

MAIN STREET **PRACTITIONER**

The Magazine for Tax and Accounting Professionals



**NSA's 2018-2019 Income
and Fee Survey Is Here**

2018-2019 Income & Fees of Accountants and Tax Preparers in Public Practice Survey Report

Estate Planning After the Tax Cuts and Jobs Act of 2017

New Tax Laws and Basic Fairness - Part 2

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FAIRNESS - PART 2Main Street
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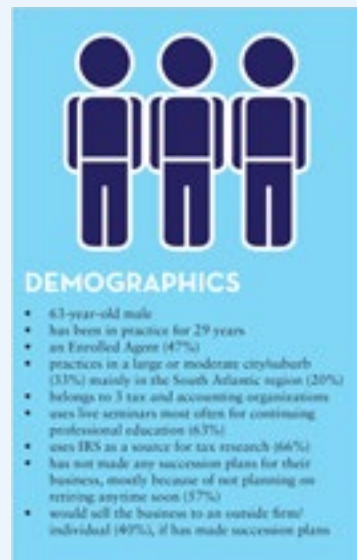
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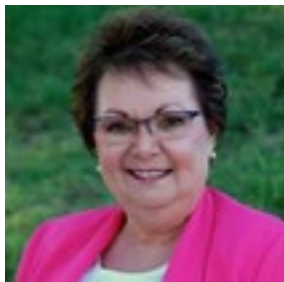
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Christine Z. Freeland,
CPA, ABA, ARA
NSA President, 2018-2019

President's Message: December 2018

As the President of NSA as well as a small business owner, I am big on staying on top of leadership trends and reading, reading, reading. Recently I had the opportunity to attend Dave Ramsey's EntreLeadership seminar here in Phoenix. I attended thinking this would be current, relevant information for a business owner. I was more than surprised by the application to both my business and to my role as the NSA President.

The Theme was "Change is Coming. You Can't Ignore It. Make It an Opportunity for Growth." It so much relates to NSA where we are implementing a new strategic plan and have a new CEO for the first time in 17 years. It is relevant to my business as I get closer to retirement and think, do I have the kind of business that a younger person (probably a millennial) would want to buy.

Some key points that really jumped out at me were, market disruption is a way of life. You are either creating the wave, riding the wave or being crushed by the wave of the market disruption.

You will be crushed by the wave if you have overconfidence, you are so busy working in your business you don't take time for strategic thought or you are protecting sacred cows. The "we've always done it this way" is never a good reason to do anything. Think about Sears and Kodak, both leaders of their industry in the past. They have both met with that slippery slope to irrelevance.

You can ride the wave by not being paralyzed by the need for perfection, getting out of your comfort zone and taking risks and stay curious about the future. Learn to see clues in the present that tell you of the future. Blockbuster had the opportunity to buy Netflix, but they passed. We all know how that story ended.

So, what does market disruption look like for us as accountants and tax professionals: QuickBooks, Xero, Turbo Tax, IFRS, Blockchain, Artificial Intelligence and so on. Some have made it easier (or appear easier) for small businesses to do their own accounting. TurboTax, FreeFile and other options make tax preparation affordable and a do it yourself job if you listen to their ads. Others are the way of the future and we are yet to see the total impact.

Now that we are disrupted what do we do? I wish I had a one size fits all answer, but I don't. I do have a couple of suggestions. Step back and look at your business as if you were an outsider. Do your systems make sense considering today's technologies and opportunities? Do I need to create a "boutique" firm with a strong specialty? Do I need to spend less time doing hands on work and more time creating a strategy for the future?

NSA is looking ahead as we implement a new strategic plan and where that will take us. I hope you will take the time to ask, "Where am I going and how will I get there?" Just as plants grow by the care they receive, so do businesses.

Happy Holidays,

Chris

PS: Please let me know what you are doing in your business to create the wave at chris@christinezfreelandcpa.com.

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* Verizon 2018 Data Breach Investigations Report

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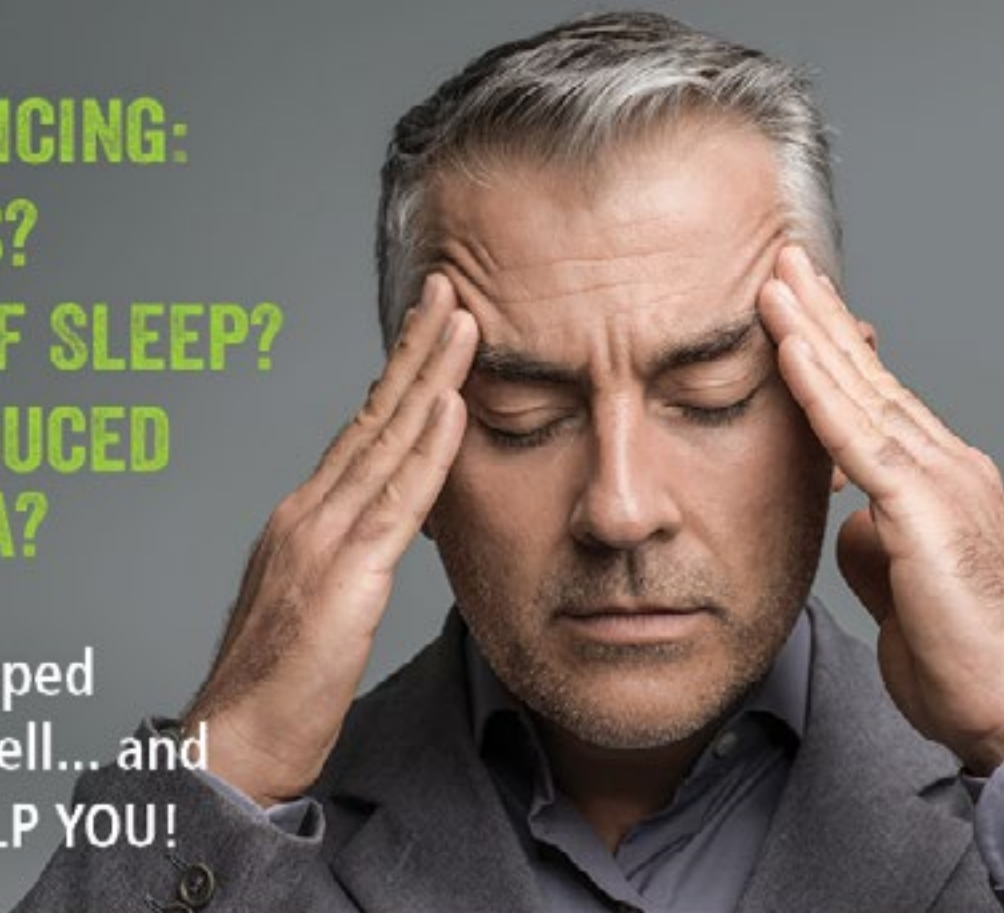
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2018-2019 Income & Fees of Accountants and Tax Preparers in Public Practice Survey Report

NSA's 2018-2019 Income and Fee Survey Is Here

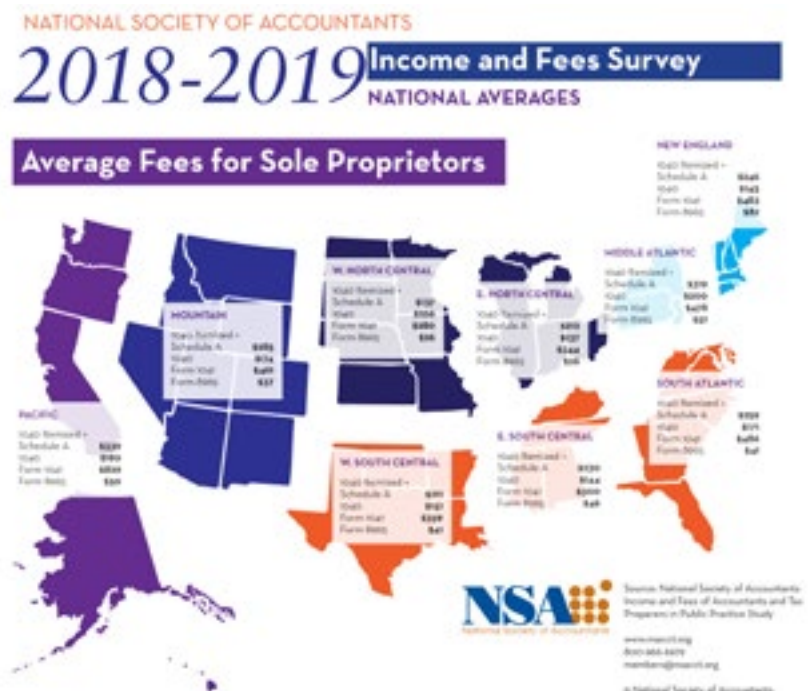
NSA

NSA's new Income and Fees Study has been released. The 2018-2019 study covers national, state, and regional information on practices, fees, and more. Demographic data on the respondents describes type of practice, community size, gender, credentials, years in practice, and education level. Operating expenses broken down by category are included in addition to information on succession planning, billing practices, practice management and more.

The 2018-2019 survey includes new schedules for federal tax returns, specifically, Schedule B (Interest and Ordinary Dividends), Schedule EIC (Earned Income Credit), Schedule H (Household Employment Taxes), and Schedule SE (Self Employment Tax). Additionally, new questions about fees for W-2 and 1099 preparation were added as well as additional detail regarding fees for bookkeeping services. The fee data collected for payroll services were reported in two separate categories of full payroll services and after-fact.

