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Tax-Saving Tips

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Backdoor Roth IRA Opportunities Still Available After TCJA

Good news. The Tax Cuts and Jobs Act (TCJA) did not harm the backdoor Roth strategy.

As you likely know, the Roth IRA is a terrific way to grow your wealth with a minimum tax downside because you pay the taxes up front and then, with the proper holding period, pay no taxes after that.

But if you earn too much, you're completely barred from contributing to a Roth IRA unless you can use the backdoor Roth technique, which involves making a nondeductible contribution to a traditional IRA and then rolling that money into a Roth.

The backdoor Roth strategy has been around for a good nine years, and it has experienced no trouble that we are aware of, so we think it's a good strategy. We also like the recent notations in the legislative history and the comments from the IRS spokesperson that show approval of the strategy.

Keep in mind that with some planning, you can avoid any taxes on the rollover. For example, if you have an existing traditional IRA, you can move those monies to your qualified plan to avoid having the backdoor strategy trigger some taxes. And if you have no traditional IRA, the nondeductible contribution to the traditional IRA and the subsequent rollover to the Roth IRA triggers no taxes.

New IRS FAQs on Section 199A

On April 11, likely after you filed your tax return, the IRS updated its Section 199A frequently asked questions (FAQs) by increasing the number of questions and answers from 12 to 33. The IRS often publishes FAQs on its website to help educate you on various tax law provisions. Section 199A is no different: the IRS has been updating its FAQ website with additional questions and answers on the new qualified business income (QBI) tax deduction.

We noted three of the FAQs that help fill in some holes in the final Section 199A regulations but will cause problems for many taxpayers. In fact, there will be taxpayers who will need to file amended tax returns because of the FAQs.

FAQ 29: QBI Subtractions for Partnerships

In this FAQ on partnerships, the IRS hints at the following:

- Unreimbursed partnership expenses and business interest expenses reduce QBI in some, if not all, circumstances.
- Traditional IRA contributions based on self-employment income don't reduce QBI (since the IRS didn't include them), while SEP, SIMPLE, and qualified plan deductions do reduce QBI.

FAQ 32: QBI in Final vs. Proposed Regulations

In FAQ 32, the IRS clearly states that the definition of QBI is the same in both the proposed and the final regulations. Since the definition was clarified in the final regulations, this was a surprise to many.

And what this means is that you reduce QBI by the self-employed health insurance deduction, the one-half of self-employment tax deduction, and the qualified retirement plan deductions.

FAQ 33 Has to Be Wrong

FAQ 33 states that an S corporation shareholder who owns more than 2 percent may have to reduce QBI at both the entity (S corporation) and the shareholder (1040 tax return) levels.

We don't agree with the double subtraction indicated in IRS FAQ 33, for three reasons:

1. The final regulations state that you reduce QBI "to the extent that the individual's gross income from the trade or business is taken into account in calculating the allowable deduction." Unlike the proprietorship, the S corporation reduces its business income by reimbursing or paying for the health insurance that it puts on the more than 2 percent shareholder's W-2.
2. Under Notice 2008-1, the self-employed health insurance deduction for the 2 percent S corporation shareholder requires that you include the insurance cost as shareholder wages. The wages reduce QBI.
3. And income from the trade or business of being an employee is not QBI.

Website Is Not an Authority

If you don't like the positions taken on the IRS's FAQ website, then there's one silver lining: FAQs don't constitute an authority for tax return positions.

TCJA Allows Bonus Depreciation on Purchase of Leased Vehicle

Before the Tax Cuts and Jobs Act (TCJA), your purchase of the vehicle you were leasing did not qualify for either Section 179 expensing or bonus depreciation. But times have changed.

