1. Bonus Depreciation Regulations
2. Multilevel Marketing (MLM)
3. Opportunity Zones
4. New Health Reimbursement Arrangements
OVERVIEW

• Bonus Depreciation
  • TCJA increased bonus 1st year depreciation to 100%
  • TCJA extended bonus depreciation to used property
  • Final and proposed regulations clarify requirements

• Qualified Opportunity Fund Investments
  • Final regs clarify capital gain deferral and gain recognition
  • 3 safe harbors + facts & circumstances tests for determining qualified opportunity zone business
• Multilevel Marketing is a booming industry
• Employer Health Reimbursement Options (new in 2020)
  • Individual coverage HRA
  • Excepted benefit HRA
• **Qualified Opportunity Fund Investments**
  - Final regs clarify capital gain deferral and gain recognition
  - 3 safe harbors + facts & circumstances tests for determining qualified opportunity zone business

• **Employer Health Reimbursement Options (new in 2020)**
  - Individual coverage HRA
  - Excepted benefit HRA
ISSUE 1: BONUS DEPRECIATION

- IRC §168(k) additional first year (bonus) depreciation
- TCJA increased to 50% and included used property
- Phases out 20% per year starting in 2023
Phaseout is 20% per year starting in 2023

<table>
<thead>
<tr>
<th>Beginning Date</th>
<th>End Date</th>
<th>Bonus Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/28/2017</td>
<td>12/31/2022</td>
<td>100%</td>
</tr>
<tr>
<td>1/1/2023</td>
<td>12/31/2023</td>
<td>80%</td>
</tr>
<tr>
<td>1/1/2024</td>
<td>12/31/2024</td>
<td>60%</td>
</tr>
<tr>
<td>1/1/2025</td>
<td>12/31/2025</td>
<td>40%</td>
</tr>
<tr>
<td>1/1/2026</td>
<td>12/31/2026</td>
<td>20%</td>
</tr>
<tr>
<td>1/1/2027</td>
<td>Thereafter</td>
<td>0%</td>
</tr>
</tbody>
</table>
2019 REGULATIONS (FINAL AND PROPOSED) P. 362

Final Regulations eligibility rules for property acquired and placed in service after September 27, 2017

Prop. Regulations rules for the definition of qualified property
QUALIFIED PROPERTY

Qualified property must be one of the following:

1) MACRS property w/ a recovery period of 20 years or less
2) Certain computer software
3) Water utility property
4) Qualified film or television production
5) Qualified live theatrical production

Some qualified improvement property (discussed later)
1) Property for which a taxpayer has elected out of accelerated
cost recovery (e.g., autos using standard mileage rates)
2) Property that must be depreciated under ADS
3) Any class of property for which the taxpayer elects out of
bonus depreciation (entire class)
4. A specified plant for which the taxpayer made an election to apply bonus depreciation for a prior year
5. Any class of property for which the taxpayer elected a credit instead of bonus depreciation (some property placed in service in tax years beginning before January 1, 2018)
6. Certain public utility property and property of certain businesses that have floor plan financing indebtedness
Pre-TCJA qualified property included qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property.

- TCJA combined the three categories into qualified improvement property (QIP).
  - Any improvement made after 12/31/17 to the interior of a nonresidential building any time after the building was placed in service except:
    - Enlargement of building, Elevator or escalator
    - Internal structural framework: load-bearing internal walls and structural supports (columns, girders, beams….)
A TCJA drafting error made QIP 39-year property and ineligible for bonus.

CARES Act specifies QIP is 15-year property and is eligible for bonus depreciation.

Rev. Proc. 2020-25 provides guidance for claiming bonus depreciation of QIP placed in service before enactment of CARES Act (3/27/20)
TCJA requirements to include used property:

1. Property was not *used by the taxpayer or a predecessor* at any time prior to the acquisition (next 2 slides defines these terms)
2. Property was not acquired from related party, and does not have a carryover basis, or basis from a decedent
3. The cost of the property does not include basis determined by reference to other property held by acquirer
Property is treated as being used by the taxpayer or a predecessor if either had a depreciable interest in the property prior to such acquisition (5-year lookback period)

- Previous depreciable interest not taken into account if:
  - TP acquires and places property in service
  - TP or predecessor no prior depreciable interest
  - Disposition to unrelated party within 90 days
  - TP reacquires and again places in service
The term *predecessor* is defined as:

- Transferor of an asset to a transferee in an IRC §381(a) transaction (e.g., merger)
- Transferor of an asset to a transferee in a transaction in which the transferee has carryover basis
- A partnership considered continuing after a merger consolidation, or division
- Decedent for an asset acquired by an estate
- Transferor of an asset to a trust
EXAMPLE 11.1

