Tax Law Updates, Tips, and Tools

Timber Tax Presentation 2020

Matthew P. Broyles, CPA

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Recent Tax Bills

Tax Cuts and Jobs Act (TCJA)

- Signed into law Dec. 22, 2017
- Known as the "Trump" tax law
- Reformed many provisions of individual and business tax code
- Focused on economy boosting and simplifying tax code

Further Consolidated Appropriations ACT, 2020

- Signed into law Dec. 20, 2019
- Included two separate tax provisions:
  - Setting Every Community Up for Retirement Enhancement Act (SECURE Act)
  - Taxpayer Certainty and Disaster Tax Relief Act of 2019 (Disaster Act)

A&R AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Tax Cuts and Jobs Act – Individuals

- Lower tax rates
- Increased Standard deduction – essentially doubled
- Removed Personal Exemption deductions
- New/Higher dependent credits
- Multiple Changes to Itemized Deductions
  - SALT (state and local taxes) deduction limited to $10k
  - Removal of miscellaneous deductions subject to 2%
- Individual health care penalty revoked indefinitely
- Increased Estate & Gifting exclusions

A&R AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Tax Cuts and Jobs Act – Individual Planning

- Standard Deduction/Itemized Deduction strategies
  - Donate through a Qualified Charitable Distribution from your IRA
  - Find ways to utilize state & local taxes (i.e. real estate) as business deductions
  - Minimize investment expense exposure (broker fees, hobby expenses, unreimbursed employee expenses)
  - Capitalize certain taxes and other carrying costs related to now non-deductible expenses pertaining to real estate
  - Use a Health Savings Account (HSA) to maximize medical deductions

Tax Cuts and Jobs Act – Business

- Corporate tax rates dropped to a flat 21%
- Disallowance of business loss carryback claims (known as Net Operating Loss or NOL)
- 1031 exchange (Like-Kind) no longer allowed for non-real estate assets
- Increased depreciation allowances
- Added Qualified Business Income deduction (Sec 199a or pass-thru deduction) – 20% of your net business income
  - Complicated tax rule structure and extensive record keeping required
  - Limitations based on various criteria including high income & specified trades
- Loss of certain meals and all entertainment expenses

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Tax Cuts and Jobs Act – Business Planning

- Maybe being a Corporation isn't so bad – forget the S-Election depending on certain factors
  - Highest Individual rate – 37% vs. Corporate 21% plus Dividend 15% = 36%
- Take advantage of fast equipment write-offs to leverage cash flows in growing business
- Alter your expense reimbursement structure – stay away from meals and meals per diem
- Qualified Business Income deduction
  - A high income individual may benefit from paying wages to employees vs. contract labor
  - Ensure your business type falls outside of a specified trade subject to limitations

A&R AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

SECURE Act

- Focused on altering retirement tax laws to encourage participation in retirement plans
  - Bumped up Required Minimum Distributions (RMD) from 70 ½ to 72 years of age
  - IRA contributions now allowed past RMD age
  - Penalty-free withdrawal from IRA for child births up to $5k
  - Sped up death beneficiary distributions for non-spouses and non-exceptions individuals
  - Added incentives and tax credits for small employers to participate in retirement plans
  - **Non-retirement related – Law increased various penalties including Failure to File penalty.

Taxpayer Certainty and Disaster Tax Relief Act of 2019

- Provided disaster relief tax advantages for those effected by storms occurring in 2019
- Extended numerous tax code items expiring in 2019
  - Mortgage Insurance premiums includable in mortgage interest deduction
  - Medical deduction floor of 7.5% (from 10%)
  - Tuition & related expenses above the line deduction
  - Various energy credits
  - Exclusion of qualified principal residence indebtedness discharge of income

AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Timber Tax Takeaways

So how exactly does any of this information help you – timber business and timberland owners?

To the Forester…

- There seems to be a lot of time spent out of office, driving around, eating out, etc.
  - If you are an employee and your company does not reimburse you or provide a company vehicle – all your dollars spent out of your own pocket are no longer deductible.
- If you are on your own (independent contractor), the QBI deduction now applies to you. Are you getting the most out of your deduction?
  - An S-Corporation forester with a high income, may not benefit from paying small wages – QBI deduction will phase out
    - There is a trade-off between paying Social Security & Medicare taxes vs. Income Taxes
      - Which one of these actually provides a benefit?