The TCJA made two changes that mean 100 percent bonus depreciation is available on the vehicle you lease and then purchase, regardless of whether you purchase it during the lease term or at the end of the lease. The two technical reasons you can do this are as follows:

1. During the lease, you had no depreciable interest.
2. Bonus depreciation is now available on used property.

Technically, the two changes work like this:

- While you were leasing the vehicle, you had no depreciable interest in the vehicle. The lessor depreciated the vehicle. You, the lessee, paid rent.
- Your purchase of the vehicle that you were leasing is the purchase of a vehicle that you had NOT used under the bonus depreciation law, because you did not have a depreciable interest in it at any time.

Example. You pay $32,000 for a pickup truck that you have been leasing for business purposes. The pickup truck has a gross vehicle weight rating of 6,531 pounds, and your mileage log proves 90 percent business use. You may use bonus depreciation to deduct the $28,800 business cost of the pickup ($32,000 x 90 percent).

Note the difference: As with prior law, with Section 179 expensing, you get no additional deductions. But with bonus depreciation, you can expense your entire business cost.

How to Handle Multiple Rental Activities and the 199A Deduction

There's a lot of confusion out there around your rental activity and Section 199A. Your Section 199A considerations multiply when you have multiple rental activities. Here's what you need to consider:

- Are your rental activities multiple trades or businesses, or one trade or business?
- Can you aggregate the rentals for Section 199A purposes? Do you want to?
- How does the Section 199A rental safe harbor impact your Section 199A deduction if you use it?

Whether your rental activities are each a trade or business, or they constitute one trade or business, is inherently based on the facts of your particular situation. The IRS also believes that multiple trades or businesses will generally not exist within an entity unless it can use different methods of accounting for each trade or business under the Section 466 regulations. These regulations explain that you can't consider a trade or business separate and distinct unless you keep a complete and separable set of books and records for that trade or business.

This determination is an important factor for you if any one rental activity (taken individually) doesn't rise to the level of a trade or business, but all the rental activities (viewed collectively) do rise to the level of a trade or business. One of the factors the IRS looks to when determining whether a rental activity is a trade or business is the number of properties rented.

Aggregation

The Section 199A regulations allow you to aggregate multiple trades or businesses such that you treat the aggregated group as one trade or business for determining your Section 199A deduction. This is an important consideration if one or more of your rental businesses have insufficient wages or unadjusted basis in assets (UBIA) to get the maximum Section 199A deduction for that property.

The final regulations tell us you can aggregate, in most circumstances, provided that the rental activities share centralized administrative functions, such as accounting, legal, and human resources functions. The big wrinkle is the type of rental business: you generally can't aggregate residential rental businesses and commercial rental businesses with each other because they aren't the same type of property.

Rental Safe Harbor

Along with the final regulations, the IRS gave you an optional safe harbor to deem your rental activities as qualifying for the Section 199A deduction. The safe harbor isn't the best strategy because most rentals qualify as a trade or business anyway.

Deduct Your Costs of Sponsoring Sports Teams

Have you wondered what it takes to deduct the costs of sponsoring a sports team? What if you play on the team? Could you pay for the team travel expenses?

Revenue Ruling 70-393 states that the monies spent to outfit and support a sports team are similar to monies spent on other methods of advertising; accordingly, you may deduct them as business expenses for federal income tax purposes.

In the *Strong* case, Strong Construction Co. Inc. advertised its business primarily through either word of mouth or athletic sponsorships. As part of the athletic sponsorships, the corporation paid for the uniforms, logo design, hats, T-shirts, sweatpants, coats, bags, and pants for all players on its sponsored teams (broomball, softball, wrestling, etc.). The court ruled that the expenses were ordinary and necessary business expenses and that Strong could deduct them as advertising or promotion.

In the *Bower* case, James Bower sponsored the Lafayette Bower Housing Hustlers basketball team, and he was both an assistant coach and a player. As the Hustlers' sponsor, Bower paid for the team's travel, lodging, food, promotions, AAU fees, tournament fees, gym rental, and uniforms. The court noted that Bower's sponsorship

increased his commodity brokerage commissions and generated additional clients; accordingly, the court ruled that Bower's sponsorship expenses were deductible business expenses.