2018 TAX B Supplement

NOTE – This document continues to be updated through mid-January 2019. You might want to just use it online rather than print it. Also, the links are live.

For updates related to TCJA also see Nellen TCJA Guidance Chart at http://mntaxclass.com.

Table of Contents

Errata – Corrections to the Outline or Slides

While we work hard to be complete and accurate, a mistake can happen.

Chapter 1: TCJA: Accounting Methods & Other Business Items

QTF – Parking Disallowance Calculation – Notice 2018-99

Notice 2018-99 (12/10/18) - provides interim guidance for 2018 on determining an employer's non-deductible parking expense if this qualified transportation fringe (QTF) benefit is offered. If parking is acquired from a third party, use that cost. For a parking area(s) owned or leased by the taxpayer, a reasonable method of splitting employee and other parking is allowed. The IRS provides a 4-step approach that is deemed to be a reasonable method. Under this 4-step approach, first determine the percent of spaces reserved for employees. The expenses attributed to this percent of the parking costs are not deductible by the employer. Next, for the balance of

the spaces, the employer determines the primary purpose – customers or employees. Primary means over 50%. If over 50% of the spaces are for customers, there are no other disallowed parking expenses. If the primary purpose is employee parking, the employer next (step 3) allocates a portion of the costs of these spaces to any that are reserved for customer use (this amount is deductible). The, step 4, any reasonable method is used to allocate expenses of the remainder of the spaces between deductible customer use and non-deductible employee use based on normal business hours. Employers have until 3/31/19 to change the number of spaces reserved for employees, if desired, with such change treated as made 1/1/18. Depreciation is not considered a parking expense. Several examples are provided.

Also see IR-2018-247 (12/10/18).

QTF & Exempt Orgs - Parking UBTI Calculation – Notice 2018-99

A similar approach is taken for tax-exempt organizations to determine their cost of the parking provided to employee on which they must pay unrelated business tax of 21% per §512(a)(7). See summary of Notice 2018-99 above.

Method Changes for Certain §263A Allocation Changes – Rev. Proc. 2018-56 (11/19/18)

Rev. Proc. 2018-56 (11/19/18) - Per the IRS: "Rev. Proc. 2018-56 provides the procedures by which a taxpayer may obtain the automatic consent of the Commissioner of Internal Revenue to change to certain methods of accounting provided in §§ 1.263A-1, -2, and -3 of the Income Tax Regulations, including methods described in T.D. 9843, for costs allocable to certain property produced or acquired for resale by the taxpayer. This revenue procedure modifies Rev. Proc. 2018-31, 2018-22 I.R.B 637." Includes explanation for dealing with negative adjustments.

Guidance and Method Changes under New §451(b) – Rev. Proc. 2018-60 (11/29/18)

Per the IRS (11/29/18): "Revenue Procedure 2018-60 provides the procedures by which a taxpayer may obtain the automatic consent of the Commissioner of Internal Revenue under § 446 and § 1.446-1(e) of the Income Tax Regulations to change a method of accounting to comply with § 451(b), as amended by Section 13221 of the Tax Cuts and Jobs Act, Pub. L. No. 115-97 (December 22, 2017), relating to the timing of the recognition of income for taxable years beginning after December 31, 2017. This revenue procedure also provides procedures for certain qualifying taxpayers to make a method change to comply with § 451(b) without filing a Form 3115, Application for Change in Accounting Method. This revenue procedure modifies Rev. Proc. 2018-31, 2018-22 I.R.B. 637."

IRS Practice Unit -- Partial Disposition Elections

IRS has published a Practice Unit focused on identifying when taxpayers elect a partial disposition of a building or its structural components.

Chapter 2: TCJA: §199A – Aggregation, SSTBs, and Trusts, Estates, Beneficiaries

Chapter 3: TCJA: Interest Expense Limit, Partnerships and S Corporations

TCJA Interest Deduction Limitation of §163(j) – Prop Regs and Rev. Proc. 2018-59

Prop regs (REG-106089-18, xxxx) of 439 pages (double-spaced). Also see IR-2018-233 (11/26/18).

Rev. Proc. 2018-59 (11/26/18) – Per IRS: "provides a safe harbor that allows taxpayers to treat certain infrastructure trades or businesses as real property trades or businesses solely for purposes of qualifying as electing real property trades or businesses under section 163(j)(7)(B) of the Internal Revenue Code. Taxpayers that make an election for an infrastructure trade or business to be an electing real property trade or business under section 163(j)(7)(B) are not subject to the limitation on business interest expense under section 163(j), but must use the alternative depreciation system of section 168(g) to depreciate the property described in section 168(g)(8). This revenue procedure describes the types of infrastructure trades or businesses that can qualify as electing real property trades or businesses and provides general guidance on the election."

