Tax Alerts

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AUDIT | TAX | ADVISORY

The Impact of the Tax Cuts and Jobs Act on Qualified Transportation Fringe Benefits

In the years leading up to the *Tax Cuts and Jobs Act (TCJA),* Congress encouraged efforts to protect the environment by giving employees a tax break for qualified transportation fringe benefits.

Prior to *TCJA*, employers were allowed to deduct all of the costs they incurred in providing qualified transportation fringe benefits under IRC §132(f). Specifically, §132(f) allows for an exclusion from wages of commuter benefits such as qualified parking, transit passes, van pools, and bicycle commuter costs.

Effective January 1, 2018, the *TCJA* eliminates the business tax deduction through 2025, unless the benefits are necessary for ensuring the safety of the employee. This basically increases the cost of providing benefits by the new 21% corporate tax rate. Employers must now consider whether to continue providing transportation fringe benefits despite the loss of the business deduction or discontinue them altogether.

Although the *TCJA* denies the employer a deduction, it does not take away the tax-favored status to employees. Under IRC §132(f) (3), employees can still purchase benefits on a pretax tax basis if the employer continues to offer the programs. The only exception is the bicycle commuter benefit, which is no longer excludable from employees' wages and is subject to employment tax withholding.

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Things to Be Aware of for 2018 Filing Season

The 2018 filing season for 2017 tax-year returns officially started on January 27. On the other end of the filing season, taxpayers have two additional days to file their 2017 returns. The traditional April 15 filing deadline moves to April 17 this year. Some early filers, however, may find their refunds delayed if they are claiming the additional child tax credit (ACTC) and/or the earned income tax credit (EITC).

Unlike some past years, the IRS goes into the filing season without having to make too many changes to the Tax Code. The heavy haul will come this year, as the IRS implements the countless changes to the Tax Code in the *Tax Cuts and Jobs Act*. Former IRS Commissioner John Koskinen recently said that he worries the agency will not have adequate resources – personnel and monetary – to push out the necessary guidance for the *Tax Cuts and Jobs Act*. "It is a challenge," Koskinen said.

Filing deadline

April 15 falls on a Sunday this year. As a result, the filing deadline moves to Monday, April 16. However, April 16 is a holiday, Emancipation Day, in the District of Columbia. This moves the filing deadline to Tuesday, April 17.

Refunds

Tax laws do not allow the IRS to issue immediate refunds to taxpayers claiming the ATC and/or EITC. The IRS predicted that refunds related to be the ACTC and/or EITC will be deposited in taxpayer accounts or on debit cards starting February 27, 2018, approximately one month after the launch of the filing season. Taxpayers will need to choose direct deposit, the IRS explained, to get refunds deposited as quickly as possible.

As in past years, the IRS predicts that nine out of ten refunds will be issued in fewer than 21 days. The agency reminded taxpayers that many financial institutions do not process payments on weekends or holidays. This can result in further delays.

Scams

The start of the filing season also brings an uptick in refund fraud. Criminals file fraudulent returns early in the filing season before taxpayers file their legitimate returns. The Treasury Inspector General for Tax Administration (TIGTA) recently cautioned taxpayers to be on "high alert" for identity theft and refund fraud.

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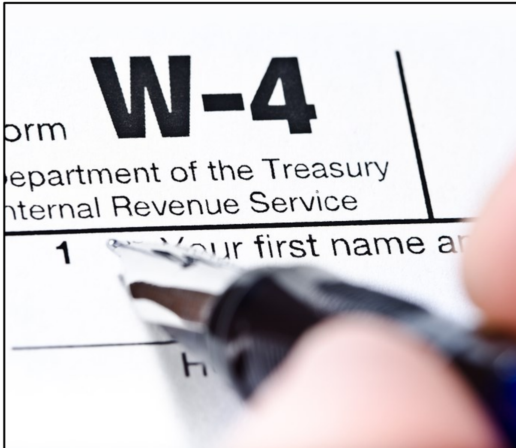
New Withholding Tables for 2018



Much-anticipated withholding tables for 2018 have been posted by the IRS. While the new withholding tables are designed to work with existing Forms W-4, the agency encouraged taxpayers to use its online withholding calculator to make adjustments if necessary. New Forms W-4, Employee's Withholding Allowance Certificate, will be released for 2019 withholding; withholding for 2018 will adapt to existing Forms W-4 already submitted by employees. Based upon the specific impact of the new tax law on their situations, some employees may wish to file a revised Form W-4 to supplement revisions to the withholding tables already being made by the IRS.

