MANAGEMENT & TAX CONCEPTS

FALL 2018

FRINGE BENEFITS: WATCH OUT FOR NEW LIMITATIONS

MORE IN THIS ISSUE...

Nexus could influence your out-of-state business plans

Document storage solutions
Should you use an electronic filing cabinet?

Planning for net investment income taxes

NISIVOCCIA LLP
Certified Public Accountants & Advisors

www.nisivoccia.com
Mount Arlington Office 973-328-1825
Newton Office 973-383-6699

Fringe benefits: Watch out for new limitations

This year, many businesses will begin enjoying substantial tax relief under the Tax Cuts and Jobs Act (TCJA). For 2018 and beyond, the top corporate tax rate has been slashed from 35% to 21%. And qualifying pass-through entities (partnerships, S corporations, LLCs and sole proprietorships) are entitled to deduct up to 20% of their business income.

At the same time, however, the law offsets some of these tax savings with new deduction limits for certain fringe benefits, including employer-provided meals, entertainment and transportation. To fully understand the TCJA's impact on your business, it's critical to evaluate the deductibility of these benefits.

MEALS AND ENTERTAINMENT

Prior to the TCJA, taxpayers were generally permitted to deduct 50% of business-related meal and entertainment expenses. The act retains the 50% deduction for business meals (including employee meals while traveling), but it eliminates most deductions for 1) activities considered entertainment, amusement or recreation, 2) membership dues for clubs organized for business, pleasure, recreation or other social purposes, or 3) facilities (or portions thereof) used regarding the above — though exceptions exist. (See "Meals and entertainment: What's still deductible?" on page 3.)

In some cases, the line between deductible meals and nondeductible entertainment may be blurred. For example, is the separate cost of a meal at a sporting event deductible if substantial business is discussed? Further guidance may be necessary to answer that question.

The TCJA also limits (and eventually eliminates) deductions for employer-provided meals that previously were fully deductible as "de minimis" or "for the convenience of the employer" fringe benefits. These include meals provided so employees can work overtime, meals furnished on or near the employer's premises, and certain expenses associated with operating on-premises eating facilities. The act reduces these deductions to 50% through 2025 and then eliminates them altogether. It doesn't affect the exclusion of these benefits from employees' income, however.

TRANSPORTATION BENEFITS

Prior to the TCJA, employers were permitted to deduct the expense of qualified transportation fringe benefits (QTFBs) and employees could exclude these benefits from their wages, up to a monthly cap. QTFBs include qualified van pools, qualified parking at or near the workplace, transit passes, and qualified bicycle commuting reimbursements. Employers could also arrange for employees to purchase QTFBs with pretax dollars through salary reductions.

The TCJA disallows employer deductions for expenses, payments or reimbursements for 1) QTFBs and 2) employee travel between home and work, except as necessary to ensure employee safety. According to a recently revised IRS publication, deductions are disallowed whether benefits are paid directly, through a bona fide reimbursement arrangement or through a compensation reduction agreement.

Employees may continue to exclude QTFBs (other than bicycle reimbursements) from their wages (up to $260 per month in 2018). The $20-per-month exclusion for qualified bicycle commuting reimbursements is suspended from 2018 through 2025. During that time, employers may deduct those reimbursements. Beginning January 1, 2026, bicycle reimbursements will be nondeductible by employers and excludable from employees' wages.

NEXT STEPS

All businesses should review their benefits programs and expense reimbursement policies with respect to these changes. Even if deductions have been reduced or eliminated, it may be possible to obtain a 100% deduction for meal or entertainment benefits by including them in employees' wages. You might even consider raising employees' compensation to cover their tax increases. In addition to those discussed above, the TCJA also limits tax benefits for employee achievement awards, moving expenses and on-site gyms.

Most businesses will likely continue to provide fringe benefits, regardless of deductibility, as an employee retention tool or, in the case of certain transportation benefits, because they're required by local law. Nevertheless, it's important to understand how the TCJA affects the tax costs associated with employee benefits and to modify your payroll and other systems to ensure that fringe benefit expenses are reported properly for tax purposes. •

Meals and entertainment: What's still deductible?