See coverage in Chapter 3 slides at the presentation and posted at http://mntaxclass.com.

Draft Form 8990, Limitation on Business Interest Expense Under Section 163(j)

Form 8990 + Instructions.

Chapter 4: Estate, Gift and Subchapter J

Estate of Streightoff, TC Memo 2018-178 (Oct. 24, 2018) -- Partnership Interest in Gross Estate was a Partnership Interest and 18% Discount OK

The IRS determined a deficiency of $491,750 in the Federal estate tax of the Estate of Frank D. Streightoff (estate). The issue was the type and value of an interest that the decedent Streightoff transferred during his lifetime to a revocable trust. The Tax Court determined that in "both form and substance, the interest to be valued for estate tax purposes [was] an *88.99% limited partnership interest* in Streightoff Investments." (emphasis added).

With respect to value, the Tax Court allowed an 18% discourt for lack of marketability:

> "We agree with the experts that there should be a discount for the lack of marketability. The estate's experts took into consideration that the interest they were valuing was an assignee interest, and this affected the conclusion in their report. Since we concluded that the interest decedent transferred was a limited partnership interest, the estate's experts' valuation is too high. The analysis in [IRS's] expert report is reasonable. We conclude that the interest should be valued using an 18% discount rate for lack of marketability."

Chapter 5: International Tax

Chapter 6: California and Multistate

Governor's Resources Guide for Businesses Impacted by the 2018 November Wildfires

See http://business.ca.gov/Portals/0/SmallBusiness/Wildfire-Resource-Guide-Nov-2018.pdf.

CDTFA and California Wildfires

Emergency tax relief information from the California Department of Tax and Fee Administration (CDTFA) - http://www.cdtfa.ca.gov/services/state-of-emergency-tax-relief.htm.

FTB To Send Summaries of 2018 Tax Year Payments to Business Entities and Tax-Exempts with UBTI

In its November 2018 newsletter, the FTB announced that it was launching a pilot project starting in 2019 to help address the frequent reason why practitioners contact the Tax Practitioner hotline – to verify tax payments of clients. Per the FTB:

"Beginning early 2019, we will be providing business entities, including corporations, LLC's, and exempt organizations that have taxable income or unrelated business income, with a summary of their 2018 tax year estimated payment, transfer and credit information. This is part of a pilot project to proactively address the most common reason tax professionals contact the Tax Practitioner Hotline: calling to verify payments.

We will mail FTB 3713, Summary of Account Payments, Transfers, and Credits to business entities who made an Estimated LLC Fee or Estimated Tax Payment for their 2018 tax year. The account summary will provide payment, transfer, and credit information including payment amounts and effective dates.

This summary will contain the same data that is available to our call center staff and is intended to assist business entities and/or their tax representatives in filing accurate and timely tax returns. Payment information is also available online to businesses and their tax representatives who have or register for a MyFTB account.

We expect the account summary to be mailed out by the end of January/beginning of February 2019."

Defective Credit Assignment Regulations Guidance

In its December 2018 newsletter, the FTB's Chief Counsel explains new regulations (23663-4) on defective credit assignments. Corrections can be made up to 9/18/19.

Also see FTB Notice 2018-03.

PL 86-272 and Delivering Goods In Company-Owned Vehicles – FTB TAM 2018-03 (12/4/18)

FTB TAM 2018-03 (12/4/18) – In this ruling, the FTB concludes: "Delivery via a private delivery truck is protected activity under P.L. 86-272. However, any activity that goes beyond the scope of delivery, such as backhauling, is not protected activity." The rationale ties to the Wrigley case defining "solicitation." Per the FTB's analysis:

"In *Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co.* (1992) 505 U.S. 214, the Court found that the term "solicitation" is "not merely the ultimate act of inviting an order but the entire process associated with the invitation is suggested by the fact that § 381 describes "the solicitation of orders" as a subcategory, not of in-state acts, but rather of in-state "business activities"- a term that more naturally connotes courses of conduct." The Court held that "solicitation of orders" covers more than what is strictly essential to making requests for purchases, which are those activities that are entirely ancillary to requests for purchases. However, there is a distinction between those activities that serve no independent business function apart from their connection to the soliciting of orders and those activities the company would have reason to engage in anyway and chooses to allocate to its in-state sales force to accomplish. Activities, such as providing a car and samples to a salesman, are considered part of

the "solicitation of orders" because these activities do not serve any independent business function aside from helping to facilitate orders. However, repair or service activities are not ancillary to soliciting purchases even though they may help increase purchases. Repairs and service activity fulfill an independent business function aside from the delivery of goods to customers. Based on the Supreme Court's analysis in *Wrigley*, the use of private vehicles for the sole purpose of delivery of goods is within the bounds of solicitation of orders. If the private vehicles are used for any other business activity along with the delivery, such as backhaul of goods, this activity would go beyond the solicitation of orders and would no longer be protected."