Recognizing the growing impact of hacking and phishing on the industry, a question about cyber liability insurance was also included this year.

Here are some highlights of the study which is available to members free as part of their benefits package.



THE PRACTICE

- operates as a sole proprietorship (32%)
- has 3.2 full-time employees
- has 1.8 part-time employees
- has 2.3 seasonal employees
- has 1.4 full-time principals/partners
- had an annual gross practice income in 2017 of \$302,267
- had a net income of \$100,290 in 2017
- in 2017, 37% of firm's total income was billed by form
- writes-off 3% of firm's gross billings each year
- derives 54% of gross income from the preparation of federal/state tax returns
- allocates 38% of its operating expenses to salaries/benefits (other than retirement)
- relies most often on referrals from existing clients (69%) for promotion of the firm, and finds referrals from existing clients very useful (84%)
- uses Facebook (24%) or LinkedIn (20%) social networks for marketing and promoting practice



Today's Practice

Tax and accounting firms surveyed are owners, principals and partners of “Main Street” tax and accounting practices who have an average of 28 years in public practice and hold multiple credentials.

The average annual gross income reported increased to \$302,267 from \$269,461 two years ago. New data suggests that 54% of gross income is derived from tax preparation, planning and related tax services, which is a decrease from 64% two years ago.

Salary and benefit expenses (other than retirement) have virtually remained that same, at just over 38% over the previous two years. Staff numbers have changed, but only a .3 decrease from 3.5 to 3.2. Seasonal hiring has decreased to an average of 2.3 the 2015-2016 survey report of 3.5, coming very close to the statistics from the 2013-2014 data.

New in this year's survey is data on how many preparers have obtained cyber liability insurance. Our data tells us that only 48% of those who responded have policies. However, the number of tax professionals who use secure file transfer portals has grown 10%, to 64%, and 69% use online/remote data backup

Fees

Average fees for federal returns have continued to fluctuate. Some forms, like Form 706 has risen from \$1,563 to \$1,784, while others have experienced marked decreases in cost. Over all, ACA forms have dropped in price as well, but only by a few dollars since 2016.

New data tells us that accountants and tax preparers (sole proprietors) are charging an average of \$158 per hour for Federal and State returns, \$200 per hour for Offers in Compromise, and \$151 for Elder Care related services. All three of these examples reflect increases. The previous survey produced the following hourly fees, \$150, \$177, and \$131, respectively.

It is also to be noted that 71% of practices charge clients a fee if they bring in disorganized or incomplete files. In contrast, 2% fewer practices charge retainer fees for IRS audits.

See the image on the next page for even more information.

**HAVE YOU WONDERED WHAT YOUR
COMPETITORS AND PEERS CHARGE
FOR SIMILAR WORK? DO YOU CHARGE
ENOUGH? THE [TAX FEE CALCULATOR](#)
CAN HELP.**

Continued on the following page

Forms:	AVERAGE FEES FOR FEDERAL TAX RETURNS: 2007-2018						
	2018	2016	2014	2012	2011	2009	2007
Form 706 (Estates)	\$1,784	\$1,563	\$1,731	\$1,833	\$1,583	\$2,044	\$1,729
Form 709 (Gift Tax)	\$389	\$413	\$420	\$313	\$270	\$284	\$271
Form 940 (Federal Unemployment)	\$65	\$69	\$68	\$59	\$61	\$58	\$57
Form 941 (Employer's Quarterly Return)	\$92	\$91	\$89	\$85	\$83	\$83	\$76
Form 943 (Employer's Quarterly for Farms)	\$81	\$89	\$80	\$56	\$67	\$66	NA
Form 990 (Exempt Organization)	\$683	\$733	\$688	\$628	\$566	\$584	\$521
Form 990-T (UBI for Tax Exempt Orgs.)	\$383	\$415	\$433	\$371	\$331	\$359	\$421
Form 1040 (Itemized-Schedule A & State Return)	\$294	\$273	\$273	\$246	\$233	\$229	\$205
Form 1040 (Not Itemized & State return)	\$188	\$176	\$159	\$143	\$128	\$129	\$115
Form 1041 (Fiduciary)	\$508	\$482	\$457	\$468	\$396	\$415	\$430
Form 1065 (Partnership)	\$670	\$656	\$634	\$556	\$524	\$551	\$518
Form 1120 (Corporation)	\$851	\$826	\$817	\$759	\$695	\$692	\$685
Form 1120S (S Corp.)	\$807	\$809	\$778	\$717	\$660	\$665	\$656
Form 3115 (Application of Change in Accounting Method)	\$299	\$282	NA	NA	NA	NA	NA
Form 5500 (Pension/Profit Sharing Plans)	\$615	\$532	\$525	\$444	\$526	\$488	\$422
Form 8824 (Like-Kind Exchanges)	\$286	\$242	NA	NA	NA	NA	NA

AVERAGE FEES FOR FEDERAL TAX RETURNS: 2016-2018		
Affordable Care Act (ACA):	2018	2016
Form 8962 (Premium Tax Credit Calculation)	\$57	\$59
Form 8965 (Health Coverage Exemptions)	\$49	\$53
Form 1095-A (Health Insurance Marketplace Statement)	\$52	\$58
Shared Responsibility Payment Calculation	\$56	\$57

AVERAGE FEES FOR FEDERAL TAX RETURNS: 2007-2018							
Schedules:	2018	2016	2014	2012	2011	2009	2007
Schedule B (Interest and Ordinary Dividends)	\$45	NA	NA	NA	NA	NA	NA
Schedule C (Business)	\$187	\$184	\$174	\$205	\$236	\$212	\$214
Schedule D/Form 8949 (Gains & Losses)	\$109	\$124	\$115	\$134	NA	NA	NA
Schedule E (Rental)	\$136	\$135	\$126	\$155	\$215	\$190	\$176
Schedule EIC (Earned Income Credit)	\$62	NA	NA	NA	NA	NA	NA
Schedule F (Farm)	\$175	\$180	\$158	\$185	\$238	\$216	\$200
Schedule H (Household Employment Taxes)	\$70	NA	NA	NA	NA	NA	NA
Schedule SE (Self Employment Tax))	\$40	NA	NA	NA	NA	NA	NA

Continued on the following page

Forms - Average Filing Charges

Form 706 (Estates)	\$1,784
Form 709 (Gift Tax)	\$389
Form 940 (Federal Unemployment)	\$65
Form 990 (Exempt Organization)	\$683
Form 1040 (Itemized-Schedule A & State Return)	\$294
Form 1040 (Not Itemized & State return)	\$188
Schedule C (Business)	\$187
Schedule F	\$175
Schedule E	\$136
Schedule D	\$109
Schedule EIC	\$62
Schedule SE	\$40
ACA FORMS	
Form 8962	\$57
Shared Responsibility Payment Calculation	\$56
Form 1095A	\$52
Form 8965	\$49



Additional Hourly Fees

Offers in Compromise	\$200
Estate/Financial Planning	\$191
Tax Services	\$160
Elder Care	\$151
Payroll Services	\$88

Audits

The majority in the current survey suggest that the number of audits has stayed the same since the 2016-17 study. Seven percent of participants feel as though their audits have increased.

Preparers charging for audit response letters – when they did not prepare the return – has become more common. In the past survey, 47.5% reported that they charge in cases like these. Now, the number of practitioners who bill for these letters is closer to 58%, with an average fee of \$136.98.

In other audit situations, when the practitioner is not at fault, 83% of offices charge an hourly fee of \$159.91 to represent their client, and an average retainer fee of \$774.

The complete survey contains even more statistical information about the state of the profession. Members can review more highlights of the study [here](#), and members can access the entire library [here](#).



Simplify Your Life BEFORE Peak Season

Hugh Duffy

You don't want to wait until you're in the thick of tax season to think about how you can simplify. You want to be prepared ahead of time and take the time to simplify your life to improve your productivity and provide some peace of mind.

If you want to reduce the stress in your life, you need to simplify your office environment AND home life. Yes, simplify both worlds for peak performance.

How to Simplify Your Office Life

- **Process all of your clients the same way each time-** A really good business uses a “cookie cutter approach” for processing clients and executes flawlessly. While this might sound impersonal, you cannot customize things for each and every client. Yes, some will get small portions that are customized for their particular situation, but most get a standard, one size fits all production process. As Henry Ford used to say, they can have any color they want as long as it's black.
- **Plan your day the night before-** Your day should be planned the night before. This eliminates wasted time in the morning used to prepare your day.
- **Declutter your space-** Get rid of stuff that's sitting around your office. File it, approve it, or shred it.
- **Learn to pass on clients that do not meet your minimum expectations-** Just say no to clients that do not fit your practice. They multiply like bunnies after you let them in.
- **Don't sacrifice your hiring standards-** A bad hire can make your entire office miserable. Pay at, or above, the market and treat proven employees well. And pick up a copy of the book written by Robert Sutton (a professor at Stanford) titled, “The No Asshole Rule.”
- **Delegate more-** Delegate more of the work on your plate onto your staff. More than likely, they can handle more than you think.
- **Stop wasting time on small tasks to save money-** Start spending money to save time. Time is your most precious resource, especially during busy season.
- **There's no such thing as perfection-** While we all strive to do our very best, we need to make a conscious choice about doing what's “good enough.” That's right, move towards doing things that are fundamentally right rather than perfect.

