Business Issues

- Issue 1: Travel and Transportation
- Issue 2: Marijuana-Related Businesses
- Issue 3: Taxation of Small Business Health Care Plans
- Issue 4: Excess Business Loss Limitation
- Issue 5: Business Interest Deduction Limitation
Issue 1: Transportation Fringe Benefits

- TCJA eliminated employer deductions for Transportation Fringe Benefits
- Still excluded from Employee’s income
- Employer deduction exception for ensuring safety of employee
- Qualified bicycle commuting, deductible by employer, income to employee
Issue 1: Parking

- Notice 2018-99, allows potential deduction
- Payment made to 3rd party
- Excess over monthly exclusion ($265)
  - employer can deduct,
  - employee has compensation
- If employer leases/owns parking facility, can deduct parking expenses
Issue 1: Employee Exclusion

pp. 439 - 441

- 2019 exclusion amount for all is $265/month:
  1. Use of commuter highway vehicle
     - Less amt provided for Transit Passes
  2. Transit passes
     - Less amt provided for Commuter Hwy vehicle
  3. Qualified parking
     - Allowed in addition to #1 & #2
Issue 1: Business Travel

Deduction for business travel allowed if:
- Expenses incurred away from home
- Amount are solely for business
- Not Lavish or Extravagant

Self-employed TP – deducts on Sch C

Employer – deducts on its return
- If reimbursed under accountable plan
  Employer can deduct
  Employee can exclude from income
Issue 1: Traveling Away from Home

- Travel away from home:
  - Required to be away from the general area of our tax home longer than ordinary day’s work, AND
  - TP needs sleep/rest to meet the demands of work

- Place of business:
  - > 1 place of business, main place of business
  - No main place of business, residence

- Temp assignment – expected to, and actually lasts for 1 year or less
Issue 1: Business Purpose

- Travel expenses:
  - Deductible if trip is related to business
  - If personal, no deduction even if business conducted
    - Still entitled to other business deductions

- “Business vs. Personal” based on facts and circumstances

- Expenses attributable to another, not deductible unless bona fide business purpose
International travel expenses may be limited:
- Deductible if trip is ALL to business

Not entirely business, may be considered business if:
- TP had no substantial control over arranging trip.
- TP outside U.S. for one week or less.
- TP outside U.S. > week, and spent < 25% of time on nonbusiness activities.
- TP establishes personal vacation was not major consideration, even if they arranged trip.
Issue 1: Substantiation

Records must show:
- Amount
- Date & time
- Place
- Business purposes
Issue 1: Reimbursement for Business Travel

Accountable Plan:

- Expenses have business connection
- Timely Substantiated (60 days)
- Timely returns any excess (120 days)
Issue 1: Per diem rates

pp. 443 - 444

- Business may use per diem rates
- TP still must verify:
  - Date
  - Place
  - Business Purposes
- Mileage Allowance
Issue 1: Standard Mileage Rate

Can elect standard mileage rate or actual expense deduction for first year

Choice is binding for all years for that vehicle

Standard Mileage Rate (SMR) for 2019 is: 58¢
Standard Mileage Rate not allowed if:

- 5 or more autos used at same time
- Claimed depreciation other than S/L
- Leased vehicles
- TP is a rural mail carrier
Issue 1: Additional expenses

- In addition to SMR, Taxpayers may claim:
  - Personal property taxes paid on vehicle
  - Tolls & parking fees
  - If self-employed, auto loan interest
### FIGURE 11.4 Gain on Sale of Vehicle after Claiming SMR