CDTFA Cannabis Emergency Regulations (12/11/18)

Per the CDTFA – "The California Department of Tax and Fee Administration (CDTFA) has adopted proposed emergency Cannabis Tax Regulation 3702, *California Cannabis Track-and-Trace*, to require the wholesale cost and retail selling price of cannabis and cannabis products to be recorded in the California Cannabis Track-and-Trace (CCTT) system."

See: http://www.cdtfa.ca.gov/taxes-and-fees/reg-3702-2018.htm

Wayfair Decision and New Potential Sales Tax Collection Obligations for All Vendors with California Customers

California Revenue & Taxation Section 6203(c) put the state in an unusual position after the June 2018 Supreme Court decision in *South Dakota v. Wayfair, Inc*. The California Department of Tax and Fee Administration (CDTFA) had to decide what the decision meant and administer that finding. Meanwhile, the state legislature had to determine its role and the timing of any action.

R&T Section 6203(c) provides:

"Retailer engaged in business in this state" as used in this section and Section 6202 means any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."

This meant something different on June 21, 2018 than it did prior to that date. With the Court finding that *Quill* and its physical presence standard for commerce clause nexus was "unsound and incorrect", what is the new standard?

The Court found the 2016 South Dakota law (SB 106) which was before it acceptable as a nexus standard due to these three features:

1. Threshold - Collection obligations only exist if a seller had over $100,000 of sales into the state in the prior or current calendar year, or 200 or more transactions.
2. No retroactive application.

3. South Dakota adopted the Streamlined Sales and Use Tax Agreement (SSUTA) which provides some simplification and requires the state to offer free software to remote sellers and audit protection if they use it.

Well, how do those factors apply in California which is a much larger state than South Dakota and has not adopted the SSUTA and does not provide free software?

South Dakota has just under 1 million people which California has over 39 million. So, with far more buyer in California as well as far more business buyers, considering the worldwide market, the South Dakota threshold would cause hundreds of thousands of small businesses to become collectors of California sales tax In Etsy's amicus brief filed in the Wayfair case, it noted that in 2017, its 1.9 million sellers generated $3.25 billion of gross sales (page 8). That means average sales for an Etsy business of $1,710, well below the $100,000 threshold. But, it would be very easy for many of these businesses to have 200 or more transactions in California in a year. Think of all of the sellers using Fulfillment by Amazon (FBA), eBay, Etsy, crowdfunding sites, and others to sell low value items. With over 39 million possible buyers in California, the CDTFA should be seeing an incredible increase in registered sellers.

Can a state that does not follow the SSUTA or provide free software to remote vendors meet the Court's new nexus standard? We don't know.

Well, on December 11, the CDTFA announced that it would follow the South Dakota thresholds starting April 1, 2019 (NR-18-59). This allows some lead time for the thousands of remote vendors who crossed one of the thresholds in 2018 (the calendar year prior to 4/1/19). It also gives some time for all remote vendors to start tracking sales into California. However, the new procedure does not provide any lead time once you cross the threshold. For example, let's say a vendor selling $10 socks online makes its 200th transaction to a California customer on July 1, 2019, based on 2019 sales. It needs to register and start collecting immediately (similar in most other states as well). There is no lead time once the threshold is crossed to allow for updating or obtaining software and being prepared for the new compliance obligations. For more, see CDTFA Special Notice L-565 (Dec. 2018). Note: The CDTFA held a stakeholder meeting to explain its role per R&T 6203(c) and obtain income (see information and links here).

