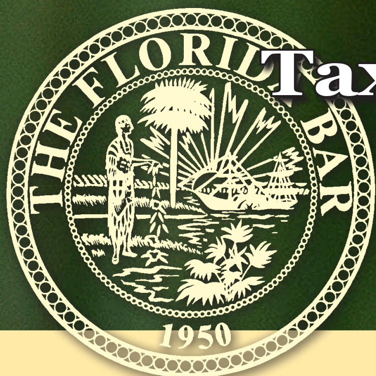

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THE FLORIDA BAR

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The Florida Bar Tax Section Meeting Locations and Dates

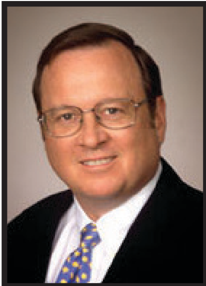
2019 Annual Meeting
Rosen Shingle Creek Orlando – May 2 - 4, 2019

2019 Organizational Meeting
Amelia Island Plantation Resort – July 3 - 6, 2019

2019 Fall Meeting
The Don CeSar, St. Pete Beach – October 10 - 12, 2019

Chair's Message
AT THE TABLE IN WASHINGTON D.C.

By: Michael D. Minton, Tax Section Chair



There is a saying one hears frequently, both in Tallahassee and in Washington, D.C., that if you're not at the table, you're on the menu. As Gerald "J.J." Wehle reported in the last Tax Section Bulletin, over the last few years, the Tax Section has taken a more active role in Tallahassee on state legislative issues. In September, the Tax Section (after more than a decade since our last visit) held our Fall Meeting in Washington D.C. during which approximately 50 of our members participated in a variety of meetings that we anticipate will reestablish the Tax Section's place at the table for federal and international tax matters in D.C.

Over the 3-day time span, our attending members participated in meetings with both the Chief Tax Counsel and tax staff of the minority & majority parties of the Senate Finance Committee, Chief Tax Counsel and tax staff of the majority party of the House Ways & Means Committee, regulation authors and employees of the Internal Revenue Service and the Department of the Treasury, and the Department of Justice. We also visited the Tax Court and met with Chief STJ Carluzzo, as well as Clerk of the Court and her Deputy. During the Tax Court meetings, we developed some very helpful contacts for the upcoming 30th Annual Moot Court Competition the Tax Section will jointly sponsor with the University of Florida College of Law next March.

While in D.C., we held our Directors' Committee Meeting and hosted a reception sponsored by MPI at The Florida House on Capitol Hill. For those of you who are not familiar with The Florida House (also referred to as the Florida Embassy), under the leadership of Rhea Chiles (wife of then Senator Lawton Chiles), a non-profit organization acquired The Manning Home located just a block from the Capitol near the U.S. Supreme Court which was restored as The Florida House. The Florida House is open to residents of the State of Florida. It made for the perfect backdrop for a reception, where we hosted staff members from the various agencies and committees with which we were meeting and from the offices of our Florida congressional delegation. For more information about The Florida House, I encourage you to visit their website: https://floridahousedc.org/.

During our Executive Council meeting on Saturday, we produced 2.5 hours of CLE which was highlighted by a fireside chat between Mark Prater (previously Chief Tax Counsel for the majority Senate Finance Committee, our recipient of the 2018 Marvin C. Gutter Outstanding Public Service Award, and now with Price Waterhouse Coopers [PWC]) and his counterpart, Barbara Angus (who was Chief Tax Counsel for the then-majority party on the House Ways & Means Committee). Their presentation regarding the evolution of the Tax Cuts & Jobs Act, the recently-introduced Tax Reform 2.0 legislation and anticipated issues to be addressed in the technical corrections bill was a highlight of the meeting. Our members also enjoyed a presentation moderated by Fred Murray, Director of the Graduate Tax Program at the University of Florida College of Law, between Hans Tanzler IV of PWC and Tony Coughlan, Senior Tax Counsel with the majority party on the Senate Finance Committee.

Those of you familiar with our Tax Section meetings know, however, that our trips are rarely all business, and our attending membership were treated to: (i) evening monument tours hosted by our sponsor, Jones Lowry; (ii) East and West Wing White House tours; and (iii) a menu of extraordinary behind-the-scenes visits to the Smithsonian Institution's Natural History Museum, African American History & Culture Museum, and the Museum of the American Indian.

The Smithsonian Institution is an extraordinary national treasure. We will be hosting a reception at the Smithsonian's Aquarium in the Port of Fort Pierce in January. If you wish to help support the Smithsonian Institution, please visit https://giving.si.edu/ways-to-give and click Give to a Museum, Research Center or Program in order to donate to one of the Smithsonian's many incredible facilities.

We were also pleased to entertain our members at the hospitality suite sponsored by our other generous sponsors, Coral Gables Trust and Alliance Bernstein. Mark Scott and Chair-Elect, Janette McCurley, did a masterful job of stocking the hospitality suite and providing our signature libation for the monument tours created by mixologist Mark Scott entitled "The Wilbur" in honor of the late Congressman, Wilbur Mills.

continued, next page

CHAIR'S MESSAGE . . .
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Our trip culminated with an evening at The Occidental Restaurant located in the Willard Hotel, just one block from the White House. The Occidental is known for its discretion and anonymity; many important international accords have been developed there. It was shared with our ranks that the initial conversation that helped defuse the Cuban missile crisis started over a meeting at The Occidental.

As I shared with those that joined us, I couldn't be more pleased with the results of our trip, nor more proud and thankful of the effort put forth by so many to plan and orchestrate this trip, prepare the various white papers and topics we submitted to address with the various agencies and committees, and to successfully implement our plan which resulted in a trip that I am sure our membership will not soon forget. Our fall CLE programs address the various topics discussed while in D.C. and bring to the rest of our membership the most recent information and insight from the appropriate agencies and committees. We are also drafting comments on the proposed regulations promulgated on Section 199A and Opportunity Zones under Section 1400Z.

One final item of business that was undertaken during our Fall Meeting on which I wish to report relates to the decision made by the Directors' Committee and the Executive Council to establish the International Tax Division as a separate, freestanding division on equal footing with the Federal Tax and State and Local Tax Divisions. This was a topic that was discussed during the Long Range Planning Retreat last winter. At the Organizational Meeting at Amelia Island, I formed a special committee of members from both the Federal Tax Division and the Long Range Planning Committee, which was co-chaired by Shawn Wolf and Steven Hadjilogiou. Shawn delivered the report of the special committee which was a unanimous recommendation to amend the Bylaws to establish the International Tax Division as a separate, freestanding division. There will be more information on this in the future and we anticipate having an amendment to the Bylaws ready for consideration at the Directors' Committee Meeting on January 25, 2019 at the Hutchinson Island Marriott Beach Resort & Marina in Stuart, Florida. The Bylaws amendment will be presented for consideration by the Executive Council at our Annual Meeting on May 4, 2019 in Orlando at Rosen Shingle Creek Resort.

Speaking of the Annual Meeting, please plan to join us in Orlando on May 2-4, 2019. We have a first-rate seminar planned for Friday, May 3, Choice of Business Entity Post Tax Cuts & Jobs Act. On Saturday evening, May 4, we will enjoy the "Run for the Roses" (Kentucky Derby) before celebrating the lifetime accomplishments of our co-recipients of the Gerald T. Hart Outstanding Tax Attorney Award, Bruce H. Bokor and Leslie J. Barnett.

Finally, amid the frenzy of holiday season, I hope you will register for the upcoming 37th Annual International Tax Conference and 4th Annual ITC Boot Camp, scheduled for January 9-11, 2019, at the JW Marriott Miami. This year's Boot Camp will focus heavily on the recent international tax changes resulting from the Tax Cuts and Jobs Act and we have a wonderful line up of speakers and topics. The two-day International Tax Conference is a premier educational event bringing together attorneys and CPAs. Find all the details in the event brochure and register today!

I look forward to seeing you at our future meetings. Please watch for additional information on timely CLE programs emanating from our trip to D.C. There has never been a better time to be a tax attorney!

