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TAX AND TRUSTS & ESTATES UPDATE

December 2018

Charitable Giving in 2018 under the Tax Cuts and Jobs Act of 2017

The passing of the Tax Cuts and Jobs Act of 2017 (the "2017 Act"), the largest tax reform act since 1986, at first created confusion and uncertainty for both taxpayers and charities alike. What would changes to the standard deduction mean for taxpayers? Could donors still reap the benefit of a deduction for charitable giving? Would the countless worthy causes supported by donations suffer? Although the 2017 Act's impact cannot fully be quantified yet, one thing is clear: changes to the tax code create an opportunity for donors to assess and consider their philanthropic giving.

Changes in the Standard Deduction and "Bunching" Donations

Perhaps the most significant two changes most taxpayers will encounter with regard to charitable donations are the 2017 Act's increase in the standard deduction ($12,000 for single filers and $24,000 for married couples, up from $6,350 and $12,700) and the $10,000 cap on deductions for state income and property taxes. For donors whose deductible expenses, such as mortgage interest or real estate taxes, are less than the standard deduction, they may no longer receive the full benefit of additional itemized charitable deductions. For example, a married couple with state taxes of $10,000 or more and mortgage interest expense of $10,000, who make annual charitable gifts of $10,000, will, in effect, lose $4,000 of charitable deduction benefits and will only get an additional tax deduction of $6,000 from their $10,000 charitable gifts. This is because the state tax deduction of $10,000 plus the mortgage interest deduction of $10,000 plus the charitable deduction of $10,000 will total only $6,000 more than the $24,000 standard deduction.

However, donors who are unable to take full advantage of their annual charitable deductions because of the increased standard deduction, may benefit greatly by setting up a Donor Advised Fund (DAF) and bunching their anticipated charitable donation over the next two or more years, in the DAF this year. "Bunching" describes the practice of concentrating charitable giving in certain years. Donors who might otherwise lose a substantial part of their charitable deduction due to the large standard deduction might instead make a large donation to their DAF every few years to fund not only the current year's charitable gifts but anticipated charitable gifts in future years. When the DAF is low on funding in a future year, another larger contribution could then be made.

Using the above example of the same married couple who gives $10,000 per year to charity, the donors lost the benefit of $4,000 of the charitable deduction each and every year. However, instead of making their usual gifts of $10,000 each year, the couple could bunch three years' of giving into one

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$30,000 gift to a DAF in a single year. By doing this, they now exceed the standard deduction in this year by $26,000. The next few years of charitable gifts can be made from the DAF, which can be replenished every few years with additional contributions. After obtaining the immediate tax benefit in year one, the couple may continue to benefit from bunched donations every few years. Additionally, to most efficiently maximize this bunched donation, donors may look to make their gifts to the DAF with long-term appreciated marketable securities, providing a charitable deduction based on the fair market value of the appreciated securities.

Donor Advised Funds and Pledges

In December 2017, the IRS issued new guidance indicating that DAFs may be used to fulfill pledges to charitable organizations. Donors still may not receive more than an incidental benefit for such donations, but the new guidance permits DAF holders to recommend a grant to satisfy a pledge to a qualified non-profit organization.

Qualified Charitable Distributions

The 2017 Tax Act did not change the ability of donors over the age of 70½ to donate their required minimum distributions (RMD) from an IRA to a charitable organization.

Finally, for donors making larger cash gifts, the 2017 Act increased the limitation on deductibility from 50% to 60% of a donor's adjusted gross income.

If You Want to Make Gifts to Charities or Others in 2018, Be Sure Those Gifts are "Completed" this Year for Tax Purposes

As the year end approaches, many of you may want to make charitable gifts that can be deducted this year, or gifts to family or friends to use the 2018 annual gift-giving exclusion ($15,000 per recipient).

If you're a "last minute" gift-giver, how can you ensure that your gift will conclusively be "made" in 2018?

In all events, you must unconditionally deliver the gift to the recipient (or an agent of the recipient) in 2018.

- A charge to a credit or debit card in favor of the recipient in 2018 is a completed gift.

- Delivery of an endorsed stock certificate to the recipient or an agent of the recipient in 2018 is a completed gift. Delivery of an endorsed stock certificate to anyone else (e.g., your stockbroker, or the corporation's transfer agent) is not good enough, unless the transfer is actually recorded on the corporate books in 2018.