2018: Alice purchased new property for $35,000 and used in trade/business
2020: Joan purchased property from Alice for $20,000 and makes $5,000 improvement

Alice:
Original use
Eligible for bonus depreciation based on $35,000 cost basis

Joan:
$20,000 used property eligible for bonus depreciation
$5,000 improvement original use property eligible for bonus depreciation
EXAMPLE 11.2

2018: Mark and Norm purchased new property and used in their separate businesses (50% ownership each)

2020: Norm purchased Mark’s interest. This purchased interest qualifies for bonus depreciation because Norm did not have a depreciable interest prior to purchase.
Previously leased property qualifies for bonus depreciation if, when acquired:

- It is otherwise qualifying property, and
- Neither taxpayer nor predecessor had prior depreciable interest

**Example 11.3**

2018: Ken leases machine to Louie (unrelated)
2020: Louie buys machine from Ken for FMV
Louie *qualifies* for bonus depreciation

**Example 11.4**

Same facts except Ken and Louie are related. Louie *does not qualify* for bonus depreciation b/c Ken’s depreciable interest makes property nonqualifying for Louie.
OTHER QUALIFIED PROPERTY ISSUES

Substantially Renovated Property:
- **In General:** Renovated property – does not satisfy the original use criteria
- **Exception:** If used parts < 20% of total property cost, original use is met
  - Taxpayer / predecessor depreciable interest prior to renovation is NOT considered

Acquisition Date:
- **Self-Constructed Property:** Generally date construction / mfg./production begins - deferred to date when more than 10% of total costs incurred

Related Transactions: Used property acquired from a related party is ineligible
Partnership property NOT ELIGIBLE for bonus depreciation:

- Contributed by partners (carryover basis from contributor) – Ex. 11.6
- 704(c) remedial special allocations
- 732(b) property distributed to partner
- 734(b) basis adjustment to partnership assets
Partnership property ELIGIBLE: 743(b) adjustments on purchase of interest if

1) Transferee partner / predecessor had no depreciable interest in property subject to 743(b) adjustment, and
2) Transferor and transferee are unrelated
LIKE-KIND EXCHANGES

• Bonus depreciation applies only to $ paid in addition to exchange property or in excess of basis of replaced property
• Post TCJA only real property qualifies for like-kind exchange
  • Exchanges of personal property are fully taxable and eligible for bonus depreciation

• Example 11.9
EXAMPLE 11.9 LIKE-KIND EXCHANGE  P. 368

12/2018 AA Corp. purchases a used drill press $10,000
Trade-in allowance on old drill press 2,000
Basis in drill press $10,000
New “used” drill press qualifies for bonus depreciation
100% bonus depreciation $10,000
ELECTING OUT

IRC §168(k)(7) allows election out for qualifying property placed in service during tax year.

- **Election applies by class**
- **Elect by attaching statement** to timely filed return (including extensions)
- **Revocation**
  - Taxpayer may revoke automatically by filing amended return within 6 months of the due date (excluding extensions) of return (otherwise, revoke only with IRS consent)
What will be the Bonus Depreciation rate be in the year 2024?

1. 100%
2. 80%
3. 60%
ISSUE 2: MULTI-LEVEL MARKETING (MLM)

2019: 6.8M direct selling generating $35.2B in sales

FIGURE 11.1 Direct Selling in the United States 2019 Industry Overview

FIGURE 11.2 Direct Retail Sales

Sales by Product Category

- 36.0% Wellness
- 23.0% Services
- 16.0% Home & family care/durables
- 15.1% Personal care
- 7.2% Clothing & accessories
- 2.7% Leisure & educational

$29.6 billion

Direct Retail Sales

$35.2 billion

2008 2010 2012 2014 2016 2018
Direct Sellers Association “DSA” - Independent contractors who sell products/services outside fixed retail establishment

Federal Trade Association “FTC” - Person-to-person sales

IRS - Direct sellers – (2 types) single-level marketing (SLM) and multi-level marketing (MLM) - MLM have downliners
99.9% of direct sellers are classified as independent contractors

**IRS - IRC 3508 - Statutory Nonemployee:**

- Special rules apply to direct sellers classifying them as “statutory non-employees” (same as independent contractor)
- If I.R.C. § 3508 requirements met, direct seller is treated as an independent contractor even if common law tests would classify as employee
Statutory Nonemployee Requirements:

• **Sales Business**: consumer products in home or location OTHER than permanent retail establishment
  • **INCLUDES** recruiting activities
  • **INCLUDES** buy-sell and commission arrangements
• **Substantially All Remuneration from Sales**: At least 90%
• **Written Contract**
• **Dual Services** – subject to common-law tests (separately)
EXAMPLE 11.10

Brett sells & installs siding
- Written contract
- Includes installation (greater than 10%)
- Nonemployee only for sales
- Common law test for installation services

PP. 371-372

If the installation value was < 10%, nonstatutory employee rules would apply for both.
If seller must purchase inventory for resale, gross profit = revenue – COGS

**Inventory Retained for Own Use:** Cannot be deducted, subtract from COGS

**COGS formula:**

- Beginning inventory
- Purchases (net of retained, returns, allowances, rebates & refunds)
- Ending inventory

**Ex. 11.11**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Inventory</td>
<td>$0</td>
</tr>
<tr>
<td>+ Net purchases*</td>
<td>5,560</td>
</tr>
<tr>
<td>- Ending inventory</td>
<td>(300)</td>
</tr>
<tr>
<td><strong>COGS</strong></td>
<td><strong>$5,260</strong></td>
</tr>
</tbody>
</table>

*Net purchases:

- Purchases $6,000
- Gifted (400)
- Retained (40)

**Net Purchases** $5,560
If seller must purchase inventory for resale:

Gross profit = Revenue – COGS

COGS formula:

- Beginning inventory
- Purchases
- Ending inventory
= Cost of goods sold
EXAMPLE 11.11.

Begging inventory $ -0-
+ Net purchases 5, 560
- Ending inventory (300)
= COGS $5,260

Net purchases ($6,000 purchases – $400 gifted - $40 retained
DIRECT SELLER OTHER INCOME  

**Commissions**: Included in gross income  
- Paid by MLM company (orders placed and fulfilled by MLM company, seller gets commission)  
- Paid by downline (a % of sales/commissions kicked upline)  

**Prizes & Awards**: Amount of cash and FMV of in-kind prizes and awards received included in gross income  
- **Host(ess) Gifts**: “Gifts” received for hosting a party are compensation to the host(ess) and deductible by payer
DIRECT SELLER DEDUCTIONS

Start-up Costs

• IRC §195 costs otherwise deductible if taxpayer in business when incurred. First $5,000 deducted, remaining amortized over 60 months from date business begins. If costs > $50,000, up front deduction is phased out $1 for $1

• May include:
  • Cost of exploring different direct-selling opportunities
  • Cost of training
  • Fees paid to MLM company
COMMISSIONS PAID

Deductible as I.R.C. §162(a) ordinary and necessary expense Ex. 11.13

• Julie has 2 downline sellers
• MLM pays Julie 10% commission on group sales
• Julie pays downline 7%
• Group sales = $1,300 ($500 Julie, $800 downline)

Julie’s Net Income:

Commission income $ 130
($1,300 x 10%)

Less: Commissions paid
(56)
($800 x 7%)
Net Income: $ 74
SAMPLES/PROMOTIONAL ITEMS

- Purchased items used to promote sales are deductible under IRC §162(a)
- Business gifts deduction capped at $25 per person [I.R.C. §274(b)]
  - Ex. 11.14 Host(ess) “gift” is business expense
  - Ex. 11.15 Prize is a business expense
  - Ex. 11.16 Samples are business expense
GOODS USED FOR DEMONSTRATION

Treatment depends on how acquired and used

• **Available for Sale to Customers:** Include in COGS
  • **Not Available for Sale to Customers:**
    • Used for \( \leq 1 \) year: Expense in the year used
    • Used for \( > 1 \) year: Capitalize
If auto used for business, taxpayer may:
• Use the standard mileage rate, or
• Actual costs

Commuting costs are not deductible
TRAVEL EXPENSES

Travel expenses are deductible if:
• Reasonable and necessary
• Incurred away from home
• Solely for business
• Not lavish and extravagant

Example 11.18. Lucy flies to convention to learn sales/new products. She can deduct airfare, deductible cost of meals/lodging.
BUSINESS USE OF HOME

IRC § 280A

Use must be “regular and exclusive”
- More than incidental/occasional
- Identifiable specific area (physical barrier is not required)
HOBBY OR BUSINESS

Is the MLM activity engaged in for profit?
  • If yes – general rules apply (business expenses deductible)
  • If no – “hobby loss” rules apply