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FRIDAY, MAY 3, 2019

ROSEN SHINGLE CREEK, ORLANDO

2018 Ullman Year in Review

By: Arthur L. Jones III, Esq.

and

Thomas Treece, Snyder & Snyder, P.A.

The 2018 Ullman Year In Review was an eventful and informative presentation by some of the Florida Bar Tax Section's (the "Section") most experienced and highly regarded members. With the recent enactment of the 2017 Tax Cuts and Jobs Act (the "TCJA"), this year's presentation consisted of a panoply of updates and insights into significant changes to the tax laws under the TCJA. The presentation commenced with an introduction and welcoming remarks from the Section's Chair, Michael Minton, of Dean Mead, and the hostess of the event, Janette McCurley, of B. Gray Gibbs, PA.

Of note, this year's Ullman Year In Review was bitter sweet as the Section honored the legacy of Bilzin Sumberg Tax Partner, Samuel C. Ullman ("Sam"), who passed away in March at age 74. In addition to his substantial contributions to the Section over the span of decades, Sam was an adjunct professor at UF's Fredric G. Levin College of Law in Gainesville, where he also graduated from law school in 1967.

I. INTERNATIONAL TAX

Sean P. Wolf kicked off the lecture portion of the 2018 Ullman Year in Review with a deep dive into changes in the international tax realm under the TCJA. Sean discussed some of the changes in ethical compliance, noting that, in recent years, many foreign countries have started cracking down on their own noncompliant taxpayers. Such countries have established amnesty programs similar to the U.S. Offshore Voluntary Compliance Program and are increasingly enforcing criminal penalties for tax evasion.

Sean then addressed some of the recent income tax changes affecting pass- through entities, in particular, the Section 199A deduction for qualified business income of pass-through entities. The spirit of Section 199A, which permits owners of sole proprietorships, S corporations, and partnerships to deduct up to 20% of the income earned by the business, is to allow such business owners to keep pace with the significant corporate tax cut also provided by the TCJA. Finally, Sean shifted gears to explain changes in U.S. estate tax laws affecting nonresident aliens. Old section 163(j) was replaced by an expanded limitation that now applies to most business interest expenses. On April 2, 2018, the U.S. Department of the Treasury and the IRS released Notice 201 8-28 to provide interim guidance on the section 163(j) interest deduction limitation.

II. CIVIL TAX PROCEDURE

Next, Charlotte A. Erdmann, of Erdmann Law, PLLC,

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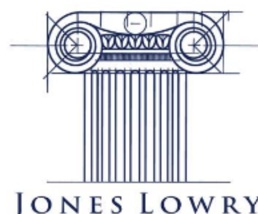

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2018 ULLMAN YEAR IN REVIEW . . .
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headed an informed discussion on the recent changes in civil tax procedure under the TCJA. Charlotte's presentation started off with an illustration of the District Court's power to enjoin taxpayers from taking future action or requiring that taxpayers do specific acts. The District Court is authorized under section 7402[1] to use injunctions as a tool to prevent, among other things, the Pyramiding of Employment Taxes. Charlotte referenced a recent case, *U.S. v. Askins & Miller Orthopaedics, P.A.*, to illustrate the District Court's power in such a situation.

Charlotte then focused on an instance in which the IRS and other courts are split on a recent ruling with potentially significant ramifications to individual taxpayers. In *United States v. Craft*, the District Court held that a federal tax lien attaches to the liable spouses' interest in property owned as tenancy by the entirety.[2] The IRS and the courts are currently split on how such an interest should valued in such instances. The IRS has taken the position that there should be a 50/50 split, while certain Circuit Courts are split between utilizing an actuarial interest of the spouses and the 50/50 position the IRS has taken. [3]

Charlotte's presentation concluded with discussion of other practical and useful tools in the area of tax civil procedure, including information on the Taxpayer Bill of Rights various examples of penalty approval forms.

III. STATE AND LOCAL TAX

Jeanette Moffa, of the Law Offices of Moffa, Sutton, & Donnini, P.A., gave a great presentation on recent changes in the area of state and local taxation. Jeanette started off her presentation with a Supreme Court update. The Due Process Clause requires some definite link or minimum connection between a state and the person, property, or transaction it seeks to tax.[4] With revenue shortfalls, the erosion of a tax base with digital goods and the inability to collect from remote sellers, states would look for ways to move around the ruling in *Quill*.

Amazon.com, LLC v. New York State Department of Taxation and Finance was a prefect case to test the boundaries of the prior ruling in *Quill*. In Amazon, the Court ruled that Amazon and Overstock.com had a "sufficient presence" in the state because of affiliated independent sites that linked to the retailers in return for a commission.[5]

Jeanette then went on to illustrate the overruling of *Quill* through the case *South Dakota v. Wayfair, Inc*. In South Dakota, the Court overruled the physical presence test in *Quill* in order to keep pace with the new digital age of sales.

Jeanette's presentation culminated with discussion regarding how the law was being applied currently by Florida courts. The Florida Supreme Court held that substantial nexus was lacking even when the company was physically present in Florida for three days a year. However, in making this ruling, the Florida Supreme Court relied heavily on *Quill* and *National Bellas Hess*, which were very recently overruled.

IV. SUMMARY JUDGMENT STANDARDS OF REVIEW

Christopher Pavilonis, of the IRS Office of Chief Counsel, provided an update of the summary judgment standard of review. Christopher commenced his presentation with an update of the new standard in the 11th Circuit and briefly explained the old standard in this Circuit. Christopher illustrated the old standard with the case, *Mays v. U.S.*, in which the Court stated that a "court exercises an independent review of motions for summary judgment, and conclusions of law are subject to the same standard of appellate review as any question of law raised on appeal." [6]

Christopher then addressed the controlling law with the federal rule for Motion for Summary Judgment and the overruling case, *U.S. v. Stein*. Federal Rule 56 went on to state that summary judgment is appropriate when "there is no dispute as to any material fact"[7] and the moving party is "entitled to judgment as a matter of law."[8]

In wrapping up his presentation, Christopher pointed out that, even now, an affidavit cannot be conclusory.[9] Also, self-serving and uncorroborated testimony may defeat a Motion for Summary Judgment, but a taxpayer still needs to present his or her case at trial. Moving forward, *Stein* will have the most visible impact on government cases to reduce assessments to judgment, alter ego determinations and foreclosures on notice of federal tax liens in District Court.

V. TAX CUT AND JOBS ACT

Mark Prater, the Staff Director for the Joint Select Committee on Deficit Reduction, did a deep dive into the "politics" of passing the TCJA with a focus on the behind the scenes maneuvering of both political parties in the House and Senate. Mark laid out the framework for the document that was put in place on September 26th. This version of the TCJA presented the biggest partisan difference when it came to the changes in the tax laws affecting individual taxpayers. The Democrats did not want lower tax rates, while the Republicans wanted lower rates through broadening the tax base.

VI. TAX EXEMPT ORGANIZATIONS

Peter Blumeyer, of Holland & Knight, discussed tax-

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exempt organizations and started off his presentation with various reasons to incorporate charitable planning into one's practice. Peter's presentation then shifted focus to the effects the TCJA on charitable planning. Specifically, Peter noted that the estate tax rate and exemption, as well as the Generation-Skipping Transfer tax rate and exemption, has increased substantially, which may dramatically increase the volume of charitable giving by High Net Worth Individuals. Some of the changes affecting the amount of expected charitable giving include the modifications to unrelated business tax and specific changes focusing on colleges and universities. The TCJA has modified the unrelated business income tax by disallowing the deduction of losses from one activity against unrelated business income tax from another activity, as well as including fringe benefits in the unrelated business income tax for a number of items.