Continued on the following page

How to Simplify Your Home Life

- **Let go of an activity or commitment-** Step back and look at all of your commitments in your life. Let one go that is consuming too much time and not critical to your life.
- **Turn off the TV-** We all waste too much time in front of the tube. Establish a budget of how many hours per week is acceptable and stay beneath the hourly amount. This will free up time to do much more important stuff in your life. You will feel relieved and get more done.
- **Learn to say NO-** Learn to say no, especially during busy season.
- **Get rid of stuff-** Stop collecting stuff along the way. If you haven't worn it in a year, toss it or donate it. If it's broken and hasn't been repaired by now, pitch it or get it fixed this weekend.
- **Cancel a couple subscriptions-** If some magazines are not getting read, do not renew them. If your regular phone line at home is not necessary because you have a cell phone with decent reception, cancel it.
- **Do something spontaneous-** Do something that's out of character for yourself. It doesn't have to be an item on the "bucket" list but it should be a treat for someone close to you. Put some extra thought into it so it's memorable.
- **Schedule a vacation-** Make the commitment now to schedule that vacation. Delegate if need be but commit now.
- **Live beneath your means-** If you want to achieve economic independence, learn to live beneath your means. Reduce your credit card debt and avoid buying a new car. Remember that most of America's self-made millionaires are frugal.
- **Go to bed early-** The vast majority of adults do not get enough sleep each night. Make a plan to hit the hay at the same time each night and get up early each day. You'll be surprised how much better you'll feel by getting a quick start to the day.

Stop working so hard to make a living and start to savor life's precious moments. It's not as hard as you think.

About the Author:



Hugh Duffy, Build Your Firm Inc., MBA in Marketing, BS in Finance is the Co-Founder and Chief Marketing Officer of Build Your Firm, a website development and marketing company for accounting firms. With more than 30 years of marketing experience, he has been coaching accountants on how to improve their marketing and make more money from their accounting practice since 2003. Hugh takes great pride in the impact his coaching has on the practices and lives of his clients.

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New Tax Laws and Basic Fairness - Part 2

J. Michael Pusey

(This is the second installment of a two-part feature by J. Michael Pusey, CPA.)

Itemized Deductions Eliminated Even Though They Relate to Taxed Income

It is a rather lengthy list, items that were deductible as itemized deductions subject to being over 2% of adjusted gross income. These are no longer deductible prior to tax years ending after December 31, 2025. ((Conf. Rep., p. 273-276.))

Employee related business expenses include:

- depreciation of the home computer used for the job;
- home office expenses even though the office is used regularly and exclusively for work;
- work-related education;
- tools and supplies used for work;
- travel, transportation, entertainment, meals, gifts, etc. related to work;
- work-related magazines (and let's not forget books though only magazines are mentioned in the legislative history);
- legal fees and malpractice insurance fees related to work;
- union dues and expenses;
- licenses and regulatory fees such as a CPA license even though needed or at least related to work;
- casualty and theft losses from property used in performing services as an employee (seemingly this could include the car wrecked in business driving);
- business bad debts of an employee;
- business liability insurance;
- payments to an employer related to breach of contract;
- chamber of commerce dues and professional society dues related to the job;

- educator expenses beyond some minor allowances;
- lab breakage fees (the example listed but breaking anything at work could be a problem);
- medical exams required by an employer;
- occupational taxes;
- passport fees necessary for business travel;
- repayment of an income aid payment received under an employer's plan;
- research expenses of the professor;
- rural mail carrier's vehicle expenses;
- and work clothes necessary for the job.

Expenses related to earning investment or other income which includes or may include:

- investment fees and expenses (including those from pass-through entities);
- clerical help and office rent related to investments;
- depreciation on home computer use related to investments;
- fees to collect interest and dividends;
- excess deductions on termination of an estate or trust;
- hobby expenses, indirect expenses from pass-through entities;
- losses on deposits in an insolvent or bankrupt financial institution;
- losses on IRAs and Roth IRAs when all amounts have been distributed;
- and repayments of income.

Under the miscellaneous itemized deduction disallowance discussion in the legislative history, there is, yes, a final section called "miscellaneous," which includes repayments of Social Security benefits and certain repayments of income under a claim of right.

Some of the items are rare but potentially large when they arise; e.g., losses on deposits at a financial institution. Many of the items are common.

Some of the items may raise issues of interpretation. For example, is the prohibition on deducting repayments of income supposed to apply even when the income and repayment are in the same week?

Tax preparation fees are now generally disallowed. There will undoubtedly be a move to allocate some of these expenses to business and rental expenses, reasonably so. How to classify such expenses may be debated but in general they have something to do with determining "income" under our income tax system, which is arguably becoming, often, a gross receipts tax. There are related issues, larger-dollar issues, which would arise here – legal fees in going to Tax Court, CPA fees for protests arising from long, complex IRS or state tax exams, etc. Tax preparation fees per se may also be "major" in some cases; e.g., the taxpayer with a hundred partnership interests.

The discussion of particulars could go on and on, but generally and conspicuously, there is a retreat from the concept of offsetting related expenses.

Some increase in itemized deduction thresholds doesn't fully explain such an approach to measuring taxable income, particularly when it comes to potentially major expenses directly related to income.

The Unrelated Business Income (UBI) Offset Problem

The statute declares that for the exempt organization's taxable years beginning after 2017, "unrelated business taxable income, including for purposes of determining any net operating loss deduction, shall be computed separately with respect to each such trade or business..." ((Act Section 13702 amending Section 512; Conf. Rep. p. 118.))

Continued on the following page

The basic idea is that some business activity within the charity or flow-through items from its investments doesn't necessarily put its exempt status at risk, but there is a tax (or potential tax) to prevent unfair advantage to the charity relative to the business community. The way this new rule works seems to put charities at a relative disadvantage to individuals with the same fact pattern. We anticipate that some charities with bigger or more complex UBI situations will even consider forming a for-profit corporation to report such activities for tax purposes.

The "businesses" can sometimes be such activities as ad sales. An issue here will be identifying what is a separate trade or business; e.g., whether all ad sales are one activity, or part of a bigger activity, or whether there may be separate businesses from ad sales here or there.

The scope of the new rule is to some degree being debated; e.g., whether what is essentially an investment is subject to this particular no-offsetting rule even though the activity generates UBI.

The net operating loss aspects and details generally of this new rule are rather complicated.

Our basic focus, again, is that we see here a move away from allowing offsets, in this case allowing a loss from one unrelated trade or business to offset income from another unrelated trade or business.

Historically, as one would read the legislative history of a particular provision, it explains and justifies why the changes are being made. The legislative history may say the current statute isn't working for this reason or taxpayers are going too far is doing this or that. But the legislative history here is devoid of such justification. Why shouldn't losses from one unrelated business activity offset income from another unrelated business activity? The author finds no explanation of rationale in the legislative history. One would gather that this is just another revenue-generating measure.

The Parking Problem

On the for-profit side of the changes in these rules, the basic idea seems one of concern with "too much" rather than the nature of the activity. Providing a place for employees to park at work would hardly seem a controversial undertaking. But the result was disallowance under the 2017 Tax Act for employer-paid parking and then there was some concern with achieving parity in the exempt sector. ((See also "A Planning Introduction to the 2017 Tax Act – Charitable Donations and Exempts," section titled "How Did the Expense of Parking at the Homeless Shelter Become Taxable Income," Bob Rojas, Rojas & Associates, April 2, 2018. See generally Conf. Rep., p. 119, 408, 409 as to exempts, and as to parking for for-profit employers, see Conf. Rep. p. 74, 75, 402-407. The changes are effective for expenses paid after 2017 without regard to the tax year of the employer.))

The legislators basically ended up adding the parking expense to the charity's unrelated business income, though the nature of the problem is paying an expense. The charity has unrelated business income from paying an expense directly related to fulfilling its exempt work. The expenditure is not unrelated, not business, nor is it income, yet it gets classified (misclassified) as unrelated business income.

I've had some problem recently with my glasses lenses falling out of the frames because I rub them too vigorously in cleaning, and I blame that problem in part to reading provisions such as this.

Conclusion / the Bigger Problem

As taxpayers and tax practitioners, we may not agree on all of the details. But there would seem to be a retreat from reasonableness and fairness in many of the new provisions, including a significant retreat from the basic concept of allowing related expenses to offset the income that is being taxed within the context of a rate structure aimed at net income, not gross receipts.

About the Author:



J. Michael Pusey, CPA, MSA, is a National Tax Director with Rojas and Associates, CPAs, Los Angeles. He has over forty years experience in tax and finance. Mr. Pusey has written or contributed to four tax books, including an AICPA Tax Study, and a finance book. Mr. Pusey began his career with KPMG before working nine years in "national tax" for Laventhol & Horwath and Grant Thornton. He was V.P., Assistant Tax Director, Manager of Research and Planning for a NYSE financial institution prior to beginning his practice, then joining Rojas and Associates.



A Planning Introduction to The 2017 Tax Act - The 20% Of Business Income Deduction - Part 3

Bob Rojas, J. Michael Pusey

(Part 3)

Whether there may be unforeseen complexities or issues of interpretation under Section 199A with respect to passive activities remains to be seen. ((There is some discussion of the passive activity rules in the Sec. 199A legislative history in the House version. See Conf. Rep., e.g., p. 211 of the legislative history from the House. Conference followed the Senate version.))

The focus of the statute is on items that affect taxable income, so the authors consider it unlikely that the IRS will interpret Section 199A to remove from the computations passive losses that arise in pre-enactment years and enter into taxable income after 2017.

The potential effect of Section 199A in the various scenarios inclusive of Section 1231 gains and/or losses on the sale of business assets is important and discussed in more detail below in “A Closer Look at What Qualifies as Business Income.”