The IRS's online withholding calculator is being reprogramed for the *Tax Cuts and Jobs Act* and will be online shorty. The guidance also sets the rates at 22% for optional flat-rate withholding on supplemental wages below $1 million, at 37% on supplemental wages on $1 million and above, and 24% for backup withholding.

Background

The amount withheld from an employee's wages is determined in part by the number of withholding exemptions and allowances the employee claims. For each exemption or allowance claimed, an amount equal to one personal exemption, prorated to the payroll period, is subtracted from the total amount of wages paid. This reduced amount, rather than the total wage amount, is subject to withholding.

A withholding table shows employers and payroll service providers how much federal tax to withhold from employee paychecks, given each employee's wages, marital status and the number of withholding allowances claimed. Employees provide their employers with Form W-4 so employers can withhold the correct amount of federal tax.

The *Tax Cuts and Jobs Act* overhauls the Tax Code. The new law lowers individual income tax rates, revises the child tax credit, repeals the personal exemption deduction, and makes countless other changes.

Withholding for 2018

For 2018, the amount of one withholding allowance on an annual basis increases to $4,150. The amount of one withholding allowance on an annual basis for 2017 was $4,050.

For 2018, the withholding allowance amounts by payroll period are:

- Weekly: $79.80
- Biweekly: $159.60
- Semimonthly: $172.90
- Monthly: $345.80
- Quarterly: $1,037.50
- Semiannually: $2,075
- Daily or miscellaneous (each day of payroll period): $16

The IRS instructed employers and payroll service providers to start using the new withholding tables as soon as possible, but no later than February 15, 2018. Until employers and payroll service providers implement the revised withholding tables, they should continue to use the 2017 tables, per the IRS.

Form W-4

Taxpayers will not need to complete new Forms W-4 immediately. "The new withholding tables are designed to minimize taxpayer burden as much as possible and will work with Forms W-4 that workers have already filed with their employers to claim withholding allowances," the IRS explained. Further, transition rules temporarily permit employees to claim exemption from withholding for 2018 by using 2017 Form W-4. The deadline to claim exemption from income tax withholding in either case was extended to February 28, 2018.

In the meantime, taxpayers should check their withholdings, the IRS recommended. "Taxpayers who itemize their deductions, couples with multiple jobs or individuals with more than one job are encouraged to review their situation," the IRS explained.

"The new withholding guidance, developed jointly by Treasury's Office of Tax Policy and the IRS, was constructed to work within the constraints of the existing payroll withholding system in order to deliver the benefits of the tax cuts as soon as possible, to as many Americans as possible, and with as little disruption as possible," Treasury Secretary Steven Mnuchin told reporters in Washington, D.C. "The withholding tables are designed to work with the Forms W-4 that workers have already filed with their employers. This will minimize the burden on taxpayers and employers," he predicted.

Senate Finance Committee ranking member Ron Wyden, D-Oregon, has asked the Government Accountability Office (GAO) to review the new withholding tables and determine whether the tables "would result in the systematic underwithholding of federal taxes from employee paychecks." Wyden and other Democrats in Congress have voiced concerns that the White House is "politically interfering with the development of the 2018 withholding tables."

Supplemental wages

An employee may receive supplemental wages in addition to regular wage payments. If supplemental wages are paid concurrently (for example, in a single payment) with regular wages, and the employer does not specify the amount of each, the supplemental wages are combined with the regular wages for the pay period for purposes of determining the proper withholding amount. If the supplemental wages are not paid concurrently with regular wages, or if they are paid concurrently but the employer specifies the amount of each, two different methods of calculating the amount of withholding on the supplemental wages are available. If supplemental wages exceed $1 million during the calendar year, the excess is subject to withholding at 37%, effective this year, the IRS explained.