VII. ESTATE AND GIFT TAX

Donna L. Longhouse, of Allen Dell, P.A., addressed recent changes in the area of estate and gift tax. The TCJA has created amendments to both the exclusion amount and the inflation index. Section 11061 of the Tax Act amends §2010(c)(3) of the Code to increase the basic exclusion amount from $5 million to $10 million. Even though the exclusion amount has increased, it could present a claw back issue for individuals down the line. Donna then highlighted some of the changes in tax rates for trust and estates. Some of her key points were that the new AMT rates do not apply to trusts and estates, which could result in additional AMT tax for trusts, and Section 199A creates the Qualified Business Income Deduction, which is available to trust and estates.[10]

VIII. EMPLOYEE BENEFITS/DEFFERED COMPENSATION

Next was a group presentation by David E. Bowers and William G. "Bill" Smith, of Jones, Foster, Johnston & Stubbs, P.A., regarding employee benefits and deferred compensation. First, the duo analyzed *Frias v. Commissioner* to illustrate an important rule in regards to a 401(k) loan, wherein the Court held that if a taxpayer takesa leave, the loan repayment does not begin until after the employee returns from leave.[11] They shed light on the importance of not ignoring Form 1099-R, because, in *Frias*, the record did not disclose whether the taxpayer had notice that the Form 1099-R had been issued. The rest of the presentation was very informative and they did a good job of detailing some of the more important rules using recent case law. For example, in *Shank v. Commissioner*, the Tax Court used the rule in *Cohan v. Commissioner*, 39 F.2d 540 (1930) to establish the basis in a taxpayer's regular IRA.[12]

IX. CORPORATE TAX

Nathan Wadlinger, a professor at the University of South Florida, presented on recent changes in the area of corporate tax. Nathan noted some of the exclusive corporate tax provisions in the TCJA and explored the practical implications of the reduced corporate tax rate of a flat 21% for tax years beginning after December 31, 2017. Nathan explained the dividends received deduction under the TCJA, which changes the 70% dividends received deduction to 50%, the 80% dividends received deduction to 65%, while the 100% dividends received deduction remained unchanged.[13] One of the more heavily covered topics during Nathan's presentation was depreciation in the corporate tax arena. Section 168(k) presented the opportunity for corporations to use "bonus deprecation"[14] Nathan provided a detailed break down of how there is an increased depreciation amount under the TCJA for luxury automobiles.

X. PARTNERSHIP/PASS THROUGH ENTITES

Similar to the corporate tax presentation, the partnership and pass-through entities presentation was filled with updates in the area due to the TCJA. Cristin Keane, of Carlton Fields, LLP, gave a great presentation on the recent developments in this area. Cristin started off her presentation with discussion of the new Section 199A. Section 199A changes pass-through entities to a more corporate like structure. Specifically, section 199A provides a 20% deduction for "qualified business income" from a U.S. trade or business conducted through a pass-through entity (partnership or S corporation) or a sole proprietorship.

Cristin then noted that the partnership loss limitation rule and the definition of substantial built in loss has been modified by the TCJA. Section 704(d) provides that, in determining the amount of a partner's allowable loss (which is limited to the partner's basis in its partnership interest), the partner's distributive share of partnership charitable contributions and taxes paid or accrued to foreign countries or U.S. possessions is taken into account.[15] The presentation was very informative and we walked away with a good grasp on the recent changes in the area of partnerships and pass-through entities.

XI. TECHNOLOGY

Last, but certainly not least, Michael A. Lampert, of the law offices of Michael A. Lampert, P.A., gave an energetic presentation on how technology in this day and age affects tax law. Michael came prepared with a box full of props and costumes to drive home the points of technology in the area of tax law!

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Michael started off his presentation with the assistance of the prior presenter, Cristin Keane. Michael and Cristin dressed up as an electrical socket and plug. Michael then gave an example of the limitation that has been placed on outgoing international wires to high-risk countries. Due to the risk inherent in wiring funds internationally, several limitations have been imposed, including the approval from the fund's chief legal officer or chief underwriting counsel at least 24 hours prior to initiating any international wire transfer to a country that is on the high-risk country list.

CONCLUSION

Without question, the 2018 Ullman Year In Review was a great presentation series! With so many changes in tax law, due the recent passing of the 2017 Tax Cut and Jobs Act, each presenter covered a variety of relevant and impactful updates in their respective areas of expertise. The 2018 Ullman Year In Review was nothing short of entertaining (for us "tax nerds"), insightful, and well structured!

(Endnotes)

1 I.R.C. § 7402(a) provides federal district courts with jurisdiction to hear these actions and to fashion appropriate orders, "as may be necessary or appropriate for the enforcement of the internal revenue laws."

2 *United States v. Craft*, 535 U.S. 274, 278, 122 S. Ct. 1414, 1420, 152 L. Ed. 2d 437 (2002)

3 Circuit Courts 2, 5, 9, and 10 have taken the position of actuarial interests of the spouses. While the Circuit Courts 3, 6 have taken the same position as the IRS in that there should be 50/50 split. The 11th Circuit has remained silent on this issue.

4 *Quill Corp. v. N. Dakota By & Through Heitkamp*, 504 U.S. 298, 306, 112 S. Ct. 1904, 1909, 119 L. Ed.

2d 91 (1992), *overruled by S. Dakota v. Wayfair, Inc.,* 138 S. Ct. 2080 (2018)

5 *Amazon.com, LLC v. New York State Department of Taxation and Finance*, 913 N.Y.S.2d 129, 81 A.D.3d 183 (2010).

6 Mays v. United States, 763 F.2d 1295, 1297 (11th Cir. 1985), overruled by United States v. Stein, 881 F.3d 853 (11th Cir. 2018)

7 Fed. R. Civ. P. 56

8 Id.

9 Lujan v. Nat'l Wildlife Fed'n, 497 U.S. 871 (1990).

10 §199A(f)(1)(B)

11 Frias v. Commissioner, TC Memo. 2017-139 (7/11/2017).

12 Shank v. Commissioner, TC Memo. 2018-33 (3/20/2018)

13 Id.

14 168(k)

15 704(d)

LLC: DISREGARDED ENTITY OR S CORP TAX STATUS?

By Joseph M. Percopo, JD, LL.M

A limited liability company ("LLC") is an entity formed under state law. For federal tax purposes, an LLC is subject to default tax classifications unless it elects otherwise. The default status of an LLC is based on the number of members. If there is only one member, then the default will be a "disregarded entity." However, if there are two or more members the default will be "partnership" tax status. A single member LLC member may elect out of the default and into a corporate tax status ("C Corp") and elect to be treated as an S Corporation ("S Corp").[1]

The tax status options may be divided into two general categories: (1) double taxation and (2) pass-through taxation. A C Corp is a double taxation entity; it pays income tax at the corporate level (both federal and state) and then any dividends paid to shareholders are taxed on the shareholders' personal income tax returns (hence, 2 layers of tax). The other tax classifications, disregarded entity, partnership, and S Corp[2] are considered pass-through entities because there is only one level of tax, which is paid by each member[3] on his or her personal income tax return.

For purposes of this article, the difference between the two most frequently encountered single member LLC entity options, disregarded entity and an S Corp, will be evaluated.[4] One factor to consider is whether a member is to be an "employee" of his or her wholly owned LLC. A disregarded entity does not file a separate tax return; instead, it is included on the single member owner's personal income tax return (Form 1040 and Schedule C). The net income generated by the business will be subject to the self-employment tax and personal income tax rates. The self-employment tax is 15.3% (consisting of 12.4% social security tax and 2.9% Medicare tax). 50% of the self-employment tax is deductible by the owner (therefore, taxable income is reduced by 50% of the total self-employment tax paid). After $128,400 of income, the social security tax drops off and only the 2.9% Medicare tax remains.[5]

For example, assuming a 24% individual income tax rate, that the LLC is a single member LLC treated as a disregarded entity, and the LLC had gross revenue of $100,000.[6] The $100,000 is first taxed by the self-employment tax, resulting in a tax of $15,300. The $100,000 is then reduced by the employment tax deduction[7] to determine the taxable income for per-

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sonal income tax purposes. Therefore, taxable income is $92,350 (= $100,000-$7,650). This results in $22,164 income tax. The total tax paid between self-employment and individual rates is $37,464. Therefore, the LLC owner will retain $62,536 of the original $100,000 after applicable taxes.