The topic of disallowed business expenses is beyond our scope, but as an example of such disallowance, we note the following in the legislative history of the 2017 Act. “Taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel.)” ((Conf. Rep., p. 407.)) In the language of the new Section 199A, we note that in its definition of “qualified business income,” it basically refers to the net figure considering “income, gain, deduction and loss...” ((Sec. 199A(c) (1).)) But query whether the IRS will require disallowed business expenses to be subtracted in computing business income subject to the new 20% deduction?

Also included in “qualified business income” are REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income. Note that a Subchapter S corporation is by definition one with a limited number of shareholders, so in this list we note only publicly traded partnership income.

Toward the goal of some simplification in our discussion of these very complex rules, we won’t include the particulars of REITs and cooperatives, which are basically flow-through entities.

Wage Income

The basic definition of a “trade or business” is “any trade or business” with two exceptions: wages of an employee and in certain cases “specified service trade or business.” ((Sec. 199A (d).))

An employee is considered to be in business, but wage income is expressly excluded from qualifying business income for this purpose. ((Sec. 199A (c') (4).))

“Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer.” ((Conf. Rep., p. 215.))

Planning point: Earnings as an independent contractor may qualify, so this is one more area of the Code where employee vs. contractor distinctions are important, possibly even placing new strategic emphasis on minimizing employee characterization.

An independent contractor gets some deduction related to the self-employment tax but pays the entire tax versus paying half the payroll tax as an employee, and bearing the incremental self-employment tax in order to access the new credit is not a persuasive strategy, with the possible exception of high compensation levels that exceed the maximums subject to FICA/FUTA. So when the employee vs. contractor classification is debatable, borderline, we wouldn't generally expect employees to be initiating requests to be reclassified as contractors.

Planning point: Subchapter S flow-through of business income generally qualifies as being eligible for the 20% of business income deduction but the new context suggests possible disputes with the IRS over whether payouts from the S corporation are nondeductible dividends or wages that should reduce the level of Subchapter S flow-through of business income. Wage classification is normally a negative because wages don't qualify as business income, but wages can help in scenarios where a level of wages or wages and capital are necessary to avoid limitations on the 20% deduction. These limitation rules are discussed below. Whether payouts from S corporations are dividends or wages triggering payroll taxes and withholding is a traditional area of dispute between the IRS and owners of S corporations, and this issue is still with us. ((See Rev. Rul. 59-221, 1959-1 C.B. 225, Rev. Rul. 74-44, 1974-1 C.B. 287, Ding, 200 F. 3d 587 (1999), CA-9, <http://caselaw.findlaw.com/us-9th-circuit/1435681.html>, PLR 20030026, 3/31/03.))

Following is an excerpt from an IRS site discussing wages in an S corporation context:

“S corporations must pay reasonable compensation to a shareholder-employee in return for services that the employee provides to the corporation before non-wage distributions may be made to the shareholder-employee. The amount of reasonable compensation will never exceed the amount received by the shareholder either directly or indirectly.

The instructions to the Form 1120S, U.S. Income Tax Return for an S Corporation, state “Distributions and other payments by an S corporation to a corporate officer must be treated as wages to the extent the amounts are reasonable compensation for services rendered to the corporation.”

Several court cases support the authority of the IRS to reclassify other forms of payments to a shareholder-employee as a wage expense which are subject to employment taxes.” (“S Corporation Compensation and Medical Insurance Issues,” “Reasonable Compensation,” <https://www.irs.gov/businesses/small-businesses-self-employed/s-corporation-compensation-and-medical-insurance-issues>.)

As above, to the extent there is just flow-through income and no payouts to the shareholder-employee, the flow through is a dividend and not wages.

In an S corporation context, to summarize, here are the “wages” issues we see with respect to closely-held shareholders.

To the extent there are payouts in the context of shareholder services and such payments are characterized as dividends, the IRS has traditionally argued, and will continue to argue, that the “reasonable compensation” element of such payments are really wages subject to payroll tax.

To the extent there are payouts in the context of shareholder services and such payments are characterized as dividends, the IRS will also argue that such payments reduce the business income otherwise eligible for the 20% of business income deduction because such payments are really wages. The IRS now has a second major incentive to classify S corporation payments to owners as wages.

When there are no payouts of wages and no payouts of dividends which could be challenged as disguised wages, will the IRS argue that for purposes of the new Section 199A, it is entitled to nevertheless characterize the flow-through income as wages to the degree of the value of the shareholder services? This concept is missing from the legislative history, is contrary to current IRS practice, and we would be very much surprised if the IRS takes such a position.

When there are payouts of wages to shareholder-employees, the taxpayer is conceding (a) payroll taxes; even above the annual FICA/FUTA limits, there is some incremental tax; (b) the wages are not subject to the 20% of business income tax;

and (c) the wages reduce the S corporation's business income flowing through to the shareholder-employee, as well as other shareholders if any. The taxpayer may gain wages classification when a level of wages or wages and capital is necessary to avoid limitations on the 20% business deduction. But it is difficult to envision it being a net advantage to the IRS to reclassify wages as a dividend. The more likely scenario is upon exam, the math indicates the wage limitation is already satisfied with other wages or not a factor because of the income level of the taxpayer, and the taxpayer's representative uncovers arguments as to why wages were overstated; e.g., the taxpayer was ill, getting older and working fewer hours, etc.

Planning point: Keep in mind that reducing the historic level of wages to shareholder-employees of an S corporation may be justified in some circumstances (age, health, other responsibilities, etc.) and may be particularly advantageous under the new 20% of business income rules.

Guaranteed Payments to a Partner

A partner receiving guaranteed payments from the partnership is not receiving qualifying business income for this purpose. ((Sec. 199A (c') (4).))

Planning point: Reviewing the level of guaranteed payments, which do affect the actual economics in a partnership context, is important because it reduces the flow-through partnership income that may otherwise qualify for the 20% of business income deduction.

The new environment of Section 199A may cause the IRS to argue that payments to partners characterized as distributions are really disguised guaranteed payments. Such an argument may be even more likely in a family partnership context.

"Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer. Similarly, qualified business income does not include any guaranteed payment for services rendered with respect to the trade or business, and to the extent provided in regulations, does not include any amount paid or incurred by a partnership to a partner who is acting other than in his or her capacity as a partner for services." ((Conf. Rep., p. 215, footnotes omitted...))

There are higher-income areas of the 20% of business income rules that introduce limits that require wages or wages and capital, and we wouldn't expect the IRS to interpret guaranteed payments of a partnership to qualify as wages for this purpose.

Foreign Income

Qualifying business income must be effectively connected with the conduct of a trade or business within the United States. ((Sec. 199A (c') (3) (A).)) Foreign earned income doesn't qualify for the deduction. The long-standing but limited exclusion for foreign earned income was not repealed in the new law.

Investment Income

In general, such items as dividends and interest income don't qualify, albeit it is possible in some circumstances to have interest income qualify if it relates to a business. ((Sec. 199A(c') (3) (B).)) Stock market gains, typical capital gains and losses in an investment rather than business context, do not qualify. ((Conf. Rep., p.215.))

Real Estate Income

One doesn't find "rent" or "rental" in the new Section 199A which is titled "Qualified Business Income." It was the Senate version that prevailed, but we note the following comment from the legislative history of the House.

"Unlike a C corporation, partnership, or S corporation, a business conducted as a sole proprietorship is not treated as an entity distinct from its owner for Federal income tax purposes. Rather, the business owner is taxed directly on business income, and files Schedule C (sole proprietorships generally), Schedule E (rental real estate and royalties), or Schedule F (farms) with his or her individual tax return." ((Conf. Rep. 208 of the House provisions, footnote omitted. There is also a reference to "rental activities" on p. 211 of the House provisions in the context of passive losses.)) It may be debatable whether these references to rentals were meant to include the activities in business income, although this does seem to say among the filings of the "business owner" is Schedule E with its rental real estate.

There are endless fact patterns but the authors suggest that most tax practitioners wouldn't consider, say, a "rental house"

to be a business activity. The self-employment tax applies generally to a trade or business but real estate rentals are generally excluded. They are excluded if the realty is held for investment. ((Sec. 1402 (a) (1); Regs. 1.1402(a)-4. See also, Regs. 1.1411-1, 1.1411-5.))

Almost certainly, one would expect, e.g., a housing contractor or hotel/motel operator to be in a trade or business. ((The following says Section 199A was “clearly intended to apply to commercial real estate,” opines that the rule about 2.5% of basis for qualified property was intended to allow the deduction for rental entities without employees, and queries whether the definition of a trade or business will emphasize Section 162 or Section 1411. See “New Code Section 199A, Pass-through Qualified Business Income Deduction,” Leon C. LaBrecque, Michigan Association of Certified Public Accountants, MICPA.org, p. 1; <http://micpa.org/docs/site/e-news/is-section-199a-of-the-code-a-windfall-for-cpa-firms.pdf?sfvrsn=6>. See also “Planning for UBTI Changes,” Dennis Walsh, Planned Giving Design Center, 1/16/18; <http://www.pgdc.com/pgdc/planning-ubti-changes.>))

Note these comments from an IRS site discussing post-construction realty rentals in a self-employment tax context:

“Rents received from the use of or occupancy of hotels, boarding houses, or apartment houses are included in self-employment income IF you provide services to the occupants. Services considered provided to the occupants are services primarily provided for the convenience of the occupants and not normally provided with the rental of rooms or space for occupancy only. Maid service, for example, is a service provided for the convenience of occupants, while heat and light, cleaning of stairways, and the collection of trash are not.. ((“Rents,” <https://www.irs.gov/individuals/tax-trails-self-employment-income-6.>))

Let’s initially consider a real estate rental fact pattern where it at least may have the appearance of a trade or business.

