The Quill

Summer 2018

Deduction for Qualified Business Income
By Jeff Raab

With the enactment of the Tax Cuts and Jobs Act, an income tax deduction is available, under Sec. 199A, for noncorporate taxpayers for qualified business income (QBI) in tax years 2018 through 2025. The deduction is generally 20% of a taxpayer's QBI from a partnership, S corporation, or sole proprietorship.

Qualified business income is the net amount of qualified items of income, gain, deduction, and loss with respect to a qualified trade or business that are effectively connected with the conduct of a business in the United States. However, some types of income, including: certain investment-related income; reasonable compensation paid to the taxpayer for services to the trade or business; and guaranteed payments; are excluded from qualified business income.

Qualified trades and businesses include all trades and businesses except the trade or business of performing services as an employee and "specified service" trades or businesses: those involving the performance of service in law, accounting, financial services, and several other enumerated fields, or where the business's principal asset is the reputation or skill of one or more owners or employees.

The deduction is limited to the greater of (1) 50% of the W-2 wages with respect to the trade or business, or (2) the sum of 25% of the W-2 wages, plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property (generally, tangible property subject to depreciation under Sec. 167). The deduction also may not exceed (1) taxable income for the year over (2) net capital gain plus aggregate qualified cooperative dividends.

The W-2 wage limitation does not apply to taxpayers with taxable income less than $157,500 for the year ($315,000 for married filing jointly) and is phased in for taxpayers with taxable income above those thresholds. Income from specified service businesses is not excluded from qualified business income for taxpayers with taxable income under the same threshold amounts.

Editor: Jeff Raab

The law is still unclear on the deductions application to rental property, the netting of qualified business income and loss for taxpayers multiple qualified businesses, determining the deduction for tiered entities, allocating W-2 wages among businesses, and whether compensation paid to an S corporation shareholder is included in W-2 wages for purposes of that limitation.

The deduction is taken "below the line" thus reducing taxable income rather than being taken "above the line" in determining adjusted gross income. But the deduction isn't an itemized deduction and can be taken by taxpayers who don't itemize their deductions and instead take the standard deduction.

We will closely monitor the application of this new deduction and will provide any updates on the application in subsequent Quill editions.

GASB Statement No. 87, Leases
By Zachary Albahary

Statement No. 87 of the Governmental Accounting Standards Board (GASB), Leases, was issued in June 2017. GASB 87 will be effective for reporting periods beginning after December 15, 2019. The objective of this Statement is to better meet the information needs of the financial statement users by improving accounting and financial reporting for leases. The idea is to increase the usefulness of the financial statements by requiring the recognition of additional assets and liabilities that were previously accounted for as operating leases. GASB 87 defines a lease as a contract that conveys control of the right to use another entity's nonfinancial asset as specified in the contract for a period of time in an exchange or exchange like transaction. Something to look out for with this Statement is that GASB 87 doesn't just cover contracts that are defined as a lease but also covers contracts that meet the definition of a lease. As a result, certain contracts that previously were not considered a lease can now be accounted for as a lease.

According to this Statement's definition, a lease is a contract that conveys control. What exactly shows if a contract conveys control? In order for a contract to convey control it must have the right to obtain the present service capacity from use of the underlying asset as specified in the contract, along with the right to determine the nature and manner of use of the underlying asset as specified in the contract. In other words, a contract conveys control when you are able to take advantage of the use of the asset, and when you can decide what the asset is going to be used for. However this does not include any intangible assets, biological assets, inventory, service concessions, or supply contracts.

So what is the change to the financial statements? There are some additional items that will need to be disclosed such as a general description of the agreements, including the basis, terms, and conditions for variable payments. The lease amount of lease assets and the amortization related to the assets will need to be included. Principal and interest requirements to maturity will need to be separately presented for five years and then in five year periods after that. Commitments under the leases before commencement of the lease have to be disclosed. Components of any losses such as an impairment loss and any change in lease liability must be reported. Any additional transactions such as sublease, sale-leaseback and lease-leaseback transactions must be disclosed as well.

Additionally under GASB 87, you would record a "right-to-use" asset which would be amortized over the life of the lease. As for the lessor, they would record a receivable for the present value of the lease payments that they will receive, along with the deferred inflow of resources. For more information on how to value the right to use asset and deferred inflow please visit GASB's website (https://gasb.org/home) or by contacting your auditor at RKO.

Qualified Charitable Distributions
By Jeff Raab

The Tax Cuts and Jobs Act (TCJA) increased the standard deduction for tax years beginning after December 31, 2017. The standard deduction increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other taxpayers. The additional standard deduction for the elderly and the blind is unchanged ($1,300 and $1,600, respectively).

With this increase in the standard deduction limits, many individuals will no longer be able to itemize deductions and thus might lose a tax benefit for their charitable gifts.