Factors to consider [Treas. Reg. § 1.183-2(b)]
1. How the taxpayer carries on the activity
2. The expertise of the taxpayer or his or her advisers
3. The time and effort expended by the taxpayer in carrying on the activity
4. The expectation that the assets used in the activity may appreciate
5. The success of the taxpayer in carrying on other similar or dissimilar activities
6. The taxpayer’s history of income or losses with respect to the activity
7. The amount of occasional profits, if any, that are earned
8. The financial status of the taxpayer
9. Whether elements of personal pleasure or recreation are involved
HOBBY ISSUES CONT.  PP. 378 - 379

Figure 11.3 Direct seller business or hobby factors

Example 11.21

Michael is a dentist, direct seller of juice and other products. Limited records and substantiation for expenses

He does not conduct the activity in a business-like manner and not engaged in for profit
POLLING QUESTION #1 DIRECT SELLER QUESTION

If I use part of my home to store samples and inventory, can I take a deduction for the exclusive use of the space used?

1. Yes
2. No
ISSUE 3: OPPORTUNITY ZONES

• IRC §1400Z-1 and -2 preferential tax treatment for investment in a qualified opportunity zone (QOZ) investment
  
  • Qualified Opportunity Fund (QOF)
  • Qualified Opportunity Zone Business
QUALIFIED OPPORTUNITY FUNDS

- Investment vehicle - classified as a corporation or a partnership
- Formed for the purpose of investing in qualified opportunity zone (QOZ) property, and
- Holds at least 90% of its assets in QOZ property
- Eligible corporation or partnership self-certifies by filing Form 8996, Qualified Opportunity Fund, annually with its federal income tax return
QUALIFIED OPPORTUNITY FUNDS CONT.  PP. 380-381

QOZ Stock or QOZ Partnership Interest

QOZ Business Property – Definition

- Tangible property used in T or B
- After 12/31/2017
- Original use or substantially improved
QUALIFIED OPPORTUNITY ZONE BUSINESS

QOZ investments may also be made through a QOZ business
- T/B in which >70% of the tangible property owned or leased by the business is QOZ business property
- Qualified business entity: a corporation or partnership deriving at least 50% gross income from the active conduct of a business in a QOZ
  - 3 safe harbors for the 50% test
  - Or facts and circumstances
TAX DEFERRAL

- For sales on or before 12/31/2026
- A taxpayer may elect to defer capital gain on the sale or exchange of property to an unrelated person if:
  - the gain is invested in an eligible QOF in exchange for an equitable interest in the QOF
  - within 180 days of the sale or exchange
180-day Period

- Direct ownership - date of sale
- Partners, shareholders, beneficiaries choose:
  - Last day of entity’s tax year
  - Same date entity 180-day period begins
  - Due date for entity’s tax return (excluding extensions) for year eligible gain realized

- **Initial Basis** is reduced by deferred capital gain (may be zero)
Basis Adjustments/Gain

Basis Adjustments
Incentives for continued QOF investment

>5 years: basis increased by 10% of originally deferred gain

>7 years: basis increased by an additional 5% of originally deferred gain

>10: years elect to adjust basis to FMV on the date investment is sold or exchanged

Adjustments apply for all income tax purposes

Recognizing Gain
Investor must include the remaining deferred gain on the earlier of an inclusion event or December 31, 2026.

Inclusion events terminate investment interest and include sale, gift, transfer to non-grantor trust, transfer to spouse or former spouse.
<table>
<thead>
<tr>
<th>EXAMPLES</th>
<th>P. 383</th>
</tr>
</thead>
</table>
| **Ex. 11.24** 1/1/23 $500K gain deferred gain by investing in QOF  
Basis = $0  
12/31/26: $500K must be recognized and basis becomes $500K  
No adjustment made prior because held for < 5 yrs. | **Ex. 11.25**  
Same facts  
Sold after 10 years for $750K  
If election made to step up, no gain. If no election made, $250K gain |
Net Capital Gain income is eligible for deferral
  • Determined based on sale or exchange
  • Gain recaptured as ordinary income is ineligible for deferral under the final regulations
  • Losses from the taxpayer’s other transactions or unrecaptured net losses from the previous 5 years will not reduce the gain eligible for deferral
  • The investment period for section 1231 transactions starts as of the date of the transaction creating the gain
• Report eligible gains per IRS instructions (e.g., Form 8949 and Schedule D)
• Election to defer: Form 8949 Part 1 Box C or Part II Box F (short-term or long-term)
• Other entries on Form 8949
• Form 8997, beginning, end, and deferred
  • Failure to file creates rebuttable presumption of inclusion event
COVID-19 ADMINISTRATIVE RELIEF

- Notice 2020-39
- Extension of Time to Invest: Automatic extension to 12/31/20
- Relief from 90% Investment Standard
- Relief from Substantial Improvement Period
- Extension of Working Capital Safe Harbor
- Extension of Reinvestment Period: Up to 12 additional months
POLLING QUESTION #2 – OPPORTUNITY ZONES

Can I take money out of my personal savings to invest in a Qualified Opportunity Zone?