<table>
<thead>
<tr>
<th>Year</th>
<th>Miles × Depr. Rate</th>
<th>Depreciation</th>
<th>Adj Basis</th>
<th>Gain</th>
</tr>
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<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$15,000</td>
</tr>
<tr>
<td>Selling price</td>
<td></td>
<td></td>
<td></td>
<td>$ 34,000</td>
</tr>
<tr>
<td>Purchase price</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>2015  14,000 × 24¢</td>
<td>$ 3,360</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>2016  18,400 × 24¢</td>
<td>4,416</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2017  19,700 × 25¢</td>
<td>4,925</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2018  17,500 × 25¢</td>
<td>4,375</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2019  18,100 × 26¢</td>
<td>4,706</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total depreciation</strong></td>
<td></td>
<td>(21,782)</td>
<td></td>
<td></td>
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<tr>
<td><strong>Adjusted basis</strong></td>
<td></td>
<td>(12,218)</td>
<td></td>
<td></td>
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<tr>
<td><strong>Gain recognized</strong></td>
<td></td>
<td>$2,782</td>
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<tr>
<td></td>
<td>First Year</td>
<td>Second Year</td>
<td>Third Year</td>
<td>Later Years</td>
</tr>
<tr>
<td>--------</td>
<td>------------</td>
<td>-------------</td>
<td>------------</td>
<td>-------------</td>
</tr>
<tr>
<td>2018</td>
<td>$10,000</td>
<td>$16,000</td>
<td>$9,600</td>
<td>$5,760</td>
</tr>
<tr>
<td>2019</td>
<td>$10,100</td>
<td>$16,100</td>
<td>$9,700</td>
<td>$5,760</td>
</tr>
</tbody>
</table>

Fig 11.6 Depreciation Limitations – No Bonus Depreciation
### Issue 1: Auto Depreciation limits

p. 453

**Fig 11.9 Depreciation Limitations – With Bonus Depreciation**

<table>
<thead>
<tr>
<th></th>
<th>First Year</th>
<th>Second Year</th>
<th>Third Year</th>
<th>Later Years</th>
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<tr>
<td>2018</td>
<td>$18,000</td>
<td>$16,000</td>
<td>$9,600</td>
<td>$5,760</td>
</tr>
<tr>
<td>2019</td>
<td>$18,100</td>
<td>$16,100</td>
<td>$9,700</td>
<td>$5,760</td>
</tr>
</tbody>
</table>
Requirements:
• Auto acquired/placed in service after September 27, 2017.
• Auto qualified property, 100% bonus depreciation allowed
• Auto has unadjusted basis > 1st yr limitation (with bonus)
• No section 179 elected.

Depreciation allowed in years 2-5 using lesser of:
1. (Adjusted basis after the first-year deduction) x (Factor from the MACRS 5-year table), OR
2. Annual limit on depreciation found in revenue procedure for year auto placed in service.
Issue 1: § 179 Deduction

pp. 455 - 456

Autos < 6,000 GVW:
- Limited to 1st yr depreciation + bonus ($18,100 for 2019)

SUVs > 6,000 GVW:
- Limited to $25,500 & percentage of business use
Marijuana compounds

- Delta-9-tetrahydrocannabinol (THC)
- Cannabidiol (CBD)
- Hemp

- Illegal under federal law
- States may allow:
  - Medical use (Ohio allows)
  - Recreational Use
Issue 2: Federal Law

Marijuana

- Schedule 1 controlled substance
- Federal law prohibits sale
- Federal law overrides conflicting state law

Taking the Happy Meal to a whole new level
CBD

- 2018 Farm Bill, removed as controlled substance
- Food, Drug & Cosmetic Act still applies
- Products containing CBD cannot be sold when drug claims are made unless:
  - Goes through new drug approval process
  - Mfg registered with FDA
  - Good mfg procedures followed
Issue 2: Taxation of MRBs

- IRC § 61 – Income from dealings in controlled substances, including production & resale is taxable
- IRC § 162 – Allows ordinary & necessary business deductions
- IRC § 280E – Bus. deductions NOT allowed if illegal
  - Disallows deductions incurred in carrying on MRB
- IRC § 263A – Illegal business cannot use
- IRC § 471 – Can use to determine inventoriable costs
Marijuana reseller:

- Capitalize invoice price of marijuana purchased, less trade/other discounts, plus transportation & other charges incurred in acquiring

Marijuana producer:

- Capitalize direct material costs (marijuana seeds or plants), direct labor costs (e.g., planting, cultivating, harvesting, sorting), and certain indirect costs
1. Repair expenses
2. Maintenance
3. Utilities, such as heat, power, and light
4. Rent
5. Indirect labor & production supervisory wages
6. Indirect materials and supplies
7. Tools & equipment not capitalized
8. Costs of quality control & inspection
Issue 2: IRC § 471 – Additional Indirect Costs

If MRB produces Financials according to GAAP:

1. Taxes deductible under section 164
2. Depreciation and depletion
3. Deductible employee benefits
4. Costs for strikes, rework, scrap, & spoilage
5. Administrative expenses related to production
6. Officers’ salaries related to production
7. Insurance costs related to production
Issue 2: Inventory Method

IRC § 448 allows TP’s with avg gross receipts for preceding 3 years < $26,000,000 (2019) to use cash method.