- A check mailed to a charity in 2018 is good enough. But if you are making a gift to an individual, the check should be paid, certified or accepted by the bank for payment, or negotiated to a third party for value before the end of 2018. The IRS may (but don't rely on this when you make your 2018 gifts) view the gifts as consummated in 2018 if the check was unconditionally delivered in 2018 (and intended to be a gift), presented at the bank for payment within a reasonable period of time after delivery, and honored while the donor was alive (IRS Revenue Ruling 96-56).

Remember that just dating a check in 2018 will not in and of itself be enough under any circumstances.

And if you are considering gifts with any complications (e.g., through trusts, etc.), you need to get started immediately if you want to consummate those gifts by year end.

Finally, given the higher standard deduction, you should consult your tax advisor before you make your year-end charitable gifts. It may make sense to accelerate 2019 gifts into 2018, or to defer 2018 gifts into 2019, depending upon which year is expected to have larger itemized deductions for you. Please see the article, *Charitable Giving in 2018 under the Tax Cuts and Jobs Act of 2017*, included in this issue.

2019 Inflation Adjustments for Tax Items

With the new year will come new inflation adjustments for several tax-related items. Some of the more significant changes that will take effect on January 1, 2019 (and noteworthy items that have remained unchanged) are listed below.

Estate and Gift Adjustments

Estate, Gift and Generation-Skipping Transfer (GST) Tax Exemption. The estates of decedents dying in 2019, as well as gifts made in 2019 above the annual exclusion, will have an aggregate exemption of $11.4 million (up from $11.18 million in 2018). The GST exemption also increases to $11.4 million in 2019 (up from $11.18 million in 2018).

Annual Gift Tax Exclusion. The annual gift tax exclusion for 2019 remains $15,000. The annual gift tax exclusion for gifts to a spouse who is not a United States citizen will be $155,000 (up from $152,000).

Personal Income Tax Adjustments

Application of the Highest Tax Rate. The tax rate of 37% affects single filers whose income exceeds $510,300 (up from $500,000) and $612,350 for married joint filers (up from $600,000).

Standard and Itemized Deductions. The 2019 standard deduction rises to $12,200 for single filers and $24,400 for married couples filing jointly (up from $12,000 and $24,000, respectively).

Beginning in 2018, and continuing in 2019, itemized deductions are no longer subject to an in overall limitation with respect to adjusted gross income exceeding specified thresholds.

Personal and Dependent Exemption. Taxpayers are no longer allowed personal or dependent exemptions for tax years beginning January 1, 2018 through 2025. Prior to 2018, taxpayers had been allowed a personal exemption, as well as exemptions for dependents, subject to certain phase outs at higher income levels.

Alternative Minimum Tax. The Alternative Minimum Tax exemption amount for taxable year 2019 is $71,700 for single filers (up from $70,300) and $111,700 for joint filers (up from $109,400).

Retirement Saving Adjustments

Retirement Plan Contribution Limits. The 2019 contribution limit for 401(k), 403(b) and 457 plans is $19,000 in 2019 (up from $18,500 in 2018), with the additional catch-up contribution limit for these plans for taxpayers who are age 50 or older remaining at $6,000. The maximum contribution to IRAs has increased to $6,000 (up from $5,500), with the additional catch-up contribution limit for taxpayers who are age 50 or older remaining at $1,000.

Deduction for Traditional IRA Contributions. The deduction for a traditional IRA for single people and heads of household covered by a workplace retirement plan will phase out at adjusted gross income between $64,000 and $74,000 (up from between $63,000 and $73,000). For married couples filing jointly, the income phase-out will be between $103,000 and $123,000 when the IRA contributor is covered by a workplace retirement plan (up from between $101,000 and $121,000), and between $193,000 and $203,000 (up from between $189,000 and $199,000) when the IRA contributor is not covered at work but is married to someone who is.

Maximum Roth IRA Contributions. For Roth IRAs, the income phase-out range is between $193,000 and $203,000 for married couples filing jointly (up from $189,000 to $199,000). For singles and heads of household, the income phase-out range is $122,000 to $137,000 (up from $120,000 to $135,000). For a married individual filing a separate return who is covered by a workplace retirement plan, the income phase-out range remains $0 to $10,000.

The New Qualified Business Income Deduction – Still Lots of Uncertainty

A new deduction, referred to as the Section 199A Deduction, was created as part of the Tax Cuts and Jobs Act of 2017. This deduction benefits non-corporate taxpayers by potentially providing a 20% deduction against income from a domestic business operated as a sole proprietorship or through an S corporation, partnership or limited liability company classified as a partnership for federal income tax purposes. While the provision contemplates a maximum 20% deduction, the calculation of the actual deduction, if any, available to a particular taxpayer is complex. Further complicating matters, the statutory rules delineating which types of income and businesses qualify for the deduction are imprecise. In August, the IRS issued proposed regulations which provided guidance to address much, but not all, of the uncertainty regarding the operation of this new deduction. A high level overview of the Section 199A Deduction is provided below.

