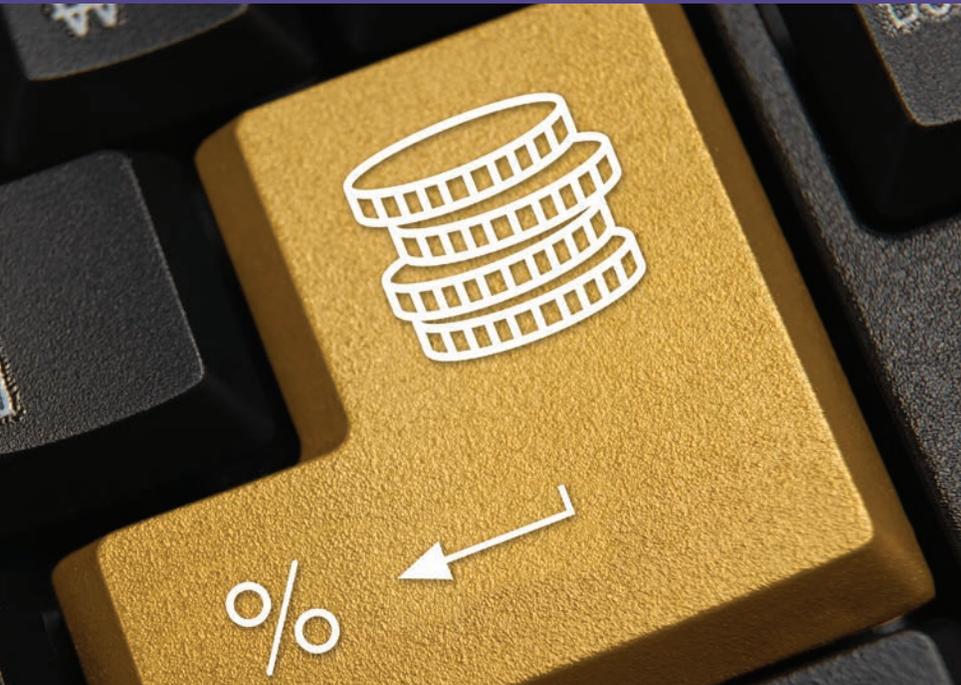


MANAGEMENT & TAX CONCEPTS



SALES TAX COMPLIANCE AFTER WAYFAIR

"Heads up!" to businesses delivering products or services out of state

SUMMER 2019

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Sales tax compliance after *Wayfair*

“Heads up!” to businesses delivering products or services out of state

In the months since the U.S. Supreme Court’s landmark 2018 decision in *South Dakota v. Wayfair*, most states have enacted, begun enforcing or proposed “economic nexus” statutes. These statutes impose sales tax collection obligations on out-of-state sellers based on their economic activities in the state, regardless of whether they have a *physical presence* in that state.

The impact of these changes will be felt most by online and mail-order sellers that, before *Wayfair*, weren’t obligated to comply with sales tax laws in states where they lacked a physical presence.

Here’s an overview of the case and the steps businesses should take to ensure compliance with these statutes.

NEXUS MATTERS

Constitutionally speaking, a state’s power to impose tax obligations on a company is derived from the business’s connection, or “nexus,” within its borders. A business establishes such a nexus when it “avails itself of the substantial privilege of carrying on business” in the state. Before *Wayfair*, that meant maintaining a substantial physical presence in the state, such as offices, stores, plants, warehouses, employees or sales reps.

In *Wayfair*, however, the Court recognized that modern technology makes it possible to establish nexus in a state solely through economic contacts, such as e-commerce sales or digital services. The Court declined to rule on the level of economic activity required to establish nexus, but in this case it found that the thresholds set by South Dakota’s economic nexus statute were sufficient.

The South Dakota statute requires out-of-state businesses to collect and remit South Dakota sales tax if, in the current or previous calendar year, they have either:

- More than \$100,000 in gross sales of products or services delivered into the state, or



- 200 or more separate transactions for the delivery of goods or services into the state.

Wayfair opened the door for other states to enact similar statutes, or to begin enforcing laws already on the books. Most states have now enacted, or proposed, such statutes. Typically, to avoid legal challenges, these laws incorporate thresholds identical or similar to those upheld in *Wayfair* — \$100,000 in sales or 200 transactions. Some states, however, have established more aggressive thresholds.

STEPS TO TAKE

If your business delivers products or services across state lines, it's critical to review your activities. Then take steps to ensure compliance with rapidly evolving sales tax requirements.

The first step is to take inventory: Compile data on all your sales transactions over the last two years or so on a state-by-state basis. Next, review any existing or proposed economic nexus statutes in the states in which you do business. Then look at whether your level of activity in those states exceeds applicable thresholds. If it does, determine the effective or enforcement date of each statute.

If your business delivers products or services across state lines, take steps to ensure compliance with rapidly evolving sales tax requirements.