One might find an office with employees and an integrated operation of real estate operations focused on real estate rentals, occasional projects that involve major improvements or even new construction, owned by two associates or a married couple. The details of rent collections, calling the plumber, etc., may be with this company, or related company possibly owned by a family member, or such company may be unrelated. One may argue the real estate rental income is still not subject to self-employment tax, which normally applies to a “trade or business.” One might argue the realty is held for investment despite a certain recurring level of activities inherent in owning multiple properties. But does such a position necessarily remove it from being a trade or business for purposes of the 20% of business income deduction? It is quite possible that the IRS will not consider real estate rentals as subject to Section 199A unless the activities are also subject to self-employment tax.

At the other end of the spectrum is the busy employee or business owner with one real estate rental property, perhaps a former residence, and whether this rises to the level of a trade or business for purposes of the 20% of business income deduction is another question.

It was the Senate version that prevailed albeit with significant modifications in conference. The legislative history of the Senate and conference discusses qualified business income without mentioning real estate rentals, and investment income without mentioning real estate rentals. ((Conf. Rep., p. 214, 215.))

Had it been the intent to include real estate rentals *carte blanche* in the definition of a trade or business for purposes of the new Section 199A, one would expect that such intent would have been made patently clear in the statute, or at least the legislative history.

At the other end of the spectrum are real estate “dealers” who are typically considered as being in a trade or business. ((Regs. 1.1402(a)-4.)) There are many cases focusing on whether the facts indicate realty sales produce ordinary income because the taxpayer was acting as a “dealer,” and the sale of realty, which often involves some level of construction or improvement, was akin to the grocer selling canned goods. ((Taxpayers sometimes unsuccessfully argue dealer status on a realty sale to avoid the annual limit on capital losses arising from the sale of investment realty. Conner, T. C. Memo 2018-6.))

Another question in this context is whether or when real estate activities, including rentals, constitute a single trade or business. Some of the details in the computations look to the income and expense of “each” trade or business. See the discussion of “Multiple Businesses.”

The real estate industry generally will have considerable focus on the development of the regulations concerning the scope

of Section 199A. ((Section 199, the domestic production activities deduction, was repealed with the enactment of Sec. 199A, and there were aspects of the real estate industry that benefitted in the past from the repealed provision. Section 199 was generally repealed for taxable years beginning after 2017. For corporate taxpayers, it was repealed for taxable years beginning after 2018. Conf. Rep., p. 400. See “Domestic Production Activities Deduction – Planning and Practicality,” J. Michael Pusey, Main Street Practitioner, <http://mainstreetpractitioner.org/feature/domestic-production-activities-deduction-planning-and-practicality/>.)

In general, we are beginning to hear some suggestions that real estate rentals are per se subject to the new 20% of business income deduction, and we have reservations. For example, if you’re a busy executive planning to buy a rent house and include this 20% of business income in the projections, we would suggest caution.

Hopefully, the IRS will prioritize real estate industry issues in their analysis of this important new legislation.

ENTITY ISSUES

Basically, a sole proprietorship, partnership or Subchapter S corporation can generate income that qualifies for the 20% of business income deduction.

An LLC with a single owner may be a disregarded entity, or it may elect to be taxed as a corporation in which case the income would not qualify unless electing S corporation status. ((See, e.g., Conf. Rep. P.206.))

A publicly traded partnership is generally treated as a corporation for tax purposes but there are exceptions. ((See Conf. Rep. p. 206; Sec. 7704 (a) (2).))

A sole proprietorship is generally not considered an entity apart from the owner, except for employment tax purposes. A sole proprietorship, whether just the individual or an LLC not considered an entity apart from its owner, qualifies under the 20% of business income rules if the income is of a nature to qualify. ((Conf. Rep. 208 reporting the House Report, see Regs. 301.7701-2(c) (2) (IV).))

“While sole proprietorships generally may have no more than one owner, a married couple that files a joint return and jointly owns and operates a business may elect to have that business treated as a sole proprietorship under section 761(f).” ((Conf. Rep., 208 reporting the House Report.))

In general, a husband and wife in a community property state may disregard their LLC for tax purposes and report results directly on the joint return. ((See Rev. Proc. 2002-69, 2002 CB 831.))

Whether a partnership or S corporation, the computations focus on the individual taxpayer; i.e., there aren’t computations that begin and end at the partnership or S corporation level for purposes of this new concept.

SOME GENERAL RULES AND ISSUES

This deduction is available in arriving at taxable income but not adjusted gross income. This deduction, for example, won’t affect such areas as medical expense deductions which arise above a percentage of adjusted gross income. This new deduction is available whether or not the taxpayer itemizes. ((Conf. Report, p. 224.))

The deduction is available to trusts and estates with provision for apportioning of the deduction between the entity and beneficiaries. ((Conf. Rep. p.224.))

This particular deduction doesn’t increase the taxpayer’s net operating loss, so if there is an incremental deduction under the rules of the new Section 199A, the rules seemingly restrict its use to current year’s tax return. There is no provision to carry over the Section 199A deduction itself.

There is some possibility of carryover within the Section 199A rules for unused business losses. ((Conf. Rep. p.214. “If the net amount of qualified business income from all qualified trades or businesses during the taxable year is a loss, it is carried forward as a loss from a qualified trade or business in the next year.”)) This carryover is only a negative; i.e., can only lessen future deductions measured by a percentage of future business income. Presumably this carryover goes away at the death of the

taxpayer.

This deduction isn't available in computing the self-employment tax. ((Conf. Rep. p. 220 reporting the Senate Report.))

While the corporate alternative minimum tax was repealed, the individual alternative minimum tax is still with us. The beginning point in computing such tax is taxable income, and apparently the new 20% of business income deduction is a deduction for AMT purposes. Seemingly this would be the deduction after applying the 20% and considering the "if less" computation which looks to 20% of taxable income as reduced by the sum of net long-term capital gain in excess of short-term capital loss and qualified dividends, as well as the myriad detailed rules and limitations, such as wage or wage and capital limitations. The basis for such statement is the absence of anything to the contrary in the new statute and its legislative history and the absence of any amendments in this regard in the AMT statute.

There is a "side note" statutory provision in the new 199A that apparently amends the minimum tax rules in prescribing how this new provision relates to those rules. It is headed "Coordination with Minimum Tax" and provides, "For purposes of determining alternative minimum taxable income under section 55, qualified business income shall be determined without regard to any adjustments under sections 56 through section 59." ((Sec. 199A (f) (2); Conf. Rep., p. 17. Sections 56 through 59 are within the minimum tax rules.)) The legislative history says, "Qualified business income is determined without regard to any adjustments prescribed under the rules of the alternative minimum tax." ((Senate report at Conf. Rep. p.220.)) The trail here is short and terse but remembering the multitude of items entering into "qualified business income," the implication seems to be to re-compute the Sec. 199A deduction separately for AMT purposes but when it comes to measuring "qualified business income," don't re-compute its elements when the measure for AMT purposes is different than for regular income tax purposes. We gather the new Sec. 199A deduction is a potential benefit in so far as the AMT but there may be a regular tax vs. AMT tax difference in measuring the deduction.

The legislative history has some broadly-worded anti-abuse language:

"In the case of property that is sold, for example, the property is no longer available for use in the trade or business and is not taken into account in determining the limitation. The Secretary is required to provide rules for applying the limitation in cases of a short taxable year where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the year. The Secretary is required to provide guidance applying rules similar to the rules of section 179(d) (2) to address acquisitions of property from a related party, as well as in a sale-leaseback or other transaction as needed to carry out the purposes of the provision and to provide anti-abuse rules, including under the limitation based on W-2 wages and capital. Similarly, the Secretary shall provide guidance prescribing rules for determining the unadjusted basis immediately after acquisition of qualified property acquired in like-kind exchanges or involuntary conversions as needed to carry out the purposes of the provision and to provide anti-abuse rules, including under the limitation based on W-2 wages and capital." ((Conf. Rep. p.223. See also Sec. 199A (b) (5).))

THE BASIC 20% MATH AND THE "IF-LESS RULE"

As discussed below, special rules may apply to certain service providers.

The computation measures the deduction looking to "combined qualified business income amount" or if less, 20 percent of any excess of taxable income over any net capital gain as defined in Section 1(h). ((Sec. 199A (a).)) The latter might be termed the "if less rule."

In general, the "if less" component introduces a new complexity to planning. In the opinion of the authors, the statute here refers to taxable income from all sources, not just business income. ((One author opines, "It is unclear whether the taxpayer's taxable income refers to the taxpayer's taxable income from all sources or just income from all qualified trades or businesses. My best guess is that it refers to all sources." "Qualified Business Deduction Under New Section 199A," Teresa Rankin Klenk, Gentry, Tipton, McLeMore, 12/20/17, <http://www.tennlaw.com/12/can-you-qualify-for-the-sec-199a-qualified-business-deduction/>.)

The concept of "combined" qualified business income nets income and losses. For example, one of only two examples in the Senate Report shows one spouse with a business loss and another spouse with business income, and the loss offsets income in figuring the net business income that gives rise to the 20% deduction in a joint return. ((The conferees were relatively terse

in their explanations but they made some very significant changes while basically following the Senate version. Conf. Rep., p. 221, 222.))