Unlike a disregarded entity, the shareholder/member is usually treated as an "employee" of the LLC.[8] Only a "qualified" entity may elect S Corp tax treatment, which will be effective for all succeeding tax years until it is terminated.[9] To be a qualified entity, the LLC must be treated as a domestic corporation which is not an ineligible corporation[10] and which does not have:

a. more than 100 shareholders[11];

b. as a shareholder a person who is not an individual (subject to certain exceptions)[12];

c. a nonresident alien as a shareholder; and

d. more than 1 class of stock (voting and non-voting can be considered 1 class of stock if all other aspects of the shares are identical).[13]

A single member LLC that has elected S Corp tax status must pay "reasonable compensation" for services the member renders to the LLC as an employee.[14] The compensation paid to a member is a deductible business expense of the LLC.[15] The LLC treats the member's reasonable compensation as ordinary income (W-2 employee treatment) and pays the necessary withholding taxes.[16] The withholding tax of a W-2 employee is broken down as follows:

1. Employee pays his or her portion of federal personal income tax withholding.

2. Employer pays its portion of applicable unemployment tax.[17]

3. Employee pays his or her portion of Social Security tax, which is 6.2% on the first $128,400 of net income.

4. Employer pays its portion of Social Security tax, which is 6.2% on the first $128,400 of net income.

5. Employee pays his or her portion of Medicare tax, which is 1.45% of all net income (no cap or limit).

6. Employer pays its portion of Medicare tax, which is 1.45% of all net income (no cap or limit).[18]

A member of an S Corp, in addition to his or her compensation, is required to report and pay taxes on his or her pro rata share of the S Corp's taxable income.[19] This necessitates that the S Corp LLC file a separate tax return[20] for the LLC and issue a K-1 to the member (which provides the amount of the distribution to the member to be included on the member's individual income tax return). However, the pro rata distribution is not subject to self-employment tax.

In revisiting the above example, let us instead assume that the LLC has made a valid S Corp election. The LLC had $100,000 of gross revenue for the taxable year. The LLC pays the member employee reasonable compensation of $40,000. The remaining gross revenue, after paying necessary business expenses,[21] is distributed to the single member. The employee pays his or her share of FICA and Medicare tax of $3,060 from his or her salary. The employer pays FICA and Medicare tax of $3,060, and the maximum unemployment tax of $420 (6% of first $7,000 of wages). The employer receives a deduction for the total FICA, Medicare, and unemployment tax it has paid of $3,480.[22] Therefore, the remaining $60,000 of gross revenue[23] is then reduced by $3,480 resulting in $56,520 being available for distribution to the member. The member reports gross income of $96,520 (= $40,000 + $56,520) on his or her personal income tax return. The member's gross income is taxed at a 24% personal income tax rate resulting in income tax of $23,164.80. The total taxes paid on the wages and distribution is $29,704.80. After paying those applicable taxes, the LLC owner retains $70,295.20 of the original gross revenue.

In comparing the two examples of the net proceeds received by the member, there is a $7,759.20 benefit to the individual making the S Corp election for the LLC. It is important to keep in mind that this example is based on a 40/60 split of the S Corp revenue between salary and distributions and does not take into consideration other costs (such as the preparation of a separate tax return for the entity). Therefore, it is extremely important to work with a qualified accountant to help determine which tax structure is best in your client's situation. If it is the S Corp, then you and the client's accountant should work together in determining how much reasonable compensation should be paid to avoid income reclassification,[24] as well as interest[25] and penalties.[26] The ratio of wages to distribution could be better or worse, all depending on the LLC specific industry standards. However, it would appear that there will be some savings using the S Corp over the disregarded entity provided the LLC generates enough income.[27] However, it is also important to take into consideration the type of business to be operated, as the business type may dictate which tax structure is best for your client's situation (e.g., you may not wish to hold appreciating real estate likely to be held for a long term in an entity taxed as an S Corp).

The drawback of the S Corp election is the increased administration. The S Corp/LLC is required to run

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payroll, file quarterly withholdings, and pay unemployment insurance (State and Federal).[28] Additionally, the S Corp/LLC must file its own tax return (separate from the member owner), make distributions, and issue a K-1 to the member. In deciding between being a disregarded entity or an S Corp, a single member should carefully consider the potential tax savings against the additional administrative costs.

(Endnotes)

1 For state law the entity remains an LLC; however, for federal income tax law the entity as treated as a C Corp or S Corp depending on the election made by the member.

2 IRC §1363(a) – S corp generally not subject to federal income tax

3 A member may also include an entity.

4 This article will not be discussing the new IRC §199A business deduction, except to say both disregarded entities and LLCs may be eligible for the deduction. Additionally, the calculations contained herein do not take into account any applicable exemptions or deductions the individual may have available to him or her.

5 Also possible for high wage earners to be subject to an additional Medicare surtax.

6 For purposes of this example assume it was a service business and there are no deductible business expenses except for those used within the example, and personal exemption and standard deduction are ignored.

7 IRC §164(f).

8 This only applies if it is a single member/shareholder of the entity who is providing services to the LLC directly; if the owner member is truly passive in the LLC or there are multiple owners it is possible for some members to avoid classification as an employee; see Rev. Rul 71-86; Rev. Rul 73-361; PLR 7949022.

9 IRC §1362(c) (the election may be made anytime during the preceding tax year or at any time during the current taxable year on or before the 15th day of the 3d month of the taxable year); IRS Form 2553 is used to make the election.

10 IRC §1361(b)(2).

11 IRC §1361(c) (special rules for calculating number of shareholders).

12 IRC §1361(b) (exceptions include an estate, ESBT or QSST, and certain exempt organizations).

13 IRC §1361(c)(4).

14 See infra FN24 (the IRS may reclassify distributions as income if salary is underpaid, this will also result in penalties, interest, and fines); see also IRC §1366(e).

15 IRC §162.

16 The withholding taxes include federal income tax withholding, unemployment tax, Social Security, and Medicare.

17 Florida Reemployment Tax (2.7% of the for the first $7,000 of an employee's wages) and Federal Unemployment Tax Act (FUTA)(6% for the first $7,000 of an employee's wages; this may be reduced by applicable state unemployment tax paid up to 5.4%).

18 In all cases, the employer automatically withholds the necessary withholding tax and remits it to the treasury. Therefore, the employee will not actually be making a separate payment on his or her own for the taxes.

19 IRC §1361(a)(1)(a); IRC Regs. §1.1366-1(a).

20 IRC Form 1120S.

21 For purposes herein, the only necessary business expenses are the FICA, Medicare, and Unemployment tax.

22 IRS §162.

23 This is the amount that remains after payment of the $40,000 salary from the $100,000 gross income.

24 Rev. Rul. 74-44; David E. Watson, P.C. v. U.S., 668 F.3d 1008 (8th Cir. 2012); Joseph Radtke, S.C. v. U.S., 895 F.2d 1196 (7th Cir. 1990); Spicer Accounting, Inc. v. U.S., 918 F.2d 90 (9th Cir. 1990); Fred R. Esser, P.C. v. U.S., 750 F. Supp 421 (D. Ariz. 1990).

25 IRC §6601.

26 Potentially penalties include, but not limited to, underwithheld income tax (IRC §3403), failure to timely deposit withholding (IRC §6656), and negligence, disregard of rules or regulations, and substantial understatement of tax (IRC §6662).

27 "enough income" varies depending on the industry and the wage/distribution split, however, an accountant can run the numbers to determine if the S Corp election will result in tax savings.

28 Also potentially workers' compensation insurance if the LLC has other employees.

Refreshing Income Tax Basis Through The Use of Powers of Appointment and Lifetime Gifts/Sales

By: Javier Chipi

Introduction

As part of the tax act that was passed in December of 2017 (the "Act"), the lifetime exclusion amount for federal estate and gift tax purposes under Internal Revenue Code ("IRC") Section 2010(c)(3) was increased from $5 million to $10 million, per person (the "Exclusion Amount"). The Exclusion Amount is indexed for inflation. For decedents who die in 2018, the Exclusion Amount is $11.18 million. In general, the Exclusion Amount is the maximum value of property that a person may give away during his or her life, or upon his or her death, without incurring any gift or estate tax liability. Since the Exclusion Amount is currently at a historical high, many families and advisors are shifting their focus from minimizing the exposure to estate tax to minimizing the exposure to income taxes for future generations, since assets left in a traditional credit shelter would not receive a basis step up upon the death of the surviving spouse or other beneficiary. Rather, estate tax inclusion and basis step-up under IRC Section 1014 is the new focus.