Many states' nexus statutes are already in effect. Some become enforceable later this year or beyond. For states whose enforcement dates have passed, register as a vendor and begin collecting sales taxes from customers as soon as possible

Don't ignore purchases

Although the *Wayfair* decision's biggest impact is on out-of-state sales, it also can affect your purchases. For example, if you purchase equipment, materials or supplies from out-of-state sellers, those vendors may not have collected sales tax from you in the past. But if your state enacts an economic nexus statute, they may begin to do so. If these purchases qualify for a sales tax exemption, such as a resale or manufacturing exemption, you'll need to furnish exemption certificates to the sellers.

Also, if you've been paying use taxes on any purchases for which no sales tax was collected, be sure to review your use tax policies and procedures to avoid double taxation if vendors begin to collect sales tax.

to minimize liability for back taxes. Also, inquire whether these states have voluntary disclosure agreement programs or other procedures that allow you to limit your tax liability for past sales.

For other states, be prepared to comply starting on the enforcement date. Be sure to familiarize yourself with each state's sales tax laws. If any of your sales are exempt from tax, you'll need to collect exemption certificates from customers to avoid charging the tax. Common exemptions in many states include sales of products intended for resale, sales to tax-exempt organizations and sales of certain items used or consumed in a manufacturing process.

WEIGH THE COSTS AND BENEFITS

As you consider your options, weigh the costs and benefits of doing business in a state. If you exceed a state's transaction threshold but have a small amount of sales (for example, 200 sales of \$2 each), the cost of registering with the state and collecting tax on those sales may exceed your potential profits. •

Choosing an employee retirement plan

So, you've decided to offer your employees a retirement plan. Maybe you've grown weary of job candidates asking about what kind of plan you offer and coming up empty-handed. Or you believe your business is now financially healthy enough to make "respectable" contributions. Whatever the reason for your decision to launch, you'll want to select the type of plan that will work best for your company and its employee base.

The following is some "starter" information about some of the most tried-and-true saving-for-retirement plan options.

401(k) PLANS OFFER FLEXIBILITY

Available to any employer with one or more employees, a 401(k) plan allows employees to contribute to individual accounts. While contributions to a traditional 401(k) are made on a pretax basis and will reduce taxable income, distributions are subject to income tax.

Both employees and employers can contribute. For 2019, employees can contribute up to \$19,000, or \$25,000 if they'll be age 50 or over by the end of the year. Within limits, employers can deduct contributions made on behalf of eligible employees.

Plans may offer employees a Roth 401(k) option, which, on some level, is the opposite of a traditional 401(k). This is because contributions don't reduce taxable income and income distributions aren't subsequently taxed.

SIMPLE IRAs are available to businesses with no more than 100 employees. Employees can decide whether to contribute. Employer contributions are required.



Establishing a 401(k) plan typically requires, among other steps, adopting a written plan and arranging a trust fund for plan assets. Annually, employers must file Form 5500 and perform discrimination testing to ensure the plan doesn't favor highly compensated employees. With a "safe harbor" 401(k), however, the plan isn't subject to discrimination testing.

EMPLOYERS FULLY FUND SEP PLANS

Simplified Employee Pension (SEP) plans are available to businesses of any size. Establishing a plan requires completing Form 5305-SEP, but there's no annual filing requirement. SEP plans are funded entirely by employer contributions, although the employer can decide each year whether to contribute. Contributions immediately vest with employees. Contribution limits in 2019 are 25% of an employee's compensation, to a maximum of \$56,000.

SIMPLEs TARGET SMALL BUSINESS

Savings Incentive Match Plan for Employees (SIMPLE) IRAs are available to businesses with no more than 100 employees. Employees can decide whether to contribute. Though employer contributions are required, employers can choose whether to match

employee contributions up to 3% of compensation (which can be reduced to as low as 1% in two of five years) or make a 2% nonelective contribution, including to employees who don't contribute. Employees are immediately 100% vested in all contributions, whether from the employee or the employer.

WORK CONTINUES POSTSETUP

After you've decided on the type of retirement plan, you'll want to draft a plan document that outlines how the plan will work. Typically, you'll want to hire an investment advisor and establish a fund for the plan's assets. You'll also want to hire a third-party administrator for recording transactions and balances.

After the plan is up and running, you'll need to ensure it remains in compliance with regulations. You'll also need to continue making required contributions and keep employees informed of changes in either their accounts or the plan.

ADDED BENEFITS

Your business can offset the costs of establishing a SEP, SIMPLE IRA or qualified retirement plan via a tax credit. It can cover 50% of the ordinary necessary costs to establish the plan and educate employees about it — up to \$500 per year for the first three years of the plan. The credit is available to businesses that have no more than 100 employees who received at least \$5,000 in compensation during the preceding year. •

Ownership structures

How should you own your vacation home?

Many families enjoy owning vacation homes and using them for family gatherings and getaways. However, many families don't plan carefully for how the ownership of the home will be structured.

There are several different ownership structures that can be used for family vacation homes, including a corporation, trust, tenants in common (TIC), and limited liability company (LLC). Given the unique aspects of vacation home ownership, an LLC is often the best ownership structure from a management and tax standpoint.

DIFFERENT AREAS IMPACTED

The ownership structure chosen for a family vacation home will impact several areas that are often relevant to vacation home ownership, including:

- Asset and creditor protection,
- Estate and gift planning,

- Sale of ownership interests to nonfamily members,
- Income and expense allocation and recordkeeping, and
- Intrafamily ownership transfers.