Taxpayers Eligible to Claim the Section 199A Deduction

The Section 199A Deduction generally may be claimed by an individual, trust or estate that owns a sole proprietorship, or an interest in an S corporation, partnership or limited liability company treated as a tax partnership.

Income which May Be Offset by the Section 199A Deduction

The Section 199A Deduction is available to offset only "qualified business income." Generally, qualified business income is the net amount of items of income, gain, deduction and loss which are effectively connected with the conduct of a "qualified trade or business." Qualified business income generally does not include capital gains and losses, certain dividends and interest income, compensation for services, and guaranteed payments to a partner. Income from qualified real estate investment trusts and qualified publicly traded partnership income may be eligible for a Section 199A Deduction.

For purposes of the Section 199A Deduction, a "qualified trade or business" is any U.S. trade or business other than: (i) a "specified service trade or business" ("SSTB"); or (ii) the business of performing services as an employee. In addition, the rental or licensing of tangible or intangible property to certain related trade or businesses is treated as a qualifying trade or business.

The scope of the qualified trade or business classification is significantly limited by the exclusion of SSTBs. An SSTB is any trade or business involving the performance of services in certain fields, including health, law, accounting, performing arts, consulting, athletics, financial services, and brokerage services. The businesses of investing and investment management, trading, or dealing in securities, partnership interests or commodities are also SSTBs. Engineering and architectural services are expressly excluded from SSTB classification.

In addition, there is a catch-all category under which "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" is a SSTB. While there is concern that this provision could be interpreted broadly, the proposed regulations narrowed the definition to generally apply to a trade or business in which a person receives fees, compensation, or other income for: (i) endorsing products or services; (ii) the use of an individual's image, name, trademark or other symbol associated with his or her identity; or (iii) appearing at an event or on radio, television or other media format.

Businesses which would not themselves be categorized as SSTBs may be nonetheless treated wholly or partially as SSTBs, if they provide property or services to certain related SSTBs.

Because an SSTB is not a qualified trade or business, its income is generally not subject to offset by the Section 199A Deduction. Nonetheless, there are two exceptions. First, the SSTB exclusion does not apply to taxpayers with taxable income below a threshold amount ($315,000 if married filing jointly and $157,000 for all other taxpayers in 2018). Second, a trade or business will not be considered an SSTB if it provides only a small amount of prohibited services (less than 5% or 10%, depending on whether gross receipts exceed $25 million).

Calculation of the Section 199A Deduction

In general, and subject to thresholds and netting and aggregation rules, the Section 199A Deduction is equal to the lesser of:

1) 20% of qualified business income; or
2) the greater of:
   a) 50% of the total W-2 wages attributable to the qualified trade or business; or
   b) the sum of 25% of the W-2 wages attributable to the qualified trade or business plus 2.5% of the unadjusted basis of certain property held and used by the business for production of qualified trade or business income.

In no event, however, may a Section 199A Deduction exceed 20% of a taxpayer's taxable income reduced by net capital gains. As such, a taxpayer with significant investment losses may have limited ability to claim an otherwise available Section 199A Deduction.

The wage and property based limitations described above do not apply to taxpayers with taxable income below $315,000 for married individuals filing jointly and $157,500 for other taxpayers in 2018. There is a phase-out for taxable income over the threshold amounts.

Conclusion

This discussion is intended to be a general overview of the Section 199A Deduction. The availability of the deduction, and its operational rules, are complex and remain subject to uncertainty even after the recent issuance of proposed regulatory guidance. Potential workarounds to maximize the amount of available deduction may be possible. Owners of sole proprietorships and interests in partnerships, limited liability companies and S corporations should carefully examine the application of the Section 199A Deduction to their particular situation.

Breaking New Jersey News – New Jersey Offers Tax Amnesty until January 15, 2019

New Jersey just recently announced a tax amnesty for state taxes due on or after February 1, 2009, through September 1, 2017. This amnesty can potentially apply to assessed but unpaid balances, as well as to taxes that have not yet been reported. The amnesty program does not forgive the taxes, but it can result in the waiver of most penalties and interest.

More information can be found on the state's website at https://taxamnesty.nj.gov/.

Anyone who might be eligible for the amnesty should consult their tax attorneys or accountants at their earliest convenience.