IRS can require change to accrual method if MRB is deducting types of costs that would be inventoriable if they were properly using an inventory method under § 471.
Issue 3: Tax on Small Business Health Care Plans

- Accident or Health Plans
- Health Savings Accounts (HSA)
- Health Spending Reimbursement Arrangements (HSRAs)
- Qualified Small Employer Health Reimbursement Arrangements (QSEHRA)
Issue 3: Accident or Health Plans

- Provides benefits for personal injury / sickness
  - Employees,
  - Spouses,
  - Dependents,
  - Children under 27

- Employer-paid premiums:
  - Deductible by employer
  - Excludable by EE
  - No SS, Medicare, FUTA, FIT withholding
Issue 3: S Corporations

- S Corp > 2% S/H, treated as self-employed

- Premiums paid:
  - Deductible by S corporation
  - W-2 wages to shareholder-employee
  - Subject to income tax withholding
  - Usually not subject to employment taxes
  - May be eligible for SE health insurance deduction
S Corp subject to penalties for non-compliance with market reform provisions

IRC 4980D excise tax will NOT be asserted for non-compliance for arrangement for 2% employee-shareholder

Market reforms not applicable to plans covering fewer than 2 current employees

- Additional employee spouse/child not counted if family coverage
Issue 3: Self Insured Plans

- Amts paid for accident or health plan applies to companies that choose to self-insure by making payments to a fund that is used to pay employees’ medical expenses (must not discriminate).

- If discrimination in favor of highly compensated employees, amounts paid included in income.

- Highly Compensated:
  - 1 of 5 highest paid officers
  - Owns > 10% in value of employer’s stock
  - Among the highest paid 25% of all employees
HSAs, FSAs, & HRAs are arrangements that offset an individual’s medical costs.

They may be paid in pre-tax $ or yield above-the-line deductions.

Benefit to individuals who do not itemize deductions or cannot reach the 10% medical deduction floor.
Contributions pre-tax (TP, Family, Employer)

Taxpayer must have high-deductible plan, no Medicare and not a dependent

Contribution limits:
- Above-the-line deduction if made by HSA owner
- 2019 limit $3,500 self / $7,000 family
- 2020 limit $3,550 self / $7,100 family

Tax-free withdrawals for qualified medical expenses

Include in income & 20% penalty if nonqualified
Issue 3: Flexible Spending Arrangements

- Employer sponsored benefit
- Employees elect amount to be deposited
- Contributions are limited to $2,700 in 2019
- Tax free withdrawals for qualified costs
- Amounts not used are lost
  - 2 ½ month grace period
  - $500 carryforward
Issue 3: Health Reimbursement Arrangements

- Employer sponsored
- Employer contribution only (no limit)
- Contributions excluded from employee income
- Unused amounts carry forward
1. Reimburse employees’ premiums & expenses;

2. Limit set by employer;

3. Can offer a regular group health plan & ICHRAs;

4. Allows employees to pay for coverage, beyond what employer reimburses;

5. Can offer higher reimbursement levels to older workers & workers with more dependents;

6. Employees can roll over excess ICHRA funds.
Issue 3: Qualified Small Employer HRA (QSEHRA) pp. 471 - 472

- Reimburses medical expense & premiums
- Not subject to market reforms
- Payment /Reimbursement excluded if employee has minimum essential coverage (MEC)
  - Include in W-2 wages if no MEC
- Notice 2017-67 provides extensive guidance
Issue 3: QSEHRA Requirements

