STARTING OFF ON THE RIGHT FOOT WHILE AVOIDING FOOT FAULTS

ISSUES AT THE FORMATION OF THE FAMILY BUSINESS

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AGENDA

• Relevant Rules from the 2017 Tax Act
• Issues to Consider in the Formation of a New Business
  • Sole Proprietorship
  • C Corporation
  • S Corporation
  • Partnerships
21% FLAT TAX ON C CORPORATION TAXABLE INCOME

- Effective for taxable years beginning in 2018 and later

- No special rate for personal service corporations

- 10-year estimated revenue loss = $1.35 trillion
10 THINGS TO KNOW ABOUT THE QUALIFIED BUSINESS INCOME DEDUCTION

1. WHO QUALIFIES

• Partner in a partnership
• Shareholder of an S corporation
• Sole proprietor
10 THINGS TO KNOW ABOUT THE QUALIFIED BUSINESS INCOME DEDUCTION

2. WHO DOES NOT QUALIFY

- C corporations and their shareholders
- Employees
10 Things to Know About the Qualified Business Income Deduction

3. Taxable Income Zones

Zone 1:
Taxable income does not exceed $157,500 ($315,000 for MFJ)

Zone 2:
Taxable income $157,500 – 207,500 ($315,000 – 415,000)

Zone 3:
Taxable income more than $207,500 ($415,000 for MFJ)
4. SPECIFIED SERVICE BUSINESSES

- Services in the fields of **health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services**
- Where the business’s principal asset is the **reputation or skill** of one or more of its employees or owners
- Services consisting of **investing and investment management**, trading, or dealing in **securities, partnership interests**, or **commodities**.
10 THINGS TO KNOW ABOUT THE QUALIFIED BUSINESS INCOME DEDUCTION

5. MUST BE ENGAGED IN CONDUCT OF U.S. TRADE OR BUSINESS

• Foreign businesses do not qualify

• Investment/personal activities do not qualify
10 Things to Know About the Qualified Business Income Deduction

6. Deduction Amount

- **Zone 1:**
  - 20% of QBI

- **Zone 2:**
  - 20% of QBI, reduced if 50% of “wage-basis” limit is less

- **Zone 3:**
  - 20% of QBI or, if less, 50% of the “wage-basis” limit

Do this for each trade or business!
10 Things to Know about the Qualified Business Income Deduction

- Net amount of items of income, gain, loss, and deduction from an eligible trade or business, except for items of capital gain and loss, and certain dividends from REITs, cooperatives, and publicly-traded partnerships

- If the net amount from all eligible businesses is a net loss, that net loss carries over to the next taxable year as a loss from a separate qualified trade or business

Compensation and guaranteed payments paid to taxpayer are NOT Q.B.I.!
10 Things to Know about the Qualified Business Income Deduction

8. The “Wage-Basis” Limit

The greater of:

• 50% of W-2 wages paid by business to employees; or

• 25% of W-2 wages paid plus 2.5% of unadjusted basis immediately after acquisition of all depreciable property used in the business still on hand at year end
10 THINGS TO KNOW ABOUT THE QUALIFIED BUSINESS INCOME DEDUCTION

9. TRUSTS AND ESTATES

• Estates and trusts with interests in partnerships and S corporations are eligible for the deduction

• The Act instructs Treasury to issue regulations explaining how the deduction is to be apportioned between fiduciaries and beneficiaries
10 Things to Know About the Qualified Business Income Deduction

10. Sunrise, Sunset

- The deduction applies in taxable years that begin after 2017 and before 2026

- In most cases, this means the deduction expires at the end of 2025
TRANSITIONING FROM S TO C

• In many cases, the transition from S Corporation to C Corporation will cause the entity to switch from cash method to accrual method
• Section 481 normally requires adjustment in year of change to prevent over- or under-inclusion
• To mitigate the impact of the “§481 adjustment,” new §481(d) prorates the adjustment over the first six taxable years starting with the year of conversion in most cases for conversions occurring on or before December 21, 2019
SOLE PROPRIETORSHIPS

- Tax Considerations
- Business Issues
- Family Considerations
- State Law Issues
- Litigation Issues
C CORPORATIONS

- Tax Considerations
- Business Issues
- Family Considerations
- State Law Issues
- Litigation Issues
S CORPORATIONS

- Tax Considerations
- Business Issues
- Family Considerations
- State Law Issues
- Litigation Issues
PARTNERSHIPS

- Tax Considerations
- Business Issues
- Family Considerations
- State Law Issues
- Litigation Issues