Another change announced December 11 affects both remote and in-state sellers. Many cities, counties and special districts in California have various sales taxes such as to help fund transportation. These are known as district taxes. Prior to *Wayfair*, an in-state vendor only had to collect them on sales delivered to districts where they had a physical presence. Now, they must be collected in districts where they meet the over $100,000 sales or 200 or more transactions threshold. See CDTFA Special Notice L-591 (Dec. 2018). So, even in-state sellers already collecting California sales tax must implement new recordkeeping requirements. The CDTFA notes that sellers might just want to "courtesy collect" the district tax for all California sales. That likely is easier than having to track sales into all counties unless the seller knows it won't meet the threshold anywhere so only has to collect where it has a physical presence.

The CDTFA provides a good deal of information on collection obligations at http://cdtfa.ca.gov/industry/wayfair.htm.

On December 10, the chairs of the state's tax committees announced that they would continue to look at whether changes are needed, noting that the decision might not work in a state with almost 40 million residents.

Observations: One area that lawmakers have to address is additional funding for the CDTFA to deal with the hundreds of thousands of new sales tax collectors that should be registering and perhaps seeking assistance of the CDTFA. These vendors are located throughout the world. Also, the CDTFA needs to get and regularly update data on the number of vendors outside of California that meet the threshold. If the number of registrants doesn't match this data, to be fair to instate tax collectors, the CDTFA needs to go out and find these vendors even though they are located throughout the world.

With such a low threshold of 200 or more transactions, the enforcement effort will be a poor use of resources. There needs to be a balance of what is realistic for the CDTFA to enforce among sellers versus continuing to collect use tax from California buyers.

Also, the risk of litigation in California or another state by small vendors challenging the 200 or more transactions threshold seems great. That threshold seems to impede interstate commerce, particularly where the transaction value is low. After all, someone selling $1 items would have to start collecting even though sales into one of several states now using the South Dakota standards is only $200!

We'll see what happens. The April 1, 2019 start date gives lawmakers time to act, such as by removing the transaction threshold and just using the $100,000 gross receipts threshold. They should also see about offering free software to remote vendors as that should help the CDTFA as well. And more funds should be allocated to the CDTFA to help with their expanded tax administration duties. The lawmakers' press release also includes a statement from former BOE member and now State Treasurer-elect Fiona Ma that suggests California should follow the lead of a few others states and have marketplace facilitators, such as Amazon collect.

EDD 2019 Rates

a. For 2019 unemployment rate and meals and lodging values, see https://www.edd.ca.gov/payroll_taxes/rates_and_withholding.htm.

b. Per EDD:

> "The Employment Training Tax (ETT) rate for 2019 is 0.1 percent. The UI and ETT taxable wage limit remains at $7,000 per employee per calendar year.
>
> The State Disability Insurance (SDI) withholding rate for 2019 is 1.00 percent [same as 2018]. The taxable wage limit is $118,371 for each employee per calendar year [up from $114,967 for 2018]. The maximum to withhold for each employee is $1,183.71.
>
> Your UI, ETT, and SDI tax rates are combined on a single rate notice, *Notice of Contribution Rates and Statement of UI Reserve Account* (DE 2088). The DE 2088 will be mailed to you in December, with a mailing date of December 31. Employers will have 60 days from the December 31 mailing date to protest any item on the DE 2088 except SDI and ETT, which are specifically set by law."

c. For 2018 and prior year tax rates and wage limits, see https://www.edd.ca.gov/pdf_pub_ctr/de3395.pdf.

New Local Taxes

Taxes enacted by voters in November 2018 include:

- Mountain View – Measure P passed on 11/6/18
  - Increased business license taxes starting 1/1/20
  - https://www.mountainview.gov/depts/manager/2018_potential_general_revenue_measures.asp
- San Francisco
  - Measure D, Marijuana Business Tax Increase
    - If marijuana business has gross receipts over $500K
      - Medicinal exempt
      - Starts 1/1/21
    - Expands nexus for all SF business taxes even if no physical presence in SF, but have over $500K of gross receipts in the city. Effective 1/1/19.
  - Measure C, Gross Receipts Tax for Homelessness Services
    - Homelessness Gross Receipts Tax "on each person engaged in business in the City that receives or is a member of a combined group that receives, more than $50,000,000 in total taxable gross receipts."
    - Starts 1/1/19

https://sftreasurer.org/taxes-passed-voters-november-6th-2018-election

Chapter 7: Centralized Partnership Audit Regime (CPAR)

Centralized Partnership Audit Regime N/A in Certain Situations – Notice 2019-06 (12/20/18)

Per the IRS: "Notice 2019-06 informs taxpayers that the Department of the Treasury and the Internal Revenue Service intend to propose regulations addressing certain special enforcement matters under section 6241(11). Specifically, this Notice explains that proposed rules will be issued that provide the IRS may determine that the centralized partnership audit regime will not apply to adjustments to partnership-related items in certain limited circumstances and that partnerships with a qualified subchapter S subsidiary (QSub) are not eligible to elect out of the centralized partnership audit regime except by applying a rule similar to the rules for S corporations under section 6221(b)(2)(A) to the QSub partner."