A&R | AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

To the Landowner…

- Passing it on – now might be the time to start moving property down the family tree.
  - The Estate and Gifting exclusion jumped from $5 million to $11 million with the Trump tax law – but here's the real kicker:
    - If you gift $11 million now (tax free) – you will not be taxed if the exclusion ever falls again (such as when the current law expires after 2025)
    - The downside to this, historically, estate exemptions typically do not fall, but note this was the largest increase to date.
- What Investment?
  - Your timberland needs to be a tree farm or timberland business operation, not an investment. If not, your investment expenses are no longer usable as ordinary deductible expenses.

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

To the Landowner…

- Paint the right picture
  - Make sure expenses such as interest expense, property taxes, utilities, etc. are being used appropriately and effectively where blurred lines exist
    - These types of expenses not used in conjunction with a business are just lost
  - If it looks, smells and tastes like a business – the IRS agent will go home (maybe)
    - Material participation
    - Profit making intentions
    - Adequate record keeping

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

To any Timber Business…

- Hedge tax losses accordingly
  - With the loss of NOL carryback claims, taking excessive losses in a current year (boosted by optional expenses) may hurt you more than it will help
    - Avoid year-to-year tax roller coasters – over time, you may pay more tax
    - Who knows what next year holds
- Entertainment is off the table
  - The Trump law had to give somewhere
- Again – QBI Deduction
  - Are you maximizing your usage of this deduction?

A&R AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Handy Tools

- Mile IQ
  - https://www.mileiq.com/
  - A pencil free business mileage log
  - Automatic tracking
  - Year end reports
  - Multiple classifications
  - Can be used from your smartphone or computer
- QuickBooks Online
  - https://quickbooks.intuit.com/online/
  - Real time, cloud based accounting
  - Anytime Accountant assistance
  - Automatic bank feeds and transaction memorization
  - App integration
  - Test Drive the system – https://qbo.intuit.com/redir/testdrive

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Handy Tools

- Local Appraisal District / Tax Assessor
  - Depending on service provider, they may provide the following information:
    - Owner Info
    - Deed transfer Dates
    - Appraised values breakdown
    - Map Tools and property lines
    - Appraisal Example - https://polkcad.org/home
    - Assessor Example - http://polk-tax.com/
- IRS Website
  - https://www.irs.gov/
  - All IRS forms and instructions at your fingertips
  - Numerous services
    - Payments
    - Check Refunds
    - Apply for tax #'s
  - Research and info on new tax regulations and publications

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Handy Tools

- Gusto Payroll
  - https://gusto.com/
  - Simplified payroll for small employers (I recommend 1-5 employees)
  - Can be as easy as hands free
  - Paperless system
- Texas Comptroller
  - https://comptroller.texas.gov/
  - Research and instructions for basically all Texas taxes
  - Entity lookup - https://comptroller.texas.gov/
  - Online filing – https://mycpa.cpa.state.tx.us/securitymp1portal/displayLoginUser.do

AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Handy Tools

- Office Lens mobile app
  - Enhances, trims and straightens document images taken by phone
  - Stores them and enables them to be transferred to other devices in readable workable formats
  - Works with most documents, including business cards
- Rocket Book
  - https://getrocketbook.com/
  - Notebook style devices that convert written text into electronic readable and transferrable data

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Handy Tools

- ShareFile
  - https://www.sharefile.com/
  - Secure document exchange
  - Temporary data cloud based storage
  - Able to send multiple and large files
  - Can be paired with e-mail

- Local CPA's website
  - May provide an available portal for secure document exchange and retention
  - News on tax laws and changes that affect the local area
  - Links and resources

A&R AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Tax Planning Strategies

Timber Tax Presentation 2020

Presented by Trent G. Cook, CPA

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Qualified Opportunity Zone and Funds