For purposes hereof, the term "child" refers to an adult child of an elderly parent (the "parent"). The parent's estate would not be subject to federal estate tax at death since the parent's assets are less than the Exclu-

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sion Amount. An upstream power of appointment trust ("UPSPAT") refers to a trust, that may be for the benefit of the parent, that is includible in the parent's estate for federal estate tax purposes (because the parent holds a general power of appointment ("GPOA") limited to a formula clause such that the GPOA will not cause any actual estate tax liability) and that later passes to child and/or grandchildren as remainder beneficiaries. All that is needed to obtain a step-up in basis is for the parent to be granted the GPOA, not that the parent exercise the GPOA. IRC Section 2041(a)(2) provides for the inclusion in the gross estate of any property over which the decedent possesses, at the time of his death, a GPOA created after October 21, 1942.

Planning Strategies that Achieve a Refreshed Basis

There are several planning opportunities available to make use of what would otherwise be a parent's unused Exclusion Amount (thereby increasing the basis of assets and saving income taxes (e.g., capital gains tax) upon a later sale of the assets by a child of the parent).[1]

1. Outright Taxable Gift. Although not ideal and often impractical, a child may make a taxable gift (using some of the child's lifetime Exclusion Amount) to a parent who will die owning the assets and who will leave those assets to the child through the parent's estate plan, at a stepped-up (or down) basis. However, this leaves the child with no control over what the parent does with the asset. Additionally, careful consideration should be made regarding the potential appreciation in value of the asset together with the child's other assets since the child would have less Exclusion Amount at their death and thus the threshold for triggering an estate tax would be lower.

2. GRAT and Upstream Trust. A child may create a grantor retained annuity trust ("GRAT"), which pays to the child an annuity for a term of years with a vested remainder, after such term, passing to an UPSPAT. The GRAT may be structured such that the remainder has a value that is "zeroed-out," which would not use any of the child's Exclusion Amount (important if the child has a taxable estate or may in the future); alternatively, to the extent the remainder interest has value, then child would be making a gift to the parent and would use at least a portion of the child's Exclusion Amount. After the annuity term, the GRAT's assets are payable to the UPSPAT and then the assets ultimately pass back to the child per the UPSPAT terms. The USPAT causes the assets to be included parent's estate at death and thereby stepping up the basis of such assets. Alternatively, if the GRAT leaves assets to the parent outright after expiration of its term, the parent can leave such assets to a generation-skipping trust for the benefit of the child and the child's children. One important planning consideration is that depending on timing and how this strategy is structured, the IRS could argue that this is a prearranged plan and re-characterize the outcome under the step-transaction doctrine.

3. Sale to UPSPAT. This strategy works like any sale to an intentionally defective grantor trust. A child may create a grantor trust (the UPSPAT) and sell assets to it in exchange for a promissory note. For income tax purposes, this installment sale would be ignored.[2] The UPSPAT may provide that the parent has a testamentary GPOA over the trust property. When the parent dies holding this testamentary GPOA the assets will be included in the parent's estate.[3] The UPSPAT may be able to remain a grantor trust to the child after the parent's death so long as the parent does not exercise the GPOA; however it is not entirely clear that the death of the parent will not terminate the grantor trust status to the child and cause the sale to be recognized by the child (this situation is distinguishable from a situation in which grantor trust status is terminated upon the death of the grantor child).[4] In such an event, the trustee can use the UPSPAT assets to pay off the note. Alternatively, the parent can exercise the GPOA at death and appoint the assets back to the child (through the parent's estate or revocable trust). This would presumably cancel out the note.

Other Planning Opportunities

Downstream power of appointments should also be considered. Many beneficiaries of trusts will not have a taxable estate at their death. Giving such beneficiaries a general power of appointment in a dynastic trust setting can give old assets a fresh basis. An additional benefit is that a beneficiary's Generation-Skipping Transfer Tax ("GSTT") exemption could be allocated to a trust that would not otherwise be GSTT exempt since the beneficiary who holds the GPOA becomes the transferor for GSTT purposes. An independent third-party trust protector can trigger an optional GPOA, which can be limited to a formula such that the trust assets will be includable in the beneficiary's estate only up to the beneficiary's available estate tax exemption when combined with his/her other assets. Thus, this strategy can be structured so that there are no negative tax consequences to anyone. Careful drafting and trust administration must be employed to ensure that trust shares are created if necessary to cause a share to have only a zero (0) or a one (1) for the GSTT inclusion ratio. Older trusts should be reviewed for opportunities to create estate tax inclusion and trigger a step-up in basis when possible and beneficial to the family. It may be necessary to decant an older trust into a new trust, seek a non-judicial modification, or a judicial modification in order to grant the general

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power of appointment. It should be noted that various tax consequences may be triggered from those actions, which are outside the scope of this article.

Here are two (2) real world applications where the planning scenarios discussed above could benefit taxpayers owning real estate:

1. It is not uncommon for a child who has found success to purchase a home for their parent to live in for that parent's lifetime. However, the title to the home generally remains in the name of the child. If the child were to transfer that property to an irrevocable trust with terms granting the parent a general power of appointment over the home, then at the parent's death the home would receive a step-up in basis.[5] Likewise, the home could be gifted outright to the parent. In addition to allowing the parent to live in the home out of love and affection the child would receive a tax benefit (thus making the arrangement more palatable for the child). This particular scenario has benefits and drawbacks in terms of the availability of homestead protections and benefits under Florida law, protecting the parent from exploitation by others or elder abuse, and other transfer considerations such as documentary stamps taxes and lender approval. The best fit for a particular family must be considered taking all of these factors into account.

2. A child could use one of the above mentioned methods of accomplishing an upstream transfer of assets with the asset in particular being real estate. Granting a parent a GPOA over a rental property that has been substantially depreciated would result in the property returning to the child at a refreshed basis such that the property could be depreciated again or could be sold while avoiding any depreciation recapture and capital gains tax.

Other issues important to consider with transfers of real property is how property taxes, insurance, repairs and maintenance will be handled and which parties are liable for those expenses.

Caution for Blended Families

Children with parents in a second marriage should use caution if considering moving assets upstream. In such a scenario a gift in trust would be advisable compared to an outright gift. Further, careful consideration should be given as to whether the parent's spouse may be able to reach those assets as a creditor depending on state law and if the couple had entered into a pre or postnuptial agreement. Would those assets be included in an elective estate or subject to an elective share claim? Another concern arises if the parent has significant debt; could creditors stake a claim to the assets in the trust? These are some of the factors to be considered when doing this type of planning.

Sibling Rivalry

Another issue that may arise in the context of moving assets upstream is how a child's siblings will view the tax planning. A sibling may have difficulty understanding this type of planning and feel that an elderly parent is being taken advantage of or that his or her share of the parent's estate is somehow being dwindled by all of this. A planner should try and resolve these misconceptions and familial conflicts by explaining that the gift of basis is a terrible thing to waste. Furthermore, the planner should try to understand the existing relationship between siblings, since there may already be jealousy and mistrust directed towards the more successful sibling. In most cases where this planning can be employed, a parent's testamentary plan will not need to be altered such that any sibling's stake to assets will be reduced. Moreover, the basis at which the siblings receive their respective assets should be the fair market value because the testamentary GPOA can be drafted to limit the parent's ability to appoint property to an amount that will not cause the parent to owe any estate taxes. A little bit of communication on the front-end may save a lot of headache and disagreement on the parent's death.

Final Tax Considerations

In all of the scenarios discussed above, the GPOA can be limited to being exercisable only in favor of the most appreciated assets held by the trust.