More Tax Accounting Options for Small Businesses in 2018

The Tax Cuts and Jobs Act enacted in December 2017 permits more small businesses to use the cash method of tax accounting. This method of tax accounting may be advantageous to taxpayers who would benefit from recognizing income and expenses in the tax year during which that income is received and those expenses are paid.

Effective for tax years beginning on or after January 1, 2018, small business taxpayers with average annual gross receipts of $25 million or less for the three prior tax years may report taxable income using the cash method of tax accounting. For tax years beginning on or after January 1, 2019, the threshold increases to $26 million. These are significant increases over the pre-2018 threshold of $5 million in average annual gross receipts. In addition, the 2017 legislation provides small business taxpayers with an exemption from certain accounting rules for inventories, cost capitalization and long-term contracts.

In August, the IRS issued Revenue Procedure 2018-40, which sets forth the procedures for obtaining an automatic consent to change tax accounting methods to take advantage of the new legislation.

New Jersey has Challenged the Limit on Federal Deduction for State and Local Taxes – Stay Tuned

The Tax Cuts and Jobs Act enacted in December 2017 placed a $10,000 cap on an individual's annual federal deduction for state and local taxes, with no carryover for taxes paid in excess $10,000. Not surprisingly, this was disadvantageous for taxpayers in states, such as New Jersey, with high state and local taxes.

To mitigate the effect of these new rules, some states, including New Jersey, enacted workarounds that would have allowed donations to local government organizations to offset federal taxable income. In response, the federal government issued proposed regulations which effectively negated the benefit of these workarounds.

In another attempt to provide relief from the drastic limitation on deductions, New Jersey, along with New York, Connecticut and Maryland, has taken the federal government to court to challenge this limitation on constitutional, historical and policy grounds. The federal government, however, has moved to dismiss the lawsuit, contending that the states cannot properly contest this limitation on deduction and that, instead, affected taxpayers should pay the tax then request a refund.

New Jersey Sales Tax Update

As of November 1st, New Jersey began collecting sales tax on on-line sales from vendors whose New Jersey sales exceed certain thresholds. Historically, internet sales were only subject to sales tax in states in which the seller had a physical presence. Sellers who did not have the requisite physical presence in New Jersey were not required to collect and remit New Jersey state sales tax. In June, however, the U.S. Supreme Court ruled that a state could impose sales tax based upon an economic connection to the state, absent a physical presence. Many states, New Jersey among them, have expanded their sales tax collection policies in response to the Supreme Court ruling. New Jersey will now impose sales tax collection and remittance obligations on any seller who, during the current or prior calendar year: (i) has gross revenue from sales of tangible personal property, specified digital products, or services delivered into New Jersey exceeding $100,000; or (ii) has sold tangible personal property, specified digital products, or services delivered into New Jersey in 200 or more separate transactions. Sales tax upon sales by vendors with a physical presence in New Jersey has not been changed.

Another Reminder About IRS Revised Partnership Audit Procedures

In August, the IRS published final regulations clarifying and enhancing the Revised Partnership Audit Procedures, which went into effect on January 1, 2018. The Revised Partnership Audit Procedures significantly changed the manner in which partnership tax audits and deficiency proceedings and collections are conducted. Limited liability companies that are treated as partnerships for federal income tax purposes are similarly subject to these new rules. Accordingly, references in this discussion to partners and partnerships shall likewise refer to members and limited liability companies.

Under the prior partnership tax regime, applicable for tax years beginning prior to January 1, 2018, assessments of tax underpayments (including related interest and penalties) were collected only at the partner level. For tax years beginning on or after January 1, 2018, the Revised Partnership Audit Procedures provide that, unless an exception applies, audits will be conducted against the partnership, and any “imputed underpayments” of tax, interest and penalties will be collected from the partnership itself. As a result, with respect to tax years beginning on or after January 1, 2018, partners in a partnership may find themselves indirectly bearing a tax liability which, under the prior partnership tax regime, would have been borne by former partners in the partnership. Furthermore, because imputed underpayments are generally calculated using the highest tax rate for the tax year under review, the imputed underpayment may overstate the amount of tax that would have been due if the partnership adjustments had been properly reported. There are several options to address these undesirable consequences.

First, certain partnerships with no more than 100 partners can make an annual “opt-out” election on a timely filed partnership tax return. The opt-out election is generally available only to partnerships where each partner is an individual, C corporation, S corporation, or estate of a deceased partner. If any of the partners is another partnership or a trust, the partnership cannot elect out of the new regime. For purposes of the 100-partner test, S corporation shareholders are counted individually.