Although the TCJA limits deductions for many meal and entertainment expenses, several types of expenses remain fully or partially deductible:

- Business meals and meals while traveling on business are 50% deductible.
- Meals and entertainment treated as employee compensation or included in a nonemployee's income are 100% deductible.
- Expenses for recreational or social activities — such as holiday parties, picnics or other outings — are 100% deductible, provided they're primarily for the benefit of employees other than officers, certain owners and highly compensated employees.
- Meals and entertainment provided at employee or stockholder business meetings are deductible. The 50% limit applies to meals, but it appears that entertainment expenses are 100% deductible.
- Expenses related to attendance at Chamber of Commerce or other business league meetings (other than membership dues) appear to be 100% deductible.

Nexus could influence your out-of-state business plans

Your business is considering doing business in another state. You're estimating new income and expenses. But are you fully taking *new taxes* into account?

ACTIVATING NEXUS

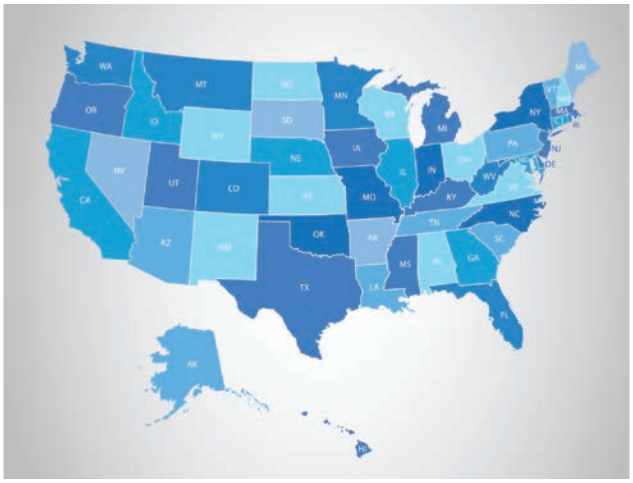
An important question to ask when it comes to facing taxation in another state is: "Do we have 'nexus'?" Essentially, this term indicates a business presence that's substantial enough to trigger that state's tax rules and obligations. Nexus has been and remains the focus of companies considering whether and how they'd be taxed across state lines.

Precisely what activates nexus in that state depends on its chosen criteria. Common triggers include employing workers, using a local telephone number, owning property, and marketing products or services in the state. Depending on state tax laws, nexus could also result from installing equipment, performing services, and providing training or warranty work in the state. This applies either with your own workforce or by hiring others to perform the work on your behalf.

A minimal amount of business activity in a state probably won't create tax liability there. For example, a furnace repairman who makes two calls a year across state lines probably wouldn't be taxed in that state. As with many tax issues, the totality of facts and circumstances will determine whether you have nexus in a state.

OPTING FOR MARKET-BASED SOURCING

If your company licenses intangibles or provides after-market services to customers, you may need to consider "market-based sourcing," instead of nexus, to determine state tax liabilities. However, not all states have adopted market-based sourcing. And states that have adopted this model may have subtly different rules.



Here's how it generally works: If the benefits of a service take place and will be used in another state, that state will tax the revenue gained from that service. "Service revenue" generally is defined as revenue from intangible assets — not the sales of tangible personal property. Thus, in market-based sourcing states, the destination of a service is the relevant taxation factor rather than the state in which the income-producing activity is performed. (This is also known as the "cost of performance" method.)

> *If the benefits of a service take place and will be used in another state, that state will tax the revenue gained from that service.*

Essentially, these states are looking to claim a percentage of any service revenue arising from residents (customers) within their borders. But there's a trade-off: Market-based sourcing states sacrifice some in-state tax revenue because of lower apportionment figures. (Apportionment is a formula-based approach to allocating companies' taxable revenue.) But these states feel that, even with the loss of some in-state tax revenue, they'll see a net gain as their pool of taxable sales increases.

PLANNING AHEAD

If your company is considering operating in another state, you'll need to look at more than logistics and market viability. A nexus study can provide insight into potential out-of-state taxes to which your business activities may expose you. There's a possibility that, because of differing state rules, you may find yourself subject to tax in more than one state.

If that happens, you'll need to navigate the rules with caution to determine how best to reconcile the inconsistencies. Once all applicable income, sales and use, franchise and property taxes are factored into your analysis, the effect on profits could be significant.