Under IRC Section 1014(e), if a child gifts appreciated property to a parent during the 1-year period ending on the date of such parent's death and such property is appointed or transferred back to the child (or such child's spouse) upon the parent's passing, then no step-up in basis will occur. However, the limitations under IRC 1014(e) should not apply if the assets in the trust were purchased by the trust, because a gift has arguably not occurred and therefore a step-up in basis should be achievable. If there is a concern about IRC 1014(e), the parent can appoint the assets into a trust for the child's children instead of to the child and allocate GSTT exemption accordingly. Alternatively, the assets could pass into a discretionary trust for the benefit of child rather than passing outright to child. [6]

IRC Section 2041(b)(1) provides that the term "general power of appointment" means a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate, except that a power to consume property for the benefit of the decedent that is limited by an ascertainable standard relating to health, education, support, or maintenance of

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the decedent is not deemed a general power of appointment. If the child is concerned the parent will not appoint the property back to him/her, the child can limit the GPOA to being exercisable only in favor of the creditors of the parent's estate (thus making it more likely the parent will not exercise the power). However, a powerholder may be able to circumvent this restriction by making the party he intends to leave the property to a creditor of his estate (such as with a promissory note payable upon his death). Additionally, the powerholder's state law should be considered, as merely having a general power of appointment exercisable in favor of creditors may give those creditors a demand right in certain states.

Providing a wealthy child's older, poorer, parent with a GPOA necessitates the filing of a Form 706 and Form 8971 at the death of the parent to establish what the value is of the assets for income tax purposes.[7] Also keep in mind when drafting powers of appointment that flexibility is important, especially if the estate tax exemption reverts to $5 million (indexed for inflation), as it is scheduled to do after 12/31/2025.

Conclusion

With the strength of the economy currently and high values there are undoubtedly many clients who have substantial unrealized gains. Now is the perfect time to begin discussions of the various opportunities and strategies that may be used to minimize future recognition of gains and plan for a refreshed basis.

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(Endnotes)

1 See Heckerling Estate Planning Conference 2018 materials entitled, "Putting It On & Taking It Off: Tax Basis Management Today (For Tomorrow)" prepared by Paul S. Lee, Ellen Harrison, and Turney P. Berry for a substantive explanation of certain basis planning opportunities.

2 Rev. Rul. 85-13; CCA 2013-43021

3 IRC 2041

4 Treas. Reg. 1.671-2(e)

5 IRC 1014(b)(9), IRC 2041

6 See PLR 90036036; See Heckerling Musings 2018 and Estate Planning Current Developments by Steve R. Akers for a more substantive discussion of this planning technique.

7 Treas. Reg. 1.1014-3

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BLSE BRINGS IT- 2018-19

by Kim Ashby, Chair of BLSE

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IRS Publishes Proposed Section 199A Regulations

By: Thomas P. Ward, Patrick J. McCurry, Alejandro Ruiz and Kevin Hall

[**Summary:** The IRS recently issued proposed regulations under Section 199A, a provision enacted as part of tax reform to allow individuals and certain other non-corporate taxpayers to deduct up to 20 percent of qualified business income. The proposed regulations provide operational rules on calculating this deduction, an aggregation rule, detail on the scope of trades or businesses that are not eligible for this deduction and rules applying this deduction to trusts and estates.]

In Depth

Section 199A Deduction: In General

Section 199A, enacted at the end of 2017 as part of tax reform, allows individuals and certain other non-corporate taxpayers to deduct up to 20 percent of qualified business income (QBI) beginning this year. QBI includes certain income from a partnership, S corporation or sole proprietorship, as well as 20 percent of the

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total qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership income of the non-corporate taxpayer. Subject to limitations, QBI generally is taxable income (i.e., the net amount of items of income, gain, deduction and loss) with respect to a US trade or business. Passive investment income such as capital gains, dividends and interest income does not qualify as QBI (unless the interest is received in connection with a lending business).

Taxpayers with income in excess of certain threshold amounts are not eligible for the section 199A deduction if the income is attributable to a specified service trade or business, or an "SSTB." The SSTB exclusion phases in for (a) individuals filing joint returns with taxable income in excess of $315,000 and (b) for other individual taxpayers and non-grantor trusts with taxable income, in each case in excess of $157,500. These threshold amounts are indexed for inflation.

Even if a taxpayer earns QBI that is eligible for the section 199A deduction, the amount of the deduction may be limited if the taxpayer earns income in excess of the threshold amounts. The section 199A deduction, otherwise allowable, cannot exceed the greater of (a) 50 percent of the W-2 wages paid with respect to the qualified trade or business, or (b) the sum of 25 percent of the W-2 wages paid with respect to the qualified trade or business plus 2.5 percent of the tax basis of certain tangible depreciable property used in the qualified trade or business.

On August 8, the Internal Revenue Service (IRS) and US Department of the Treasury (Treasury) published proposed regulations under section 199A. The stated purpose of the proposed regulations is to "provide taxpayers with computational, definitional and anti-avoidance" guidance under section 199A.

Definition of Specified Service Trade or Business

Income exceeding the threshold amounts stated above that is from a SSTB is not eligible for the section 199A deduction because a SSTB is not a "qualified" trade or business under section 199A.

Under section 199A, an SSTB is defined as "any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners." Section 199A provides that an SSTB also includes the "performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities."

The proposed regulations take further steps to define each field that is an SSTB. While questions remain, the definitions in the proposed regulations appear to be narrowly tailored to address specific lines of services in what could otherwise be viewed as broad categories. For example, the proposed regulations define the performance of services in the field of:

1. "Health" as "the provision of medical services by individuals such as physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists and other similar healthcare professionals performing services in their capacity as such who provide medical services directly to a patient (service recipient)";

The proposed regulations exclude services "not directly related to the medical services field" such as the operation of health clubs or health spas and "payment processing, or the research, testing, and manufacture and/or sales of pharmaceuticals or medical services";

2. "Law" as "the performance of services by individuals such as lawyers, paralegals, legal arbitrators, mediators, and similar professionals performing services in their capacity as such" but exclude ancillary services that "do not require skills unique to the field of law";
3. "Accounting" as "the provision of services by individuals such as accountants, enrolled agents, return preparers, financial auditors, and similar professionals performing services in their capacity as such";
4. "Consulting" as "the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems" but states that consulting "does not include the performance of services other than advice and counsel, such as sales or economically similar services or the provision of training and educational courses";
5. "Athletics" as "the performance of services by individuals who participate in athletic competition such as athletes, coaches, and team managers in sports such as baseball, basketball, football, soccer, hockey, martial arts, boxing, bowling, tennis, golf, skiing, snowboarding, track and field, billiards, and racing";
6. "Financial services" as "the provision of financial services to clients including managing wealth, advising clients with respect to finances, developing retirement plans, developing wealth transition

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plans, the provision of advisory and other similar services regarding valuations, mergers, acquisitions, dispositions, restructurings (including in title 11 or similar cases), and raising financial capital by underwriting, or acting as a client's agent in the issuance of securities and similar services";

Notably absent from the definition of financial services is a traditional banking business.

7. "Investing and investment management" as "a trade or business involving the receipt of fees for providing investing, asset management, or investment management services, including providing advice with respect to buying and selling investments" but excluding the business of "directly managing real property";

8. "Trading" as "a trade or business of trading in securities (as defined in section 475(c)(2)), commodities (as defined in section 475(e)(2)), or partnership interests. Whether a person is a trader in securities, commodities, or partnership interests is determined by taking into account all relevant facts and circumstances, including the source and type of profit that is associated with engaging in the activity regardless of whether that person trades for the person's own account, for the account of others, or any combination thereof";

9. "Dealing in securities" as "regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business"; or

10. Any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners.

    The proposed regulations provide that a business is an SSTB under this rule if it is a business in which a person receives fees, compensation or other income, including receipt of a partnership interest or S corporation stock, for: (a) endorsing products or services; (b) the use of a person's image, likeness, name, signature, voice, trademark or any other symbols associated with the individual's identity; or (c) appearing on radio, television or another media format.

Other SSTB services specifically listed in the proposed regulations are actuarial science, performing arts and brokerage services. The performance of services in the field of performing arts does not include the provision of services that do not require skills unique to the creation of performing arts, such as the maintenance and operation of equipment and facilities for use in the performing arts. Brokerage services do not include services provided by real estate agents and brokers, or insurance agents and brokers.

The definition of SSTB, like many other provisions in the proposed regulations, become effective only when the Treasury publishes final regulations. Taxpayers may, however, rely on these definitions (and certain other specified provisions) until the Treasury publishes final regulations.