Second, if a partnership becomes subject to an audit and is issued a final partnership adjustment (“FPA”), it may make a “push-out” election to have the assessment made against the persons who were partners during the tax year under audit. This election must be made by the partnership within 45 days of receiving the FPA and the partnership must provide the IRS with a statement of each such partner’s share of any adjustment to income, gain, loss, deduction, or credit. The partners need not amend their prior year tax returns to reflect the adjustment but must pay their share of the deficiency with the return for the tax year in which the FPA is issued. Note, except as set forth below, the deficiency is calculated at the highest tax rate for the year under review and doesn’t account for the particular tax position of the partner in the year in question.

Third, a partnership can reduce the amount of an imputed underpayment to the extent partners file amended returns for the tax year under audit and pay the corresponding tax due. To implement this, the partnership must submit information to the IRS sufficient to modify the imputed underpayment within 270 days of receiving the notice of proposed partnership adjustment.

Finally, partners may contractually provide for indemnification provisions in their partnership agreement to ensure that the ultimate responsibility for any tax assessment is borne by the partners in the year with respect to which the tax was assessed. Without this, the tax responsibility will generally fall on the partners in place at the time of the deficiency notice.

Under the Revised Partnership Audit Procedures, each partnership is required to designate a “partnership representative.” The partnership representative replaces the “tax matters partner” and can be any person who has “substantial presence” in the United States. To have “substantial presence”, a person must have a U.S. taxpayer identification number, a U.S. phone number and a U.S. address and must be reasonably available to schedule phone calls and meet with the IRS and make the books and records of the partnership available to the IRS. The partnership representative may be an individual, including a non-member, or an entity. If an entity is designated, the partnership must appoint an individual (who has substantial United States presence) to act for such entity. The partnership representative has sole authority to act on behalf of the partnership and bind the partners and the partnership in all interactions with the IRS, including with respect to tax audits. The partnership representative also has authority to make tax elections under, and otherwise implement, the Revised Partnership Audit Procedures. Therefore, partners should confirm that their partnership agreement appoints a qualified and trustworthy partnership representative and provides for the orderly replacement of the partnership representative. In addition, because the Revised Partnership Audit Procedures significantly curtail the ability of partners to participate in an audit or litigation with the IRS, partners may wish to revise their partnership agreements to contractually define the rights and obligations of the partnership representative vis-a-vis the partners with respect to tax audit, assessment and collection procedures.

Partners should review their partnership agreements to ensure that they address the Revised Partnership Audit Procedures. Consideration must be given to the level of authority granted to the partnership representative and the potential for partners to shoulder the tax burden of assessments from underpayments arising in years in which they were not partners. In addition, persons engaging in partnership acquisitions or dispositions must consider the impact of the Revised Partnership Audit Procedures to avoid an unwanted shifting of responsibility for partnership tax adjustments from former partners to the partners in place at the time of a tax adjustment. After review of their current partnership agreements, partners should make any modifications necessary to ensure that their agreements continue to reflect their intentions with respect to each partner's rights and obligations in light of the recent legislative changes.

A Note about the Registration of New Jersey Private Foundations

Pursuant to the New Jersey Charitable Registration and Investigation Act of 1994 (the "CRI Act"), all charities that (i) have been granted a Section 501(c)(3) tax exemption from the IRS, (ii) are domiciled in New Jersey, and (iii) solicit New Jersey residents for donations must register with the Charities Registration Section of the New Jersey Department of Consumer Affairs. Such charities are also required, on an annual basis, to renew their CRI Act registration and, in the course of doing so, provide certain financial information related to their activities. A public directory is available on the website of the Department of Consumer Affairs listing those charities that have complied with the foregoing requirements.

New Jersey private foundations that do not accept donations from anyone other than the founder (or founders) and do not conduct activities other than making gifts to public charities are generally exempt from this filing requirement. However, they are frequently being listed as "non-compliant" on the Consumer Affairs website for having failed to submit annual filings. Being listed as "non-compliant" will not necessarily result in any adverse consequences to a private foundation (assuming it meets the requirements for the filing exemption). Nevertheless, many foundation founders and foundation personnel are distressed to see their foundations listed as "non-compliant" on a public, state-sponsored site.

While the registration forms can be a bit onerous, if you want your private foundation to be listed as "compliant" on the state website, the best option is to simply file the annual forms and take comfort in knowing that anyone who decides to search for your foundation's information on the state's website will see the foundation reflected as "compliant."

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