We noted above that there is a concept of carrying forward a loss within the Section 199A rules from a previous year. Within this concept of a loss related to Section 199A calculation, presumably such a carryover could only be post-2017; i.e., couldn't precede the Section 199A rules.

But query the impact of a net operating loss carryover from 2017 or earlier on the calculations under Section 199A? The issues here should be considered in deciding whether to elect to carryover any NOL incurred in 2017.

First, how does an NOL carryover affect the basic 20% of business income computation? The 20% is applied to "qualified business income with respect to the qualified trade or business," subject to some limitations, or more specifically, "the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business." ((Sec. 199A (b) (1) (A) and 199A(c).)) We also note Section 199A(c) (3) defining the relevant items as "effectively connected with the conduct of a trade or business within the United States..." It goes on to ask if such amounts are "included or allowed in determining taxable income for the taxable year." ((Sec. 199A(c) (3) (A) (ii).)) One could argue the language here includes an NOL deduction arising even from pre-enactment years, at least as it relates to business losses.

Computing the NOL under Section 172 is complicated but it basically works from taxable income with adjustments, such as removing personal exemptions and nonbusiness deductions except to the extent of nonbusiness income. So it is roughly true that an NOL carryover would reflect losses from a trade or business. Yet an added complication is that it is possible an NOL would reflect non-business casualty losses as all or part of the NOL, which could also raise issues of order of absorption if the NOL also includes business losses.

When losses of non-corporate taxpayers exceed \$250,000 or \$500,000 in a joint return in tax years beginning after 2017, there is a new rule which can add such losses to the NOL carryover rather than allow such losses to offset non-business income. ((Conf. Rep. p.19, 238-239, amending Sec. 461 (l) for losses in tax years beginning after December 31, 2017.)) A possible argument for including consideration of the NOL deduction in Section 199A is that due to new Section 461(f), there are some scenarios where business losses don't seem to get deducted except as NOL carryovers. The express language of the statute refers to "disallowance." ((Conf. Rep., p. 19; Act Sec. 11012.)) Rather than press an argument based on such an unusual provision, one could also argue for special computations but that would also raise issues of order of use when the figures include such amount as only one of the NOL components.

One could also argue that to include the NOL deduction in measuring business income under Section 199A runs counter to the focus of the statute on the results of the particular year and whose goal was to encourage business and reward post-enactment results.

One could add the following argument, emphasizing that pre-2018 law permitted NOL carryovers up to twenty years and the new law permits indefinite carryforwards. Congress envisioned a new concept which focuses on trade or business income post-2017 and it added rules that in some circumstances can even require separating such income into the income or loss of "each" separate trade or business. An NOL deduction arising from carryovers from many distant years could require analyzing such figures to segregate losses into separate trades or businesses when the returns and records may no longer even be available, and require practically impossible calculations looking to absorptions of such losses in years after they were incurred. The years of absorption may also be very distant. One would reasonably argue that Congress did not contemplate integrating an NOL carryover deduction into this mix of considerations within Section 199A.

Also, Section 199A has its own carryover rule which focuses on post-2017 net losses that arise within its rules. ((Sec. 199A (c') (2).)) Seemingly this raises the question of duplication. How would the taxpayer apply the carryover rule within the new code section and also the normal NOL carryover rules?

Within the Section 199A rules, there is statutory provision dealing with carryover of unused, excess loss, but not carryback, which may raise such questions as this: Does the taxpayer losing \$100,000 in year 1 and earning \$100,000 in year 2 get no 20% deduction in either year, but as to the person who earns \$100,000 and then loses \$100,000 in the second and last year of the business, does this person, whom we assume retires, get to deduct 20% of \$100,000 in year 1 and the \$100,000 loss from the discontinued business just carries over until his/her death, then disappears? This would seem to be the result given the new law contemplates carryover of unused losses but no carryback.

As to the basic question of whether the NOL deduction should reduce the base of the 20% of business income calculation, we would argue that this particular deduction should not reduce the base, and this should hold true of NOLs from pre-enactment and post-enactment years.

On the other hand, the authors would anticipate that the IRS will likely conclude an NOL carryover, even though from a year or years before enactment of the Section 199A concept, would reduce taxable income under the “if less” portion of the calculation. This figure is just basically taxable income with certain adjustments times 20%, and the list of adjustments doesn’t include any NOL carryover deduction. For example, if a taxpayer elects to carryover a large NOL from 2017 to 2018, we would caveat that this would likely have a significant detrimental effect on any benefit under the new Section 199A rules.

Planning point: In deciding whether to carryback an NOL from 2017, consider that as an NOL carryover, it may have a detrimental effect in so far as accessing the 20% of business income deduction.

Planning point: Not to suggest that a couple will often opt out of a joint return because of these rules but it may arise in some circumstances; e.g., if one spouse has a business loss that offsets business income of the other spouse that might otherwise benefit from the 20% deduction. It is not impossible the regulations may try to limit such planning.

As one reads the statute, the term “qualified business income amount” doesn’t have a “20%” beside it, but it is a 20% figure. ((See Sec. 199A (a) (1) (A), (b) (1) (A), (b) (2) (A).))

Planning point re business expense elections: Assuming the basic computation looks to 20% of qualified business income and the “if less” concept focusing on taxable income doesn’t otherwise apply, one can see that decisions that maximize business expenses have to be viewed from the standpoint of their effect on the Section 199A deduction. For example, if the taxpayer opts to expense a capital expenditure rather than claim normal depreciation, this reduces taxable income and saves tax. But while one can normally calculate tax savings of an incremental deduction by applying the marginal tax rate to the deduction, one needs in these circumstances to factor in the fact that the decision to call a capital expenditure an expense will also reduce the 20% of qualified business income deduction directly. By reducing taxable income, it may also bring into play the “If less rule” that focuses on 20% taxable income with adjustments.

Planning point re Keogh contributions: A Keogh contribution can also bring into play the taxable-income-if-less rule when the deduction would otherwise be based on net business income. Such decisions as whether have a Keogh or whether to maximize the deduction may now have to be weighed against projected or potential long-term reductions in the new Section 199A deduction. It may also be an issue whether or to what degree Keogh or other benefit programs may be considered as directly reducing the 20% of business income calculation, and whether, e.g., one distinguishes payments benefitting owners.

Planning point re nonbusiness expenses and nonbusiness income: Under the basic concept that the deduction is 20% of qualified business income or, if less, 20% of taxable income as reduced by the sum of net long-term capital gains in excess of short-term capital losses and qualified dividends, one can see certain areas where the 20% deduction is pared down by nonbusiness deductions, including the standard deduction, which was increased with the new legislation. For example, under the “if less rule” looking to 20% of taxable income, assuming a taxpayer with just qualified business income and the standard deduction, the standard deduction triggers a reduced 20% deduction, whereas it would not if there were, say, interest income in an amount equal to the standard deduction. One can envision circumstances where if this particular scenario applied, the taxpayer would have been better off investing in high-yield bonds versus low-yield growth stocks.

There can be scenarios in which the 20% of business income deduction goes up with incremental nonbusiness income. Nonbusiness income planning can significantly affect planning here if the deduction looks to taxable income.

Planning point re charitable donations: One can envision the Section 199A rule being a disincentive in some circumstances for charitable donations because the contributions increase itemized deductions and bring into play the “if less rule” looking 20% of taxable income with adjustments rather than 20% of business income. We later show another scenario in which the charitable donation looks to enhance the deduction.

Planning generally gets much more mathematical, particularly considering the breadth of the two components we discuss, one being combined “business income” which includes flow-through income which is often difficult to predict, and the other being “taxable income.”

An IRS exam that adjusts taxable income may well result in a re-computation of this deduction and it could affect either

of the two major components that determine the basic deduction. One can envision circumstances where an IRS exam would increase taxable income without adjusting business income and the result would be diminution of the if-less limitation, such that the Section 199A deduction increased and mitigated the tax increase arising from the IRS adjustment.

There is a third rule saying the deduction can never exceed taxable income as reduced by net capital gain as defined in Section 1(h). ((Sec. 199A (a), last sentence.)) As discussed below, net capital gain for this purpose appears to be net long-term capital gains in excess of short-term capital losses plus qualified dividends.

For an even deeper dive into this topic, members can read the unabridged article [here](#).

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Estate Planning After the Tax Cuts and Jobs Act of 2017

Frank Leffingwell

Under the Tax Cuts and Jobs Creation Act of 2017 (the “Tax Act”), the estate and gift tax exclusion amount for 2018 is \$11,180,000 (for an unmarried person) and \$22,360,000 (for a married couple). However, the estate and gift tax exclusion amount will return to \$5,000,000 (for an unmarried person) and \$10,000,000 (for a married couple) on January 1, 2026 if the tax law is not sooner extended or modified. Because the anti-clawback provisions of IRC 2010(g)(2) have been preserved, a unique opportunity to make gifts prior to 2026 as a hedge against a potential reduction in the estate and gift tax exclusion amount (keeping in mind that gifted assets will not receive a step-up in basis).

Additionally, under the Tax Act, the gift tax annual exclusion has been increased for 2018 to \$15,000 (up from \$14,000 in 2017). Accordingly, in 2018 an unmarried person can make annual exclusion gifts of up to a total of \$15,000 to an unlimited number of recipients. Similarly, in 2018 a married couple is able to make annual exclusion gifts of up to a total of \$30,000 to an unlimited number of recipients. Remember that the gift tax annual exclusion is separate from and in addition to the estate and gift tax exclusion amount (described in the preceding paragraph) and that there is an unlimited gift tax exclusion for amounts paid on behalf of an individual paid directly for medical care and to educational institutions for tuition.