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

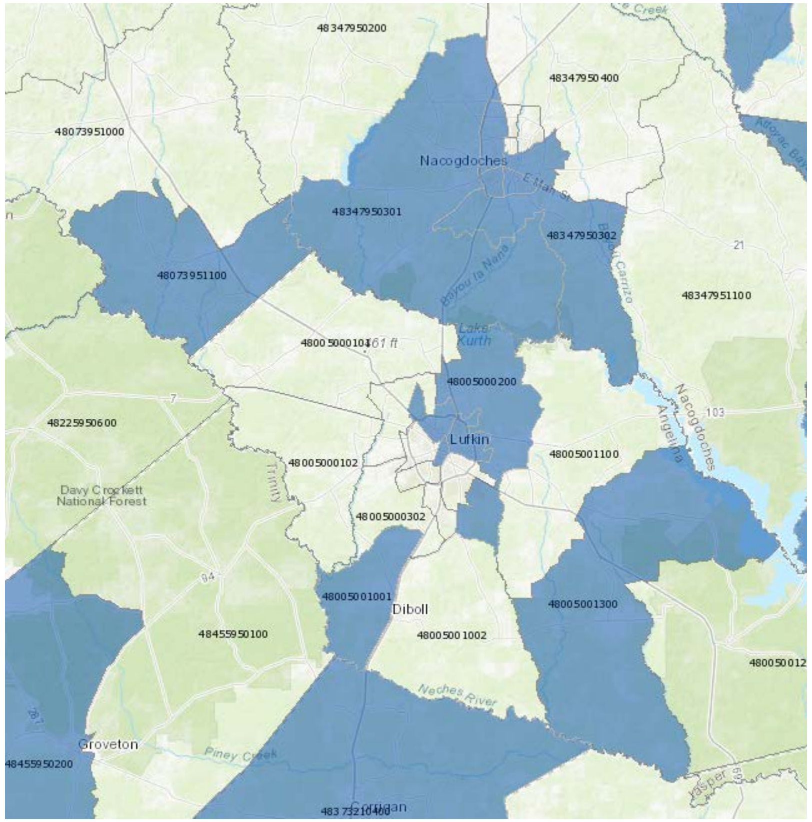
What is a Qualified Opportunity Zone?

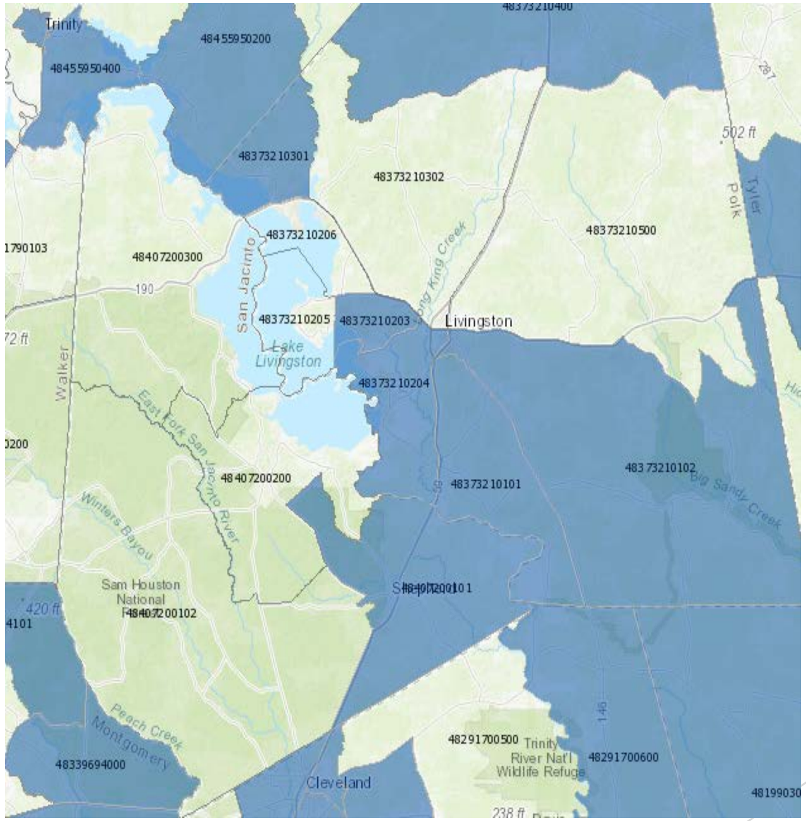
- New Code §1400Z-1 and §1400Z-22
- Allows individual and corporate taxpayers to defer capital gains on the sale of stock, business assets, or any other property
  - Invest the proceeds in a Qualified Opportunity Fund
- Result in partial forgiveness of deferred capital gains and gains from future appreciation
- Located in an economically distressed, or low-income, community
- Each Opportunity Zone has been nominated by the state and certified by the Secretary of the U.S. Treasury.
- Designed to spur economic development and job creation