Bear in mind that the results of a nexus study may not be negative. If you operate primarily in a state with higher taxes, you may find that your company's overall tax liability is lower in a neighboring state. In such cases, it may be advantageous to create nexus in that state by, say, setting up a small office there. If all goes well, you may be able to allocate some income to that state and lower your tax bill.

NOT A SIMPLE DECISION

Issues surrounding nexus and market-based sourcing are somewhat complicated. Knowing the rules is critical. Contact your CPA to discuss the options. •

Document storage solutions

Should you use an electronic filing cabinet?

It's a tough challenge that almost every adult faces: storing financial and tax documents. Not only is there confusion about which documents to keep, and for how long, but people also wonder *how* they should store and retain these records.

Traditionally, important financial documents have been stored in paper form in a filing cabinet, fireproof safe or bank safe deposit box. But in the digital age, electronic document storage — also sometimes referred to as "electronic filing cabinets" — is gaining in popularity.

PLUSES OF ELECTRONIC STORAGE

There are many potential benefits to electronic document storage. Perhaps the biggest is a reduction in the amount of paper that must be sorted, organized and stored manually. Also, you can conduct a keyword search for documents that reside in an electronic filing cabinet. That's, of course, better than manually searching for paper documents that may or may not have been filed correctly.

Documents stored digitally tend to be more secure than paper documents. Electronic filing cabinets can be password protected. And they aren't as vulnerable to damage or destruction by floods, fire or other disasters — especially when you back them up on the cloud.

In addition, electronic documents can be digitally date-stamped, which helps ensure that you're accessing the most recent versions. You can easily track edits to electronic files, monitor who's been viewing them and restrict access to sensitive documents.

Electronic filing cabinets usually work in tandem with a scanner, which is used to convert paper documents into digital versions such as PDF files.

Most paper documents can be shredded once they've been digitized. However, you may want to retain paper versions of estate planning documents such as wills and trusts.

WEB-BASED OR SELF-HOSTED?

There are two main types of electronic document storage: Web-based systems and self-hosted systems. Web-based systems use the Internet to store documents in the cloud. Self-hosted systems store documents on a computer, external hard drive or portable drive (such as a USB thumb drive) kept in the home or office. Each option has advantages and drawbacks.

Web-based systems tend to be highly secure — data storage facilities typically use the most sophisticated encryption technologies to keep your files safe. Cloud storage also is inexpensive. For example, up to 50 gigabytes of data can be stored on iCloud for 99 cents per month. But, if your hosting service is interrupted for any reason, you could lose access to your files for a period.

With a self-hosted system, you'll be responsible for storing documents on your own computer or hard drive. This eliminates the chance that a lost Internet connection or service interruption at your host could restrict access to your files. But you also run the risks of:

- A computer crash,
- Computer or hard drive damage due to a fire or flood, or
- Loss of a flash drive.

If any of these happen, all your files could be lost if they're not backed up properly. Regular, periodic backups are essential.

Whether self-hosted or Web-based, it's also a good idea to be sure that at least one other person knows how to access your information. That way it'll still be available even if you become incapacitated or are otherwise unable to retrieve the data.

EFFICIENCY BECKONS

If you still save hard copies of some documents, consider going fully electronic. You're likely to feel less overwhelmed by the task of organizing and storing all that paper. Not only might this be a more efficient storage solution, but a more environmentally friendly one as well. •

Planning for net investment income taxes

Despite its name, the Tax Cuts and Jobs Act (TCJA) left several taxes unchanged, including the 3.8% tax on net investment income (NII) of high-income taxpayers. Fortunately, there are some strategies you can use to soften the blow of NII taxes.

ARE YOU SUBJECT TO THE TAX?

You're potentially liable for NII taxes if your modified adjusted gross income (MAGI) exceeds $200,000 ($250,000 for joint filers and qualifying widows or widowers; $125,000 for married taxpayers filing separately). Generally, MAGI is the same as adjusted gross income. However, it may be higher if you have foreign earned income and certain foreign investments.

To calculate the tax, multiply 3.8% by the *lesser* of 1) your NII, or 2) the amount by which your MAGI exceeds the threshold. For example, if you're single with $250,000 in MAGI and $75,000 in NII, your tax would be 3.8% × $50,000 ($250,000 - $200,000), or $1,900.