- Small employer (< 50 Full Time Employees)
- Solely employer funding
- Payment/ Reimbursement after employee provides proof of coverage
- 2019 Limits: $5,150 (self) / $10,450 (family)
- Must be offered to all eligible employees on same terms
- Must provide written notice to all eligible employees
Issue 4. Excess Business Loss Limitation

- TCJA enacted §461(l) 2018 through 2025
- Affects: individuals, sole proprietors, passthrough entity owners

Disallowed loss carries over as NOL
Rule applies to Partners & Shareholders
  • Does not apply if TP is C Corp

Include proportionate share of business items

Combined with personal items to determine excess business loss
Facts:
Lucy is single, has $600K investment income.
Sole Prop has: $50K income & $450K deductions

$255K of the loss is deductible
$145K is EBL and carried forward as an NOL
### Multiple Businesses

<table>
<thead>
<tr>
<th></th>
<th>Income / Gain</th>
<th>Deductions /Loss</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Harry</td>
<td>$200,000</td>
<td>$1,000,000</td>
<td>($800,000)</td>
</tr>
<tr>
<td>Wendy</td>
<td>$600,000</td>
<td>$150,000</td>
<td>$450,000</td>
</tr>
<tr>
<td>Totals</td>
<td>$800,000</td>
<td>$1,150,000</td>
<td>($350,000)</td>
</tr>
</tbody>
</table>

- **Total Business Deductions**: $1,150,000
- **Total Business Gross Income + Gains**: $800,000

\[\text{Total Business Deductions} - \text{Total Business Gross Income + Gains} = \text{EBL}\]

\[\text{EBL} = $0\]
Issue 4: Business Income

pp. 474 - 475

- Not specifically defined in 461(l)

- 461 Instructions define it as:
  - Primary purpose is Profit
  - Involvement is continuous & regular

- JCT explained: “EBL does not take into account gross income, gains or deductions attributable to performing services as an employee.”
Deduction or losses limited to amount “at-risk”

At- Risk is:
  - Money contributed
  - Debts for which TP is personally liable

Order of limitations:
  - At-risk limitation
  - PAL limits
  - Excess business loss rules
Issue 4: PAL Rules Interaction

- Passive losses only offset by passive gains
- Disallowed amounts suspended and carried forward until:
  - Passive gains generated, OR
  - Activity disposed of in taxable transaction
- Applies after at-risk
- Applies before EBL
Issue 4: NOL Interaction

- TCJA (Post-2017 NOLs)
  - Eliminated 2 yr carry back (except farmers / ins co)
  - Carry forward indefinitely
  - Deduction limited to lesser of:
    - Available NOLs, OR
    - 80% of TI before the NOL deduction

- EBLs are added to NOL carryover

- Apply EBL rules BEFORE taking into account NOL carryovers
Issue 5. Excepted Businesses

Business interest loss limit does not apply to:

- Employee services
- Electing real property T or B
- Electing farming businesses
- Certain regulated utility businesses

pp. 478 - 479
Issue 5. Electing Real Property Trade or Business

- Election is irrevocable
- §469(c)(7)(C) defines real property trade or business
  - Includes RP T/Bs conducted by corporations or REITs
- Must use ADS depreciation for:
  - Non-residential real property
  - Residential real property
  - Qualified improvement property
Issue 5. Electing Farming Business

pp. 478 - 479

- Election is irrevocable

- Electing farming business:
  - Farming Business as defined in 263A(e)(4)
  - Specified horticultural cooperative per 199A(g)(2)

- Must use ADS depreciation
  - Only applies to >10-year MACRS property
Issue 5. Election Procedures

- Attach election to timely filed return
- Statement titled “Section 1.163(j)-9 Election.”
- Must contain:
  - TP’s name, address & SSN or EIN
  - A description of the business, include principal business activity code
  - A statement that the taxpayer is making an election under section 163(j)(7)(B)
Any business interest expense over the deductible amount is carried forward to the next year.
Facts:

- Acme Corporation has $100,000 ATI
- $20,000 business interest income
- $120,000 business interest expense.

### Issue 5: Example 11.24

$20,000 + $30,000 + $0 = $50,000

- Nondeductible $70K ($120K - $50K), carried forward
Thank You!