Chapter 8: Non-TCJA and Non-CPAR Entities Update

Time Sensitive Acts – Rev. Proc. 2018-58 (11/20/18)

Per the IRS: "Revenue Procedure 2018-58 updates Revenue Procedure 2007-56, providing clear guidance with regard to time-sensitive acts that may be postponed for taxpayers affected by a federally-declared disaster, a terroristic or military action, or individuals serving in a combat zone. The list of acts in the revenue procedure supplements the list of postponed acts in section 7508(a)(1) of the Internal Revenue Code and Treas. Reg. § 7508A-1(c)(1)(vii)."

Tax-Exempt Orgs and Gaming – IRS Publication 3079 (Oct 2018)

IRS Publication 3079 (Oct 2018) – This guide helps non-profits that raise funds via bingo games, lotteries and other gaming activities. It covers the possible effect on the entity's tax-exempt status, UBTI, recordkeeping, excise taxes, and reporting of winnings.

21% Excise Tax on Employees Paid over $1 Million By Tax-Exempt Entities – Notice 2019-09 (21/31/18)

Per the IRS: "Notice 2019-09 provides interim guidance on the provisions of the new §4960 added by the Tax Cuts and Jobs Act, and announces the intent of Treasury and the IRS to issue proposed regulations. Section 4960 provides that excess remuneration and excess parachute payments paid by an applicable tax-exempt organization to a covered employee are subject to an excise tax (currently 21 percent). This notice provides interim guidance defining (1) "applicable tax-exempt organization," (2) "excess remuneration," (3) "covered employee," and (4) "excess parachute payment." In addition, the notice instructs taxpayers on how to report and pay the excise tax."

The notice is 92 pages long!

Chapter 9: Employment Taxes and Worker Classification

Market Facilitation Program (MFP) Payments – PMTA 2018-21 (12/10/18)

In PMTA 2018-21, the IRS concludes that "absent legislation providing specific income exclusion for these MFP payments, the amounts received by farmers as MFP payments must be included in gross income under section 61 and are generally included in net earnings from self-employment income under section 1402."

Chapter 10: ACA

Additional Time to File Information Reports – Notice 2018-94 (11/29/18)

Per the IRS: "Notice 2018-94 extends the due dates for certain 2018 information reporting requirements for insurers, self-insuring employers, and certain other providers of minimum essential coverage under section 6055 and for applicable large employers under section 6056. Specifically, this notice extends the due date for furnishing to individuals the 2018 Form 1095-B, Health Coverage, and the 2017 Form 1095-C, Employer-Provided Health Insurance Offer and Coverage, from January 31, 2019, to March 4, 2019. This notice also extends transitional good-faith relief from section 6721 and 6722 penalties to the 2018 information reporting requirements under sections 6055 and 6056."

Proposed Rules to Avoid Employer Mandate with Certain HRAs – Notice 2018-88 and Proposed Regulations

Per the IRS (11/19/18) – "Notice 2018-88, is intended to initiate and inform the process of developing guidance under sections 4980H and 105(h) that would address these issues, and requests comments on potential approaches developed by the Treasury Department and the IRS, so employers understand how to structure integrated HRAs to avoid assessable payments (section 4980H) and potential loss of the exclusion from income for employer-provided health benefits (section 105(h)).

Notice 2018-88 is related to a notice of proposed rulemaking (REG-135724-17) [appears should be Reg. 136724-17] issued on October 23, 2018 (83 FR 54420) that, in relevant part, would (a) remove the current prohibition on integrating HRAs with individual health insurance coverage (integrated HRAs) if certain conditions are met, allowing employers to offer employees integrated HRAs in lieu of providing more traditional group health plans (the proposed integration regulations being proposed by the Treasury Department, DOL and HHS); and (b) address when individuals offered coverage under an integrated HRA who are otherwise eligible for a premium tax credit (PTC) will remain eligible for the PTC (proposed PTC regulations being proposed by the Treasury Department and IRS). The proposed integration regulations and the proposed PTC regulations would raise issues concerning the application of section 4980H (the employer shared responsibility provisions) and section 105(h) (addressing discriminatory self-insured group health plans) to employers offering integrated HRAs and their employees."