Definition of Trade or Business

"Trade or business" is a key term in section 199A; only amounts earned in a qualified trade or business are eligible for the full benefit of the deduction. However, neither section 199A nor its legislative history defines trade or business.

The proposed regulations adopt the definition of trade or business for purposes of Section 162 of the Internal Revenue Code (the "Code"), with modifications. The proposed regulations also aggregate certain related entities into a single trade or business. This extension of the trade or business definition allows more than one legal entity to be treated as conducting a single trade or business for purposes of the section 199A deduction, potentially increasing the amount of a taxpayer's deductible QBI.

The proposed regulations extend the definition of trade or business to include the rental or licensing of tangible or intangible property to a commonly controlled trade or business even if such rental or licensing business does not itself constitute a trade or business under Section 162 of the Code and the case law applying Section 162 to real estate rental activity. Treasury stated that the purpose of this extension is to allow taxpayers that segregate legal ownership of rental or other property from an operating business to aggregate the operating business with such property for purposes of qualifying for the section 199A deduction.

SSTB Related Party Rules

The proposed regulations adopt three rules intended to address arrangements between separate but commonly owned entities engaging in purportedly distinct businesses, one of which includes an SSTB (the SSTB Related Party Rules). Each of the SSTB Related Party

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Rules applies only if an SSTB and an otherwise qualifying trade or business are "related." Businesses are related for this purpose if they share 50 percent or more common ownership. Ownership is determined under special constructive ownership rules under the Code. Under the SSTB Related Party Rules:

1. Any trade or business that provides 80 percent or more of its property or services to a related SSTB is itself treated as an SSTB;
2. A trade or business is treated as an SSTB if (1) it shares expenses (including wages or overhead) with a related SSTB and (2) the trade or business's gross receipts represent 5 percent or less of the total combined gross receipts of the trade or business and the related SSTB during a taxable year; and
3. Even if a trade or business is not treated as an SSTB in its entirety under either of the prior two rules, any portion of a trade or business providing property or services to a related SSTB is treated as part of the SSTB.

Any income earned by a trade or business that is treated as an SSTB (under either of the first two SSTB Related Party Rules) or as part of the related SSTB (under the third SSTB Related Party Rule) will not be QBI. Such income therefore will not be eligible for the section 199A deduction unless the taxpayer's taxable income is less than the previously mentioned applicable threshold.

The SSTB Related Party Rules are effective for any tax year ending after December 22, 2017, the date tax reform was enacted.

Exception for de minimis SSTB

The proposed regulations add a de minimis exception to the definition of SSTB, which was not included in section 199A. Under the exception, a business that generates $25 million or less gross receipts for a taxable year will not be an SSTB if less than 10 percent of its gross receipts are attributable to the performance of services in the fields that are SSTBs. A business that generates more than $25 million of gross receipts for a taxable year will not be an SSTB if less than 5 percent of its gross receipts are attributable to the performance of services in the fields that are SSTBs.

Anti-Abuse Provisions for Trusts

Certain limitations on the section 199A deduction, including the preclusion of the deduction for SSTBs, apply only to taxpayers with taxable income in excess of $315,000 for joint filers and $157,500 for other taxpayers. A non-grantor trust is treated as a taxpayer and is subject to the section 199A limitation only if its income exceeds is $157,500.

The grantor of a grantor trust is treated as directly receiving any QBI received by the grantor trust. The threshold income amounts for a non-grantor trust, on the other hand, are determined at the trust level (without taking into account deductions for trust distributions). Absent an anti-abuse rule, taxpayers could circumvent the income thresholds by creating multiple trusts, each of which would take advantage of its own threshold income amount.

The proposed regulations utilize the authority granted by section 643(f) to prevent taxpayers from establishing or funding multiple non-grantor trusts in order to increase the section 199A deduction. Section 643(f), enacted in 1984, grants Treasury authority to issue regulations treating two or more trusts as a single trust if (1) the trusts "have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries" and (2) "a principal purpose" of the trusts is the avoidance of income tax. For purposes of applying this section, spouses are treated as one person.

The proposed regulations provide a presumption that two or more trusts were formed for a principal purpose of avoiding tax if the establishing or funding of a trust "results in a significant tax benefit unless there is a significant non-tax (or non-income tax) purpose that could not have been achieved without the creation" of the separate trusts. This rule is illustrated in two examples. One example clarifies that two trusts established by the same grantor for the primary of two different children would be respected as two separate trusts. However, another example provides that three separate trusts for four potential beneficiaries would be aggregated as one trust if the separate trusts were for the benefit of more than one beneficiary without further explanation.

The proposed regulations apply to arrangements involving multiple trusts that are entered into or modified after the date that final regulations are published. The proposed regulations take the position, however, that section 643(f) is self-executing and therefore section 643(f) would apply to arrangements entered into prior to the date final regulations are published if appropriate under the statute, guidance and legislative history of section 643(f).

These anti-abuse rules are effective for any tax year ending after December 22, 2017, the date tax reform was enacted.

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PROPOSED SECTION 199A . . .
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Electing Small Business Trusts

An electing small business trust (ESBT) is a special type of trust that is eligible to own stock in an S corporation. Because of language in the statute governing the taxation of ESBTs, some practitioners were concerned that ESBTs might not be entitled to the section 199A deduction. The proposed regulations clarify that an ESBT is entitled to the section 199A deduction in connection with its share of an S corporation's QBI.

Non-Application of SSTB Definitions to Section 1202

Section 199A defines an SSTB, in part, by cross-reference to section 1202(e)(3)(A) (with certain modifications). Section 1202 allows taxpayers to exclude all or part of gain recognized from the sale of certain "qualified small business stock." Similar to section 199A, certain service businesses are not treated as "qualified" for purposes of section 1202. Many practitioners expected that because section 199A defines SSTB, in part, by cross-reference to the section 1202(e)(3)(A) definition of a qualified trade or business, the content of the section 199A regulations would be useful to also provide guidance regarding the application of section 1202. However, Treasury makes clear that the definition of SSTB in the proposed regulations provides "[d]istinct guidance for section 199A" that "applies only to section 199A" and not section 1202.

Adjusted Tax Basis in Pass-Through Entities

Shareholders and partners that are allocated deductions from an S corporation or partnership typically must reduce their tax basis in their shares or partnership interests by the amount of the deduction. Section 199A provides that the section 199A deduction is applied at the shareholder level (for S corporations) or partner level (for entities classified as partnerships). The proposed regulations clarify that the section 199A deduction does not affect a shareholder's or partner's tax basis in an S corporation or partnership.

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The End of Agency Deference: How Amendment 6 Will Impact Florida Tax Law

By H. French Brown, IV, Robert S. Goldman, and Mark E. Holcomb

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Florida voters approved Amendment 6 to the Florida Constitution in the November 2018 midterm election. Amendment 6 requires state court judges and administrative law judges to interpret state statutes and regulations *de novo*, or anew, without deferring to an administrative agency's interpretation of the law. This constitutional amendment ends the state's longstanding doctrine of judicial deference to agency interpretation of the law, which has figured prominently in the development of Florida tax law.[1] This article examines the history of Florida courts' deference to the Department of Revenue's interpretation of the tax laws, and how Amendment 6 will alter the future development of those laws.

Amendment 6 Overview

Amendment 6 bundles a number of discrete constitutional provisions, from creating crime victims' rights to raising state court judges' mandatory retirement age. Tucked away at the tail end of the amendment is a less publicized provision that adds new Section 21 to Article V of the Florida Constitution:

> SECTION 21. Judicial interpretation of statutes and rules.—In interpreting a state statute or rule, a state court or an officer hearing an administrative action pursuant to general law may not defer to an administrative agency's interpretation of such statute or rule, and must instead interpret such statute or rule de novo.

Art. V, §21, Fla. Const. The amendment appears to be self-executing, because it does not require implementing legislation,[2] and becomes effective January 8, 2019.[3]

Amendment 6 was placed on the ballot by the state Constitution Revision Commission, which meets every 20 years to consider and propose state constitutional amendments that are subject to voter approval.[4] The Commission's stated intent is that the provision apply to state court judges and administrative law judges (*i.e.*, "an officer hearing an administrative action pursuant to general law"),[5] even though ALJs are not Article V judges.[6] The inclusion of ALJs is important because a greater number of tax assessments are challenged administratively before ALJs than are contested in circuit court or appellate court.