Examples of supplemental wages include bonuses, commissions, overtime pay, wages paid under reimbursement or other expense allowance arrangements, dismissal pay, vacation pay, back pay, and nonqualified deferred compensation. Other types of supplemental wages include payments for unused accumulated leave and separate payments representing sick pay and regular wages.

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No Change to Capital Gains Taxation after Tax Reform

The *Tax Cuts and Jobs Act* did not directly change the tax rate on capital gains; they remain at 0, 10, 15 and 20%, respectively (with the 25% and 28% rates also reserved for the same special situations). However, changes within the new law impact both when the favorable rates are applied and the level to which to may be enjoyed.

Capital gains rates

The maximum rates on net capital gain and qualified dividends are generally retained after 2017 and are 0, 15, and 20%. The breakpoints between the 0 and 15% rates ("15% breakpoint") and the 15 and 20% rates ("20% breakpoint") are generally the same amounts as the breakpoints under prior law, except the breakpoints are indexed using the new Chained Consumer Price Index for All Urban Consumers (C-CPI-U) factor in tax years beginning after 2018.

For 2018:

- the 15% breakpoint is $77,200 for joint returns and surviving spouses (one-half of this amount, $38,600, for married taxpayers filing separately), $51,700 for heads of household, $2,600 for estates and trusts, and $38,600 for other unmarried individuals; and
- the 20% breakpoint is $479,000 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), $452,400 for heads of households, $12,700 for estates and trusts, and $425,800 for other unmarried individuals.

"Zero" rate

In the case of an individual (including an estate or trust) with adjusted net capital gain, to the extent the gain would not result in taxable income exceeding the 15% breakpoint, such gain is not taxed.

The breakpoints are not aligned with the new general income tax rate brackets. For example, alignment for joint filers would have the 15% breakpoint at $77,400 rather than $77,200; and, more significantly, 20% at $600,000 rather than at $479,000. Instead, they continue the alignment themselves more closely to the prior-law rate brackets.

As under prior law, unrecaptured section 1250 gain generally is taxed at a maximum rate of 25 percent, and the 28% rate gain is taxed at a maximum rate of 28%. In addition, an individual, estate, or trust also remains subject to the 3.8% tax on net investment income (NII tax).

Kiddie tax

Effective for tax years beginning after December 31, 2017, and before January 1, 2026, the "kiddie tax" is simplified by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. A child's "kiddie tax" is no longer affected by the tax situation of his or her parent or the unearned income of any siblings.

Taxable income attributable to net unearned income is taxed according to the brackets applicable to trusts and estates, with respect to both ordinary income and income taxed at preferential rates. For 2018, that means that the 15% capital gain rate starts at $2,600 and rises to 20% when $12,700 is reached.

Carried interest

When fund managers receive “partnership profits interest” (also known as carried interest) in exchange for their investment management services and there is capital gain passed through from the partnership, the capital gain can be treated as long-term capital gain only if it meets an extended three-year holding period. Under the new laws, if a taxpayer holds an applicable partnership interest at any time during the tax year, this rule treats the capital gain as short-term capital gain taxed at ordinary rates based on a three-year holding period versus the usual one-year holding period for long-term capital gain treatment.

SSBIC rollovers

For sales after 2017, the new law repeals the election to defer recognition of capital gain realized on the sale of publicly traded securities if the taxpayer used the sale proceeds to purchase common stock or a partnership interest in a specialized small business investment company (SSBIC). Prior to 2018, under former Code Sec. 1044, C corporations and individuals could elect to defer recognition of capital gains realized on the sale of publicly traded securities if the taxpayer used the sales proceeds within 60 days to purchase common stock or a partnership interest in a specialized small business investment company (SSBIC).

Like-kind exchanges

Like-kind exchanges have often been used to defer taxable gains. Going forward, like-kind exchanges are allowed only for real property after 2017 (Code Sec. 1031(a)(1)). Like-kind exchanges are no longer available for depreciable tangible personal property, and intangible and nondepreciable personal property after 2017. Gain on those assets will no longer be allowed to be deferred.