It is also important to note that under the Tax Act married couples may still elect portability so that the unused portion of the first-to-die spouse’s estate tax exemption may be utilized by the surviving spouse and assets transferred at death will still receive a step-up in basis to the date of death value.

Because of the significant changes under the Tax Act, your client’s estate plan documents should be reviewed to confirm they still meet with their objectives. Many of these documents create trusts and utilize funding formulas that were appropriate under the prior tax law, but which would cause unwanted results under the Tax Act.

About the Author:



Frank L. Leffingwell is a tax attorney and president of Frank Leffingwell & Associates, PC, a Central Texas business, tax and estate planning boutique law firm. His practice focuses on the representation of entrepreneurs, investors, closely-held and family businesses, and high-net-worth individuals in business transactions, tax, financial transactions, and estate planning, with particular emphasis in partnership taxation. Frank is a 25-year “AV rated” attorney and a 2019 candidate for a Master of Laws (LL.M.) in Taxation from Georgetown University Law Center.

Connect with Frank on social media: Twitter @leffingwelllaw1 Facebook @leffingwelllaw



Introduction to the IRS Collection Financial Standards

Jassen Bowman

When representing an individual tax debtor in an IRS Collections matter, determining the taxpayer's ability to pay becomes the crux of the issue after addressing return compliance and accrual of additional tax debt. In this article, you will learn the basics of the Collection Financial Standards and how to apply them in your client cases.

The purpose of the IRS Collection Financial standards is to determine an individual taxpayer's ability to repay their taxes. The standards are applied to a variety of scenarios, including determining Installment Agreement payment requirements, eligibility for Currently Not Collectible (CNC) status, minimum Offer in Compromise (OIC) amounts, eligibility for levy releases, etc.

The only time these Standards are not applied in an individual Collections matter is when a taxpayer has sufficient equity in assets to full pay the tax liability, or if the taxpayer is eligible for Guaranteed or Streamline processing. Even, if you telephone ACS or use the Online Payment Agreement tool, you will still be asked to provide basic living expense information, even though it's not required by IRC or IRM.

As an aside, it may be helpful to remind you that, as of this writing, the IRS has not extended the Streamline test criteria that had been in place since January 1, 2017, and thus the liability thresholds for Streamline processing have reverted to normal values.

The purpose of the Standards is to differentiate between necessary and unnecessary living expenses, and the Standards are based around a middle class lifestyle. The numbers are generated from various statistical surveys and government agency data about the cost of living. The Standards are designed to cover basic living expenses only, although the Service may allow for actual expenses in certain situations. Taxpayers that are living beyond the standards will be asked by the IRS to reduce their lifestyle to below the Standards, or seek a different resolution to their tax liability.

The categories of living expenses covered by the Standards may seem narrow in scope to many of your clients. The fact that many common expenses, such as higher education tuition, tithing, retirement contributions, and the like are not allowable expenses will be a source of frustration for both you and your client. I highly encourage you to develop pre-scripted responses to address your client concerns over expenses that are not allowed, as it will be a frequent point of conversation.

Let's now look at each of the expense categories in brief. The latest IRS Collection Financial Standards can be found on the IRS website at <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.

Lump Sum National Standard

This Standard is the "catch all". It includes food, clothing, housekeeping supplies, personal care products and services, and

miscellaneous expenses, including minimum credit card payments and other non-allowable expenses. A taxpayer is allowed full credit for this Standard, at the full amount, without need to document their actual expenses.

The current allowable amount for this Standard is \$647 per month for one person in a household. It increases to \$1202 for a two-person household, \$1384 per month for three, and \$1694 for four persons in a household. For each person beyond four, add \$357 per month to the allowance for four people.

Out of Pocket Health Care and Health Insurance

In acknowledgement of the high cost of health care, and the fact that insurance obviously doesn't cover everything, the IRS allows a minimum amount for out of pocket health care costs, regardless of what a taxpayer actually spends. This amount is \$65 per month for individuals under 65, and \$114 for those 65 and older.

In addition, since the Affordable Care Act requires most people to have health insurance, a taxpayer is allowed to claim the full amount of their health insurance premiums, regardless of the level of plan they have. For example, the Standards do not differentiate between allowing for a Bronze versus a Gold plan, despite the difference in premiums.

Transportation Standards

Taxpayers are allowed a monthly expense for public transit or vehicle ownership, but not both. Taxpayers can purchase or lease a vehicle, and is intended to provide them the ability to get back and forth to work. As such, an individual is typically only allowed credit for one car. For a multi-person household, a maximum of two vehicles are typically allowed, regardless of the number of working adults within the household. There are conditional expense arguments that can be made for additional vehicles, but they are evaluated on a case-by-case basis.

The national public transit allowance is \$178 per month, regardless of where the taxpayer lives. This full amount may be claimed regardless of what they actually spend, without documentation, even if they spend less.

For vehicle ownership, the monthly lease or car payment cannot exceed \$497 per month, per vehicle. If the taxpayer's payment is less than this amount, they may only claim the actual monthly payment, not the full \$497.

Taxpayers are also permitted to claim a monthly expense for vehicle operating costs. This amount is intended to cover insurance, maintenance, registration, tolls, fuel, and other operating costs. This amount is not national, but rather based on local variations in cost.

To determine the operating expense limit applicable to your client, the IRS has broken the country into four regions (Northeast, Midwest, South, and West), and defined operating expense caps for those regions. Then, within those regions, the IRS defines metro areas that have different costs from the region. These metro regions are defined as a collection of counties.

For example, if your client is located in Abilene, TX, this would be considered part of the South region, and the taxpayer would be allowed a maximum of \$196 per month, per allowable vehicle, for operating expenses. The only special metro region defined for Texas is the Dallas-Ft. Worth area, which does not include Taylor County, which Abilene is part of.

For a full break down of the states included in each region, and the counties that comprise each metro area, along with the monthly operating expense limits for these areas, see the IRS table at <https://www.irs.gov/businesses/small-businesses-self-employed/local-standards-transportation>.

One final note on vehicle operating expenses: Technically speaking, the taxpayer is only permitted an allowance for the lesser of their actual vehicle operating costs or the Standard.

Housing and Utilities

The local standards for housing and utilities tend to be the most contentious. Since these local standards for housing do not take into consideration the variations in housing costs that occur from one end of a particular county to another, many taxpayers may think these Standards to be unfair.

The housing and utilities standards are provided in tabular format for every county in the country, broken out by state. The Standard covers either rent or mortgage payment, and also covers taxes, insurance, maintenance, heat, water, electric, landline telephone service, cell phones, cable, and Internet.

To find the allowable maximum for your client, visit <https://www.irs.gov/businesses/small-businesses-self-employed/local-standards-housing-and-utilities> and select the appropriate state, then scroll down to the appropriate county. As an example, here's the table for the District of Columbia:

County	2018 Published Housing and Utilities for a Family of 1	2018 Published Housing and Utilities for a Family of 2	2018 Published Housing and Utilities for a Family of 3	2018 Published Housing and Utilities for a Family of 4	2018 Published Housing and Utilities for a Family of 5
District of Columbia	2,211	2,596	2,736	3,051	3,100

Notice that the table caps out at a family size of five. The Collection Financial Standards do not contain any per-person additions to this amount for a larger family. Theoretically, additional housing costs for additional family members is included in the additional per-person amount under the Lump Sum National Standard. However, conditional expense arguments can be made for a higher Housing and Utilities allowance in certain circumstances. Most such arguments will be based on local child welfare laws relating to the maximum number of children allowed to share a bedroom, and what is considered appropriate under local law regarding mixing of ages and genders that share a bedroom. An excellent source of information for summaries of such local laws are foster and adoption agencies.

It's also important to note that this is another "lesser of" expense. For example, if your client lives in Washington, D.C. with a household of two, the maximum allowable expense is \$2,596 per month. If your client actually only spends \$1,778 per month on rent, electricity, and all other utilities, then the IRS would only allow the \$1,778.

Applying IRS Collection Financial Standards

Understanding these standards is fundamentally important to your ability to properly represent individual tax debtors in front of the IRS. You will apply these standards whenever you:

- Apply for an Installment Agreement on a tax liability over \$25,000.
- Apply for an Offer in Compromise of any amount.
- Request Currently Not Collectible status.
- Request levy release on financial hardship grounds.

The Standards are actually applied on the Income and Expense Table (IET) found in Section 5 of IRS Form 433-A. They are also applied to the expense section of Form 433-F, and in Section 7 of Form 433-A(OIC) found in the Form 656-B booklet. These are forms you will need to become familiar with as an IRS Collection representation practitioner.

The Standards are updated on an annual basis, usually at the end of March of each year. Be sure that you are applying the updated Standards for your client at the time of completing any 433-A/F form.

There is much more than can be explored in relation to the Collection Financial Standards, including conditional expenses and how the IRS conducts financial analysis. These topics can be reviewed in the Internal Revenue Manual Financial Analysis Handbook, section 5.15.1. This material is worth studying to enhance your competency in representation.

About the Author:



Jassen Bowman, EA, CTR has practiced exclusively in the arena of IRS Collections representation for more than ten years. Has represented nearly 400 individuals and small business clients, and has presented over 300 live continuing education webinars and seminars to CPAs, EAs, and attorneys on the subject of IRS Collections. He is the founder of TaxMarketingHQ.com, which provides practice management and marketing resources to representation practitioners to help them grow more profitable firms. He is also the author of nine books, including Tax Resolution Secrets for consumers and Tax Resolution Systems, a checklist manual for practitioners.