NII generally includes net income from, among others, taxable interest, dividends, capital gains, rents, royalties and passive business activities. Several types of income are excluded from NII, such as wages, most nonpassive business income, retirement plan distributions and Social Security benefits. Also excluded are alimony and nontaxable gain on the sale of a personal residence.

PLANNING STRATEGIES

Given the way the NII tax is calculated, you can reduce the tax either by reducing your MAGI or reducing your NII. Consider:

- Deferring income to next year or accelerating expenses into this year,
- Reducing your capital gains by selling investments at a loss,
- Decreasing your MAGI by maximizing contributions to IRAs and qualified retirement plans, or
- Investing in tax-exempt municipal bonds or in growth stocks that pay little or no dividends.

You also might be able to transfer assets that generate investment income (either directly or in trust) to lower-income family members who aren't subject to NII tax. With this strategy, though, be careful not to inadvertently create a NII tax because of the transfer. Trusts and, for this year through 2025, individuals subject to the "kiddie tax" (generally, children under 19 or, for full-time students, 24) have a dramatically lower income threshold level at which NII tax applies.

If you own rental real estate, talk to your tax advisors about how you can avoid NII tax and obtain other tax benefits by qualifying as a materially participating "real estate professional."

If you hold interests in pass-through entities — such as partnerships, LLCs and S corporations — it's important to consider the interplay between NII taxes and other taxes. For instance, it may be possible to avoid NII taxes by increasing your level of participation to convert a pass-through investment from passive to nonpassive. But in some cases, doing so may also trigger self-employment (SE) or payroll taxes, so it's important to weigh the NII tax savings against the potential SE or payroll tax costs.

> *Given the way the NII tax is calculated, you can reduce the tax either by reducing your MAGI or reducing your NII.*

HANDLE WITH CARE

There are many potential strategies for reducing NII taxes, but it's important to consult with your tax advisor before you implement them. Tax reduction is an important objective, so long as it doesn't come at the expense of prudent investment decision-making. •

This publication is distributed with the understanding that the author, publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters, and, accordingly, assume no liability whatsoever in connection with its use. ©2018 MTCfa18

DONATIONS
DONATIONS
CITY HALL
SCHOOL

EXPERIENCE You Can Count On

In order to succeed in today's complex business environment, expert advice and solid financial results you can trust are critical to your operations. Through proactive strategies and innovative solutions, we provide quality accounting, auditing, tax and business advisory services to help you understand and optimize results so your organization can succeed.

At Nisivoccia LLP, we put our clients first. Our partners and professional staff will understand your operations, priorities and goals and then work as part of your team to achieve success through advice you can understand, results you can bank on and strategies that make business sense.

Client Industries

Established in 1970, we have proudly earned a reputation for integrity, personal service and dependability. Our years of experience coupled with our specializations enable us to fully understand our client's needs and provide the most beneficial solutions and advice.

Our industry focus includes:

- Construction Contractors
- Employee Benefit Plans
- Governmental Entities
- Manufacturing and Distribution
- Medical, Dental Providers & Facilities
- Not-for-Profit Organizations
- Private Enterprises & Family Owned Businesses
- Real Estate Developers & Managers

Personalized Services to Meet Your Individual Needs

Because each client has a unique situation, Nisivoccia LLP offers a complete set of services that spans all business applications and industries. Our firm will identify, personalize and deliver the right services so you can succeed.

- Accounting & Auditing
- Business Valuation
- Financial Planning & Wealth Management*
- Fraud and Forensics
- Management Advisory Services
- Tax, Trust and Estate Planning
- Technology

For additional information about our services, please visit: www.nisivoccia.com

*Offered through Nisivoccia Wealth Advisors LLC
Securities offered through 1st Global Capital Corp, Member FINRA/SIPC
Investment Advisory services offered through 1st Global Advisors, Inc.
Insurance services offered through 1st Global Insurance Services, Inc.

BKR INTERNATIONAL

*Nisivoccia LLP is an independent member of BKR International.
Through our affiliation with BKR we are able to serve clients worldwide.*

NISIVOCCIA LLP
Certified Public Accountants & Advisors
Mount Arlington Office: 973.328.1825 | Newton Office: 973.383.6699
www.nisivoccia.com

Exceeding client expectations for over 40 years.