One of the main benefits of structuring a vacation home as an LLC is that it will (subject to certain exceptions) limit family members' exposure to personal liability lawsuits associated with the property. This includes litigation brought on by tenants who're injured on the property, personal judgments unrelated to the vacation home, and lawsuits filed by creditors that supply goods and services to the LLC.

For example, let's say that a tenant slips while walking on the pool deck of a beach house and suffers a serious head injury. The tenant successfully sues the vacation home owner and receives a six-figure award settlement. With an LLC, the owner's

personal exposure usually would be limited to the vacation home itself. The owner's other assets, such as his or her main residence and investment portfolio, couldn't be attached by the tenant.

Another big benefit is the avoidance of probate in certain situations when a vacation home owner dies. If the vacation home is owned outright, instead of through an ownership interest in the LLC, most likely the estate will need to be probated. This could be particularly burdensome if the vacation property is in a state different from the one in which the owner's primary residence is located.

Also, with an LLC, the heirs would be eligible for a step-up in cost basis to the home's fair market value upon the owner's death, just as they would if the property had been owned outright. The increased basis, of course, can reduce capital gains taxes when the home is sold.

OTHER ADVANTAGES

Often, families wish to keep ownership of a vacation home in the family over the long term. With an LLC, transfer restrictions can be included in the operating agreement that prevent the individual co-owners from selling their interest in the home to nonfamily members. Restrictions also can be placed on selling ownership interests to owners' former spouses, the use of the home by nonfamily members, and transfers of ownership interest among family members.



Choosing an LLC as the ownership structure for a vacation home also can help simplify recordkeeping. The LLC is its own separate entity. So, it can hold operating funds for the home. This allows ownership and operating expenses incurred by family members to be allocated in proportion to each person's usage of the home and payment of expenses. Additionally, any rental income can be easily allocated among family members.

Finally, since ownership interests in an LLC represent the personal property of family members, intrafamily transfers of these interests don't involve the conveyance of real property. Therefore, these transfers won't result in real property transfer taxes and fees or affect title insurance policies and rights.

COULD YOU BENEFIT?

The details of vacation home ownership can be complex. But there's a good chance that you and your family could realize many benefits by structuring ownership of your vacation home as an LLC. Consult with your financial and tax advisors for detailed guidance. •

Rental real estate investors get guidance on pass-through deductions

In a recent notice, the IRS provided welcome guidance to rental real estate investors seeking to take advantage of the new Section 199A "pass-through" deduction. Notice 2019-07 establishes a safe harbor under which qualifying rental real estate

enterprises will be treated as a "trade or business" eligible for the deduction.

Sec. 199A allows individual taxpayers to deduct up to 20% of their qualified business income from a qualified trade or business operated directly or

through a pass-through entity (such as a partnership, S corporation or LLC). The deduction is subject to several restrictions and limitations.

Unfortunately, many rental real estate owners were uncertain whether their activities rose to the level of a trade or business for purposes of the deduction. The notice is designed to mitigate this uncertainty for owners who satisfy the safe harbor's requirements.

WHAT ARE THE REQUIREMENTS?

To qualify for the safe harbor, a rental real estate enterprise — which may consist of multiple properties — must meet these requirements:

1. Separate books and records are maintained for each rental real estate enterprise.
2. A total of 250 or more hours of rental services are performed per year with respect to the enterprise, either by its owners or their employees, agents or independent contractors. (For tax years beginning after 2022, this requirement may be satisfied if 250 or more hours of rental services are performed in any three of the most recent five years.)
3. The taxpayer maintains contemporaneous time reports and other records showing the hours and dates of all services performed, a description of the services, and who performed them.

Rental services include advertising property for rent or lease; negotiating and executing leases; verifying tenant applications; and collecting rent. They also include conducting daily operations, maintenance or repairs; managing property; purchasing materials; and supervising employees and contractors.

The services *don't* include financial or investment management services, such as arranging financing; procuring property; or reviewing financial statements or operating reports. Nor do they include planning, managing or constructing long-term capital improvements, or spending time traveling to and from the property.

Two types of real estate are ineligible for the safe harbor: 1) real estate used by the taxpayer (including an owner or beneficiary of a relevant pass-through entity) as a residence for any part of the year, or 2) real estate covered by a triple net lease (one that requires the tenant to pay taxes, fees and insurance on, and to be responsible for maintenance of, the leased property).

WHAT IF YOU DON'T QUALIFY?

If you don't meet all the safe harbor's requirements, you may still be eligible for the Sec. 199A deduction. That's if you can show that your enterprise otherwise meets the general definition of "trade or business." To do so, you'll need to review the various factors considered by the IRS and the courts in determining whether real estate activities rise to the level of a trade or business. The factors include the type and number of properties, the extent of the owner's involvement, and the lease terms.



STAY TUNED

The notice contains a proposed revenue procedure outlining the safe harbor requirements. It's possible that the safe harbor will be modified, but the notice states that it can be relied upon until the revenue procedure is finalized. •

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