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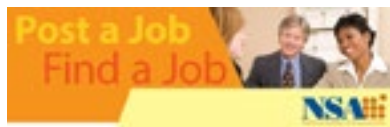
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TECH TOPICS

KEEPING YOUR DATA SAFE

If you have a smartphone, laptop, or tablet, you're carrying a massive amount of data with you at all times. Your social contacts, private communications, personal documents and personal photos (many of which have confidential information of dozens, even thousands of people) are just some examples of things you may store on your digital devices. Because we store and carry so much data, it can be hard to keep it safe—especially because it can be taken from you relatively easily.

Your data can be seized at the border, taken from you in the street, or burgled from your house and copied in seconds. Unfortunately, locking your device with passwords, PINs, or gestures may not protect your data if the device itself is seized. It's relatively easy to bypass such locks because your data is stored in an easily-readable form within the device. An adversary would just need to access the storage directly in order to copy or examine your data without your password.

With that said, you can make it harder for those who physically steal your data to unlock its secrets. Here are a few ways you can help keep your data safe

Encrypt Your Data

If you use encryption, your adversary needs both your device and your password to unscramble the encrypted data. Therefore, it's safest to encrypt all of your data, not just a few folders. Most smartphones and computers offer complete, full-disk encryption as an option.

For smartphones and tablets:

- Android offers full-disk encryption when you first set up your device on newer devices, or anytime afterwards under its “Security” settings for all devices
- Apple devices such as the iPhone and iPad describe it as “Data Protection” and turn it on if you set a passcode.

For computers:

- Apple provides a built-in, full-disk encryption feature on macOS called FileVault
- Linux distributions usually offer full-disk encryption when you first set up your system.
- Windows Vista or later includes a full-disk encryption feature called BitLocker.

Remember: Whatever your device calls it, encryption is only as good as your password. If an adversary has your device, they have all the time in the world to figure out your passwords. An effective way of creating a strong and memorable password is to use [dice](#) and a [word list](#) to randomly choose words. Together, these words form your “passphrase.” A “passphrase” is a type of password that is longer for added security. For disk encryption we recommend selecting a minimum of six words. Check out our guide to [Creating Strong Passwords](#) for more information.

It may be unrealistic for you to learn and enter a long passphrase on your smartphone or mobile device. So, while encryption can be useful to prevent casual access, you should preserve truly confidential data by keeping it hidden from physical access by adversaries, or cordoned away on a much more secure device.

Create a Secure Device

Maintaining a secure environment can be hard. At best, you have to change passwords, habits, and perhaps the software you use on your main computer or device. At worst, you have to constantly think about whether you're leaking confidential information or using unsafe practices. Even when you know the problems, you may not be able to employ solutions because sometimes people with whom you need to communicate use unsafe digital security practices. For instance, work colleagues might want you to open email attachments from them, even though you know your adversaries could impersonate them and send you malware.

So what's the solution? Consider cordoning off valuable data and communications onto a more secure device. You can use

TECH TOPICS

the secure device to keep the primary copy of your confidential data. Only use this device occasionally and, when you do, consciously take much more care over your actions. If you need to open attachments, or use insecure software, do it on another machine.

An extra, secure computer may not be as expensive an option as you think. A computer that is seldom used, and only runs a few programs, does not need to be particularly fast or new. You can buy an older netbook for a fraction of the price of a modern laptop or phone. Older machines also have the advantage that secure software like Tails may be more likely to work with them than newer models.

When Setting up a Secure Computer, What Steps Can You Take to Make it Secure

- Keep your device well-hidden and don't discuss its location—somewhere where you are able to tell if it has been tampered with, such as a locked cabinet.
- Encrypt your computer's hard drive with a strong passphrase so that if it is stolen, the data will remain unreadable without the passphrase.
- Install a privacy- and security-focused operating system like Tails. You might not be able (or want) to use an open-source operating system in your everyday work, but if you just need to store, edit, and write confidential emails or instant messages from this secure device, Tails will work well and defaults to high security settings.
- Keep your device offline. Unsurprisingly, the best way to protect yourself from Internet attacks or online surveillance is to never connect to the Internet. You could make sure your secure device never connects to a local network or Wifi and only copy files onto the machine using physical media, like DVDs or USB drives. In network security, this is known as having an "air gap" between the computer and the rest of the world. While extreme, this can be an option if you want to protect data that you rarely access, but never want to lose (such as an encryption key, a list of passwords, or a backup copy of someone else's private data that has been entrusted to you). In most of these cases, you might want to consider just having a hidden storage device, rather than a full computer. An encrypted USB key kept safely hidden, for example, is probably as useful (or as useless) as a complete computer unplugged from the Internet.
- Don't log in to your usual accounts. If you do use your secure device to connect to the Internet, create separate web or email accounts that you use for communications from this device, and use Tor (see guides for Linux, macOS, Windows) to keep your IP address hidden from those services. If someone is choosing to specifically target your identity with malware, or is only intercepting your communications, separate accounts and Tor can help break the link between your identity, and this particular machine.

While having one secure device that contains important, confidential information may help protect it from adversaries, it also creates an obvious target. There's also a risk of losing the only copy of your data if the machine is destroyed. If your adversary would benefit from you losing all your data, don't keep it in just one place, no matter how secure. Encrypt a copy and keep it somewhere else.

A variation on the idea of a secure machine is to have an insecure machine: a device that you only use when going into a dangerous place or attempting a risky operation. Many journalists and activists, for instance, take a basic netbook with them when they travel. This computer does not have any of their documents or usual contact or email information on it so there's minimal loss if it is confiscated or scanned. You can apply the same strategy to mobile phones. If you usually use a smartphone, consider buying a cheap throwaway or burner phone when travelling for specific communications.



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Legislative Link



John Ams

The IRS Advisory Council Released the 2018 Annual Report

On November 15th, the IRS Internal Review Service Advisory Council (IRSAC) released the 2018 final report to the Commissioner of Internal Revenue. This annual report contains evaluations of current practices and procedures of the present tax administration, and emerging issues, including recommendations for addressing these issues.

Subjects addressed in the report included:

- The Critical Need to Provide the Internal Revenue Service with Adequate and Reliable Funds;
- Improving the Free File Program by Increasing IRS Oversight and Restructuring the MOU;
- Statutory Authority of the IRS to Establish and Enforce Minimum Standards of Competence for all Tax Practitioners, including Tax Return Preparers;
- Improving Real-Time IRS Communications During Exigent Circumstances and Streamlining Regular IRS Communications;
- And the Future of the IRSAC.

Members of IRSAC, including Vice Chair Kathy Hettick — NSA Past President 2015-2016 — also provided opinions on operational improvements for the IRS, and shared the general public's perception of professional standards, best practices for tax professionals and IRS activities. Constructive input on effective methods of moving forward were also included in the final report.

The IRSAC 2018 Final Report can be found [here](#).

About IRSAC

IRSAC is the direct successor to the Commissioner's Advisory Group which existed before the reorganization of the Bureau of Internal Revenue into the modern Internal Revenue Service. It is comprised of four sub-groups: the Digital Services Subgroup; the Small Business/Self Employed and Wage & Investment (SBSE/W&I) Subgroup; the Office of Professional Responsibility (OPR) Subgroup; and the Large Business & International (LB&I) Subgroup

The IRSAC is tasked with providing a public forum between the tax professional community, general public, and IRS officials. IRSAC is required to meet every year, and to provide a report, in order to maintain transparency for Congress and to keep citizens informed about the activities of this advisory body.

Brady Pushes Tax Law Fixes, Extenders Package in House

On Nov. 26, Ways and Means Chairman Kevin Brady (R-Texas) released the text of an omnibus tax bill that would extend nearly 30 temporary tax provisions, make some technical corrections

Legislative Link



John Ams

to the 2017 tax reform law, reform the IRS and make numerous retirement savings changes. The newly revealed package, however, would only address a handful of the technical corrections in the 2017 tax law, including an error—dubbed the “retail glitch”—that keeps establishments from immediately writing off the costs of interior renovations and improvements.

A copy of the House tax bill is available [here](#); a summary of the IRS reforms in the bill is available [here](#); and a section by section summary of the bill’s tax extenders, retirement provisions, technical corrections and related portions is available [here](#).

On the extenders front, the package would make permanent a tax break for railroad track improvements and extend and phase out the biodiesel and renewable diesel fuels credit. The legislation would renew several other expired extenders for the 2018 tax year and just two for 2019.

The measure as released earlier this week would reduce revenue by \$53.3 billion and increase mandatory spending by \$1.4 billion in fiscal 2019 through 2028, according to an estimate from the Congressional Budget Office and the Joint Committee on Taxation. The package would increase federal deficit by \$54.7 billion over that period.

Chairman Brady’s bill was apparently assembled without Democratic input. House Republicans believed they could quickly pass the bill on a partisan vote, but announced this morning that the vote would be delayed until next week at the earliest. Some press reports indicate that a number of Republican lawmakers were unwilling to vote to further increase the deficit and increase spending, believing it politically unwise, especially since any bill passed in the House would be modified in the Senate, where Democratic support is needed to reach the 60 votes needed for passage.

Senate Finance Committee Chairman Orrin Hatch told reporters on Nov. 27 that his committee is planning to release its own year-end tax legislation. Hatch is working with Finance Committee ranking member Sen. Ron Wyden to put together a bill that could muster enough votes to receive approval by the full Senate.