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Understand Bonus Depreciation under the New Tax Law

The *Tax Cuts and Jobs Act* increases bonus depreciation rate to 100% for property acquired and placed in service after September 27, 2017, and before January 1, 2023. The rate phases down thereafter. Used property, films, television shows, and theatrical productions are eligible for bonus depreciation. Property used by rate-regulated utilities and property of certain motor vehicle, boat, and farm machinery retail and lease businesses that use floor financing indebtedness are excluded from bonus depreciation.

Timing Details

The 50% bonus depreciation rate applicable before the new law took effect has been increased to 100% for qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023. The 100% allowance continues for five years, after which it is then phased down by 20% per calendar year for property placed in service after 2022. In general, the bonus depreciation percentage rates are as follows:

- 100% for property placed in service after September 27, 2017, and before January 1, 2023;
- 80% for property placed in service after December 31, 2022, and before January 1, 2024;
- 60% for property placed in service after December 31, 2023, and before January 1, 2025;
- 40% for property placed in service after December 31, 2024, and before January 1, 2026;
- 20% for property placed in service after December 31, 2025, and before January 1, 2027;
- 0% (bonus expires) for property placed in service after December 31, 2026.

Property acquired before September 28, 2017

Property acquired before September 28, 2017, is subject to the 50% rate if placed in service in 2017, a 40% rate if placed in service in 2018, and a 30% rate if placed in service in 2019. Property acquired before September 28, 2017, and placed in service after 2019 is not eligible for bonus depreciation. However, in the case of longer production property (LPP) and noncommercial aircraft (NCA), each of these placed-in-service dates is extended one year. Therefore, a 50% rate applies to LPP and NCA acquired before September 28, 2017 and placed in service in 2017 or 2018, a 40% rate applies if such property is placed in service in 2019, and a 30% rate applies if such property is placed in service in 2020. They continue to apply to property acquired before the September 28, 2017 cut-off date set by Congress.

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California Individual Tax Return Requires More Use Tax Information

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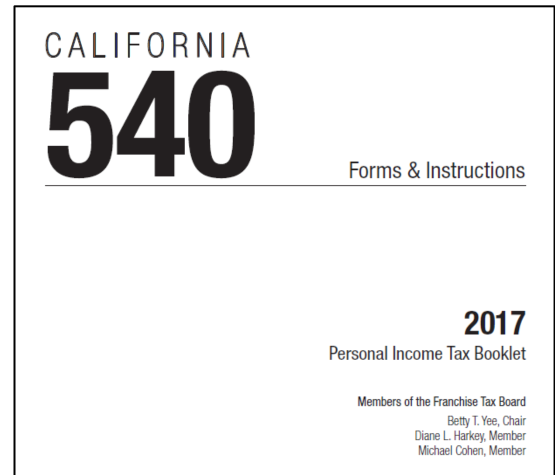
AB 1593 (Ch. 17-563) directs the California Franchise Tax Board (FTB) to revise the 2017 personal income tax returns to require that the taxpayer enter a number on the use tax line (line 91). If the taxpayer enters zero on line 91, the taxpayer must check one of two boxes indicating that either the taxpayer owes no use tax or the taxpayer has remitted his or her use tax obligation for the taxable year directly to the California Department of Tax and Fee Administration (CDTFA).



According to the FTB, tax software providers are aware of this requirement. In most cases, the software is designed to meet the requirement so that returns are successfully filed. However, if the software does not enforce this rule, the FTB's e-file system will not accept the return for processing and will provide an error message, for example: If Form 540, line 91 "Use Tax" is zero, then Line 91 "No use tax is owed' or Line 91 "You paid your use tax obligation directly to CDTFA" checkbox must be checked.

Use Tax

91 Use Tax. Do not leave blank. See instructions . . . . ● 91 ______ . 00

If line 91 is zero, check if: ☐ No use tax is owed.

☐ You paid your use tax obligation directly to CDTFA.

If a taxpayer purchased property online or out of state for which sales tax was not paid, the taxpayer must pay use tax, which is basically the same as sales tax. If the use tax had not been paid, it could be paid with the taxpayer's California individual income tax return; or, the taxpayer can fill out a Form CDTFA-401-E, State, Local, and District Consumer Use Tax Return, and pay the tax with the completed form.

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