The concept of *de novo* interpretation of a statute or regulation is well-established in Florida law. The Latin phrase means "over again" or "anew,"[7] in the sense that a legal matter is considered by a judge as though it had not been presented before and no decision previously rendered.[8] In the context of Amendment 6, *de novo* review of a state statute or regulation will require state court judges and administrative law judges to interpret and apply the law independent of a state agency's interpretation, in any proceedings between the agency and a private party.[9]

Agency Deference in Florida Tax Law

Prior to voter approval of Amendment 6, courts (with few exceptions) routinely deferred to agency interpretation of the law:

> [A]n agency's interpretation of a statute it is charged with enforcing is entitled great deference and will be approved by this Court if it is not clearly erroneous.[10]

This doctrine was fostered by a belief that agencies have special expertise in their particular areas of administration or enforcement; the revenue department was no exception.[11]

Florida courts have long afforded the Department of Revenue (and its predecessor, the State Revenue Commission) wide latitude in enforcing the state's tax laws within the bounds set by statute. Since at least the early 1950's, courts have deferred to the Department's interpretation of the tax laws, even if contrary, equally reasonable interpretations of the law favored the taxpayer:

> Although not necessarily controlling, as where made without the authority of or repugnant to the provisions of a statute, the contemporaneous administrative construction of the enactment by those charged with its enforcement and interpretation is entitled to great weight, and courts generally will not depart from such construction unless it is clearly erroneous or unauthorized.[12]

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In *L. B. Price Mercantile Co. v. Gay*, 44 So. 2d 87, 90 (Fla. 1950), the Florida Supreme Court observed that "departmental construction of a taxing statute acquiesced in for a long time by those affected by the statute is entitled to great weight when the statute is reasonably susceptible to two constructions." The Department's regulations, too, received judicial deference, fostering a climate that encouraged expansive rulemaking:

> The administrative rules interpreting the sales and use tax statute, although made by an extra-judicial body, should be accorded considerable persuasive force before any court called upon to interpret the statute. Courts generally will not depart from such construction unless it is clearly erroneous or unauthorized.[13]

These broad pronouncements of judicial deference are seemingly at odds with the equally time-honored maxim that taxing statutes must be strictly construed against the taxing authority, and all doubts or ambiguities resolved in favor of the taxpayer.[14] Some courts attempted to reign in this unbridled enthusiasm for agency deference, holding that deference was appropriate only when a statute is ambiguous, in which case the statute must be construed strongly against the government and in favor of the taxpayer.[15] Contrary to the Florida Supreme Court's observation in *L.B. Price* that deference to the Department's interpretation is appropriate where a statute is reasonably susceptible to two constructions, the appellate court in *Department of Revenue v. Brookwood Associates, Ltd.* took the opposite view:

> Taxing statutes and statutes conferring authority to impose taxes are to be strictly construed. When such statutes are so drawn that the legislative intent is in doubt or where such statutes are so ambiguous as to render the legislative intent questionable or unclear then it is the duty of the taxing authority, and the duty of the courts when litigation arises, to construe such statutes or ambiguities liberally in favor of the taxpayer or citizen and strictly against the taxing authority. If a taxing statute does not reveal with certainty the intent of the legislature and is suceptible [sic] of two meanings, the meaning most favorable to the taxpayer should be adopted. This is particularly true in instances wherein one meaning results in imposing the tax and the other relieves imposition of the tax.[16]

The latter approach seems to be the more widely accepted view in contemporary tax cases.[17]

Effect of Amendment 6 on Future Development of Florida Tax Law

Regardless of the propriety of applying agency deference in tax cases, taxpayers will not face that obstacle in the future. Taxpayers will engage the Department on a more level playing field, without having to battle supposed agency expertise in a particular area of tax law. No longer will a "tie" between two reasonable interpretations of the law favor the Department, nor will the Department be afforded wide latitude in administering the tax laws. Rather, taxpayers will stand on equal footing before the courts.

Conclusion

Amendment 6 should be an invaluable development for taxpayers challenging the Department of Revenue's interpretation of Florida's tax laws. Taxpayers will no longer fight an uphill battle against judicial deference to the agency's interpretation. For assistance with these and other state and local tax matters, please contact a member of our State and Local Tax Team.

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(Endnotes)

1 Under federal law, this doctrine is known colloquially as "*Chevron* deference," in reference to the landmark U.S. Supreme Court decision in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), setting forth the test applied to federal agencies. *Chevron* deference has proven increasingly controversial in recent years, provoking criticism from several U.S. Supreme Court Justices and proposed legislation to end the doctrine.

2 *Gray v. Bryant*, 125 So. 2d 846, 851 (Fla. 1960)("The basic guide, or test, in determining whether a constitutional provision should be construed to be self-executing, or not self-executing, is whether or not the provision lays down a sufficient rule by means of which the right or purpose which it gives or is intended to accomplish may be determined, enjoyed, or protected without the aid of legislative enactment.")

3 Art. XI, §5(e), Fla. Const. (unless otherwise provided, constitutional amendment is effective on first Tuesday after first Monday in January following November election).

4 Art. XI, §2, Fla. Const.

5 The Commission's analysis is available at: http://flcrc.gov/Proposals/Commissioner/2017/0006/Analyses/2017p0006.pre.ex.pdf.

6 Rather, ALJs are executive branch employees of the Department of Management Services, Division of Administrative Hearings. *See* Sections 20.22(2)(f) and 120.65(4), Fla. Stat.; *e.g.*, *Department of Revenue v. WHI Limited Partnership*, 754 So. 2d 205, 206 (Fla. 1st DCA 2000) (recognizing that ALJs are "quasi-judicial officer[s] of a quasi-judicial forum," but are not "judge[s] of a court of competent jurisdiction" for purposes of taxpayer confidentiality statute).

7 *https://www.merriam-webster.com/dictionary/de%20novo*

8 *E.g.*, *Lee v. St. Johns County Board of County Commissioners*, 776 So. 2d 1110, 1113 (Fla. 5th DCA 2001).

9 *See* the Commission's analysis at note 5 above.

10 *Florida Interexchange Carriers Ass'n v. Clark*, 678 So. 2d 1267, 1270 (Fla. 1996).

11 *See*, *e.g.*, *In re Advisory Opinion to the Governor,* 509 So. 2d 292, 311-312 (Fla.1987)("[T]he subordinate factors in complex areas such as taxation should be left to the appropriate agency having expertise and flexibility.")

12 *Gay v. Canada Dry Bottling Co. of Florida, Inc.*, 59 So. 2d 788, 790 (1952); *see also*, *L. B. Smith Aircraft Corp. v. Green*, 94 So. 832, 835 (Fla.1957).

13 *State ex rel. Szabo Food Services, Inc. of North Carolina v. Dickinson*, 286 So. 2d 529, 531 (Fla. 1973); *see also*, *Department of Revenue v. Skop*, 383 So. 2d 678, 679 (Fla. 5th DCA 1980)("It is also settled law in this state that a construction placed on a statute by a state administrative officer is a persuasive force and influential with the courts when not in conflict with the Constitution or the plain intent of the statute").

14 *E.g.*, *Gulf American Land Corp. v. Green*, 149 So. 2d 396, 398 (Fla. 1st DCA 1962).

15 *New Sea Escape Cruises, Ltd. v. Department of Revenue*, 823 So. 2d 161, 163 (Fla. 4th DCA 2002), approved sub nom. *Department of Revenue v. New Sea Escape Cruises, Ltd.*, 894 So. 2d 954 (Fla. 2005).

16 *Department of Revenue v. Brookwood Associates, Ltd.*, 324 So. 2d 184, 187 (Fla. 1st DCA 1975).

17 *E.g.*, *Department of Revenue v. Lockheed-Martin Corp.*, 905 So. 2d 1017, 1020 (Fla. 1st DCA 2005)("Administrative construction of a statute, the legislative history of the statute's enactment, and other extraneous matters are properly considered only when the construction of a statute results in a doubtful meaning").

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