Qualified Opportunity Fund Requirements

- Must invest 90% of its assets in businesses located in certain low income communities designated as Opportunity Zones
- An Opportunity Fund may hold interests in an Opportunity Zone business directly or indirectly through a partnership or corporation
- To qualify as an Opportunity Zone business:
  - Substantially all of the tangible assets in the business must be used in an Opportunity Zone
  - At least 50% of gross income earned by the business must be from the derived from the Opportunity Zone

https://www.cims.cdfifund.gov/preparation/?config=config_nmtc.xml





Qualified Opportunity Zones & Funds

- Can defer an unlimited amount of capital gains from the sale to any unrelated person
- Invest part or all of the proceeds from the sale in a “Qualified Opportunity Fund” during the 180 day period beginning on the date of sale
- Only capital gains realized on or before December 31, 2026, can be deferred under this program

Partial Forgiveness of Gain

- If a taxpayer holds an investment in a QOF for at least 5 years, the taxpayer's basis in the QOF is increased by 10% of the amount of the deferred gain, so that on sale of the QOF investment, 10% of the deferred gain is permanently forgiven
- If a taxpayer holds an investment in a QOF for at least 7 years, the taxpayer's basis in the QOF is increased by 15% of the amount of the deferred gain, so that on sale of the QOF investment, 15% of the deferred gain is permanently forgiven
- All capital gains that are deferred into a QOF are taxable when the QOF is sold or, if earlier, on December 31, 2026.
- Can defer any amount of capital gain, up to 100%

Forgiveness of Gains for QOF Investment

- Provision provides that the basis in a QOF investment held for at least 10 years is the fair market value of the investment on the date on which such investment is sold
- Taxpayer presumably would retain his or her investment in the QOF beyond December 31, 2026, and pay a tax on the phantom income triggered on such date

Tax Reporting Requirements

- Make a deferral election on Form 8949 on the return for which the taxpayer would have recognized the capital gain
- Qualified Opportunity Fund Self-Certification Form – Form 8996

AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Example

- Taxpayer sells a capital asset for $300,000 with a basis of $50,000, incurring a capital gain of $250,000
- The entire capital gain of $250,000 is timely deferred into a QOF
- If taxpayer has held the QOF investment for 5 years on December 31, 2026, they will pay capital gain tax on $245,000
- If taxpayer has held the QOF investment for 7 years on December 31, 2026, they will pay capital gain tax on $242,500
- The $250,000 QOF investment made by the taxpayer was held for the 10 year minimum, and sold for $400,000. Taxpayer avoids paying capital gain tax on $150,000
- Assuming 20% capital gain rate, taxpayer saved $31,000 and $31,500, respectively

Self Directed IRA

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Self Directed IRA

- Prohibited Transaction and Disqualified Persons Rule
  - IRA owner
  - IRA owner's spouse
  - Ancestors and lineal descendants of the IRA owner
  - Corporations in which 50% or more of profits or voting power are owned by the IRA owner
  - Partnerships in which 50% or more of capital interests or profit interests are owned by the IRA owner
- If this is this occurs, the "penalty" for the IRA owner is that their IRA is deemed distributed as of January 1 of the year the prohibited transaction occurred.
- Subject to 10% early withdraw penalty, and all interest, dividends and capital gains earned within the IRA that year will be subject to regular tax rates

Self Directed IRA

- Direct-Owned Real Estate
  - IRA owner cannot use the IRA owned real estate for personal use, nor can any other disqualified person
  - No de minimis exception
  - IRA owner may inspect the property but cannot do any work
  - Cannot buy or sell the IRA owned real estate to/from themselves or other disqualified persons
  - Cannot loan money to the IRA to purchase real estate or personally guarantee a loan to the IRA
  - Will be required to get periodic appraisals

Estate Tax and Planning

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Estate Tax and Planning

- 2020 Estate Tax exemption is $11.58 million
- 2020 Annual Gift Tax exclusions is $15,000
- Estate tax will revert back to old law in 2026 ($5,490,000)
- May need to file a Portability Election to preserve high estate tax limits
- Use of trusts to provide control over how beneficiaries inherit wealth
- May need to revise wills and estate plans

A&R AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

Questions?

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS