solely for this purpose, "substantially all" means at least 70%. Accordingly, a QOF that owns a QOZ business may have as little as 63% of its capital invested in qualified opportunity zone property (90% in the QOZ business, per the 90% asset test, times 70% of the business's property). This may provide additional flexibility as to the timing of capital investments into a QOF and the use of such capital.

[1] REG-115420-18.
[2] Rev. Rul. 2018-29.
[3] *See* https://home.treasury.gov/news/press-releases/sm530

[4] Note, however, that the negative impact of this rule may be mitigated by the working capital provisions discussed *infra.*
[5] It would seem that the QOF must continue to qualify as such, solely but for the expiration of the QOZ designation, but this does not appear to be entirely clear from the regulations.
[6] This, although already thought by many to be the correct result, nevertheless helpfully rebuts a technical point raised by some regarding the incorporation of certain definitions from Section 1397C of the Internal Revenue Code.

CPE Quiz

1. What is a non-grantor trust?

A. A trust created to allow one spouse to leave money to the other, while limiting the amount of federal estate tax that would be payable on the death of the second spouse.
B. A trust set up for a person who receives government benefits so as not to disqualify the beneficiary from such government benefits.
C. A trust treated as a separate taxpayer and which pays its own income tax.
D. A trust created during the lifetime of the grantor by depositing money into an account at a financial institution in his or her name as the trustee for another.

2. Which of the following describe the tax ramifications of a grantor trust?

A. Can have in the trust document a swap or substitution power.
B. Permit the tax-free sale of assets.
C. Established by a court and is determined from certain facts and circumstances.
D. Both A and B

3. The 2017 Tax Act restricted the tax deduction for non-business state and local income, sales and property taxes for both individual and married couples filing jointly to _________.

A. $5,000
B. $10,000
C. $12,000
D. $20,000

4. One of the key limitations on the Tax Cuts and Jobs Act's new 199A deduction is the taxable income threshold. If married taxpayers have taxable income above _________ for a non-SSTB then a wage or wage and tangible property limitation may apply to reduce the amount of QBI that can qualify for the 20% deduction.

A. $315,000
B. $290,000
C. $250,000

D. $219,000

5. If married taxpayers have taxable income above $315,000 for a non-SSTB then a wage or wage and tangible property limitation may apply to reduce the amount of QBI that can qualify for the 20% deduction. If the business involved is tainted as an SSTB then the 20% deduction is phased out ratably from $315,000 to _________ at which point no deduction is available.

A. $385,000

B. $415,000

C. $419,000

D. $425,000

6. Which of the following is not a field that qualifies a business a specified service trade or business (SSTB)?

A. Law

B. Performing arts

C. Retail

D. Brokerage services

7. Which of the following must be included on Schedule K-1 of Form 1065 to compute the QBI deduction?

A. Section 199A W-2 wages (code AA)

B. Section 199A PTP income (code AD)

C. Section 199A income (code Z)

D. All of the above

8. Which of the following is false regarding QBI?

A. Qualified business income means the net amount of items of income, gain, deduction and loss attributable to the practice.

B. Interest income on accounts or notes receivable received is part of QBI.

C. QBI includes guaranteed payments received for services performed for the practice.

D. Rules on the treatment of the QBI deduction for state income tax purposes depends on each state's tax conformity with federal income tax rules and special state-level rules.

9. The Tax Cuts and Jobs Act gave birth to new provision Section 199A, which permits a deduction of up to 20% of income for owners of all of the following except:

A. C corporations

B. S corporations

C. Partnerships

D. Sole proprietorships

10. Which of the following is not a condition a taxpayer must meet to claim capital gain treatment under the five- or 10-year rule when real property is subdivided into lots and actively sold?

A. No portion of the tract has ever been held for sale in the ordinary course of the taxpayer's business.

B. No other real estate was held for sale to customers in the year previous of the sale.

C. No substantial improvements have been made on the tract that materially increased the value of the lot sold.

D. All of the above

11. Only what can be rolled over into a Qualified Opportunity Zone according to the IRS' proposed regulations.

A. Capital gains

B. Pre-tax assets

C. 401K

D. None of the above

12. The Proposed Regulations include special provisions by which gain recognized by a partnership may flow through to the partners and be reinvested by such partners into (a) ______.

A. Qualified Retirement Plan

B. Qualified Opportunity Funds

C. Qualified Investment Accounts

D. Qualified Opportunity Zone

13. Although the statute provides that the Qualified Opportunity Zone designations expire after 10 years, the Proposed Regulations permit investors seeking to take advantage of the 10-year rule to hold their investments for an additional _____-year period.

A. 15

B. 20

C. 25

D. 30

14. The Revenue Ruling provides that land, given its permanence, may never be treated as originally used by a Qualified Opportunity Fund in a Qualified Opportunity Zone. However, the examples in the Revenue Ruling indicate that the land may qualify as Qualified Opportunity Zone __________ if the improvements thereon qualify, even if such land is not improved.

A. Intangible Property

B. Real Property

C. Personal Property

D. Business Property

15. Qualified Opportunity Funds may own Qualified Opportunity Zone businesses with the requirement that a Qualified Opportunity Zone business have “substantially all” of its assets be qualified opportunity zone property. The Proposed Regulations provide that, solely for this purpose, “substantially all” means at least ______.

A. 80%

B. 90%

C. 63%

D. 70%

Question Responses

The QBI Deduction

and

New "Qualified Opportunity Zone" Guidance

1. _____
2. _____
3. _____
4. _____
5. _____
6. _____
7. _____
8. _____
9. _____
10. _____
11. _____
12. _____
13. _____
14. _____
15. _____

Payment Information

Name: ____

Company/Firm: ____

Street address: ____

City/state/zip: ____

Email (required): ____

Phone: ____

Card:

☐ Visa ☐ MasterCard ☐ American Express ☐ Discover

Card number: ____

Expiration date: ___________________________

Signature:____