1. Yes
2. No
Final regulations are effective for plan years beginning on or after January 1, 2020

Two new HRAs:
- Individual Coverage HRAs (“ICHRA”)
- Excepted Benefit HRAs (“EBHRA”)

Employer contributes, excluded from employee income
Distributions to reimburse for qualified medical expenses
Background: 2010 after enactment of the ACA, many businesses ended HRAs b/c ACA penalties for not meeting market reform
  - Result was loss of tax savings to employees

2016 Qualified Small Employer Healthcare Reimbursement Arrangements (QSEHRAs): Allowed for small employers (<50 full-time employees) WITHOUT group health plans. Limited benefit ($5,250 for individual / $10,600 for family)

• ICHRA: Allows HRAs to most employers without group health plans
INDIVIDUAL COVERAGE HRA (ICHRA)

- Allows integration of HRA individual health insurance coverage or Medcare
- Cannot be used to reimburse group health coverage
- Up to any $$ amount specified by the employer
- Expenses of employee’s spouse, child under 27 allowed
- Unused amounts roll over
- Reimbursements are excluded from employee’s income
Individual Health Insurance Coverage Required

Employees and their dependents must be enrolled in *individual health insurance coverage* before being eligible for any reimbursements

- Includes Medicare Parts A and B or Medicare Part C
SUBSTANTIATION

To enroll, must prove eligible coverage

Employee / dependent must substantiate that he or she is covered by health insurance before the ICHRA can reimburse

IRS sample attestation forms for annual/ongoing coverage
Must be offered on the “same terms” to all members of an employee class. The Regulations contain 11 classes:

<table>
<thead>
<tr>
<th>1) Full-time employees</th>
<th>4) Seasonal employees</th>
<th>7) Nonresident aliens with no US source income</th>
<th>10) Temporary employees of staffing firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>2) Part-time employees</td>
<td>5) Particular collective bargaining unit</td>
<td>8) Salaried employees</td>
<td>11) A combination of the prior 10</td>
</tr>
<tr>
<td>3) Employees in same geographic area (ins. rating)</td>
<td>6) Employees who have not satisfied a waiting period</td>
<td>9) Nonsalaried employees</td>
<td></td>
</tr>
</tbody>
</table>

Minimum class rules apply
**PREMIUM TAX CREDIT IMPACT**

**PTC**: The PTC is a refundable tax credit to help eligible individuals and families with low or moderate income afford health insurance purchased through the Marketplace. PTC amount is based on income level and household demographics.

- Employees offered affordable ICHRA or receiving ICHRA are not eligible for PTC

If the ICHRA is affordable, an employee may not opt out. This can result in greater costs to individuals than if the PTC were allowed.

- See **Example 11.28** for affordability calculation – based on single plan – even for a family
EMPLOYER NOTICE

- The employer must provide an annual notice to employees at least 90 days before the start of each plan year or before the effective date of coverage (if the employee becomes eligible after the start of the plan year)
  - Notice includes impact of ICHRA on PTC eligibility
- An extended notice period is allowed for the first plan year.
- Model notices are available, See Figure 11.7
Limited dental
COBRA expenses
Short-term health plan expenses
Other uncovered expenses (group plan)
EXCEPTED BENEFIT HRA

- Excepted benefit HRA allows employers with traditional group health plans to provide an additional pretax $1,800 per year (indexed for inflation after 2020) to reimburse employees for certain qualified medical expenses, including:
  - Limited dental and vision coverage
  - COBRA continuation coverage
  - Short-term health plan expenses
  - Expenses not covered by the group health plan
- Cannot reimburse premiums (except for excepted benefits)
Members share their medical bills through the ministry and receive payments from other members to help with their medical bills

Proposed Regs

- Amounts paid for membership are IRC §213(d)(1)(D) payments for medical insurance
- HRA, ICHRA, QSEHRA can reimburse membership payments
DIRECT PRIMARY CARE ARRANGEMENTS  P. 398

Contract between individual and physicians for medical care for a fixed annual fee

Proposed Regs

◦ Payment may be a payment for medical care under IRC §213(d)(1)(A), or a payment for medical insurance under IRC §213(d)(1)(D)
◦ HRA, QSEHRA, ICHRA can reimburse for fees
Does the advanced credit payment go to me to use to pay my doctor or insurance company?

1. Yes
2. No
3. Not Sure
QUESTIONS?