Those seniors who are over 70.5 years old have to take their required minimum distributions (RMDs), from retirement accounts. Nonetheless, many seniors still have charitable inclinations. Assuming that most will no longer be able to itemize, seniors over 70.5 will take RMDs, pay tax on the latter, turn around and still make charitable contributions, but will not be able to get a tax break through itemizing.

One solution to this problem is by directing their IRA custodians to make their charitable donations for them, i.e. a QCD - Qualified Charitable Distribution, thus satisfying a portion of their RMD without having to pay tax on it while still maintaining their charitable inclinations. QCDs are limited to $100,000 per individual during any taxable year. This might not be practical for small incidental gifts but for large contributions….definitely yes. Instead of dropping $20 a week in the basket at church plan ahead and have $1,000 go out as a QCD. The same goes for college capital campaigns and other charities that clients may consistently give to each year.

Tax Cuts and Jobs Act Provisions on Tax-exempt Organizations
By Jeff Raab

Effective starting in 2018, elements in the new tax law that have an impact on tax-exempt organizations are:

- Excise tax on exempt organization's excessive compensation - Historically, executive compensation paid by tax-exempt entities was subject to reasonableness requirements and a prohibition against private inurement. The new law adds an excise tax on compensation in excess of $1 million paid by an exempt organization to a "covered" employee. The rate is set at 21%, which is the new corporate rate. Compensation for these purposes is the sum of (1) remuneration (other than an excess parachute payment) over $1 million paid to a covered employee by a tax-exempt organization for a tax year; plus (2) any excess parachute payment paid by the organization to a covered employee. A covered employee is an employee or

former employee of the organization who is one of its five highest compensated employees for the tax year, or was a covered employee of the organization or its predecessor for any preceding tax year beginning after 2016.

- Exempt organization's UBTI computed separately for separate businesses - Before the new law, a tax-exempt organization computed its unrelated business taxable income (UBTI) by subtracting deductions directly connected with the unrelated trade or business from its gross income from the unrelated trade or business. If the organization had more than one unrelated trade or business, the organization combined its income and deductions from all of the trades or businesses. Under the old law, a loss from one trade or business could offset income from another unrelated trade or business, thus reducing overall UBTI. Under the new law, an exempt organization cannot use losses from one unrelated trade or business to offset income from another one. There is an exception for net operating losses from pre-2018 tax years that are carried forward.

- Exempt organization's UBTI to include disallowed fringe benefit costs - Under the new law, an exempt organization's unrelated business taxable income (UBTI) is to include any nondeductible entertainment expenses, and costs incurred for any qualified transportation fringe, parking facility used in connection with qualified parking, or any on-premises athletic facility. However, UBTI is not to include any such amount to the extent it is directly connected with an unrelated trade or business regularly carried on by the organization.

Tips and Tricks for Implementing GASB 75

By Miranda Carroll

What is GASB 75?

GASB 75 pertains to Postemployment Benefits Other Than Pensions. These benefits are paid to retirees, and occasionally these benefits can include termination benefits, but only when they are converted to or supplement a defined benefit other post-employment benefits (OPEB). GASB 75 will affect state and local governments with a fiscal year beginning after June 15, 2017.

What can you do?

Ensure all of your documentation related to benefit terms is retained and accurate. In addition, double check that your policies and procedures are up to date and consistent with the documentation you are keeping. Communicate with human resources to have an accurate listing of retired employees receiving these benefits. Review the note disclosure and Required Supplementary Information (RSI) if prepared by RKO and ensure your understanding of the change to your financial statements. In addition, inform the board of these changes before issuance of statements.

How will your financial statements change?

In the financial statements the liability will be shown at the discounted present value and include benefits to be provided for both active and inactive employees. An expenditure for the current year portion of the liability will be reported in the notes to the financial statements.

In addition, the financial statements will contain additional note disclosures. The RSI will require a reconciliation of deferred inflows and outflows of resources related to OPEB and the impact of a one percentage point decrease or increase in the trend rate cost for healthcare.

Where will this information come from?

The annual audit of Maine Public Employee Retirement System will provide much of the information required for Group Term Life Insurance. Retiree health care information will be provided by Maine Municipal Employees Health Trust. Not a part of the Maine Municipal Employees Health Trust? Contact an actuary to provide relevant financial information. If you have explicit OPEB, a separate actuarial report will need to be obtained.

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Firm Announcements

RKO's Nonprofit Department Manager, **Kristin Starzyk**, had a baby girl on **May 25**. Congratulations to Kristin and her family on the arrival of Mercedes Lynn!

Eiranne Christy and Jenny Duve joined RKO as Assistant Accountants this summer. Welcome Eiranne and Jenny!

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