

Tax Implications for Pass-Through Entities Post-Tax Reform



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Section 199A – How Did We Get Here?

- The Tax Cuts and Jobs Act (H.R. 1) – December 22, 2017
- Are insurance brokerage firms that are pass-through entities eligible for the deduction?

Nov. 15, 2017

The House passed its version of the tax plan with 227 Republican votes. **Section 199A was not included in the version passed.**

Dec. 2, 2017

The Senate passed their version of the tax plan in the early hours of December 2, 51 to 49 in favor. **The Senate version added a deduction under Section 199A with respect to qualified business income of a pass-through entity.**

Dec. 13, 2017

Republican leaders from the House and Senate reached an agreement on a final tax bill. **The conference report included the Section 199A, as amended in the Senate version.**

Dec. 22, 2017

The bill was signed into law by the President.

Section 199A – Framework

- Section 199A – a 20% expense deduction for **qualified business income** for owners/shareholders of pass-through entities

Qualified business income: the net amount of qualified items of income, gain, deduction, and loss with respect to any **qualified trade or business** of the taxpayer

- For owners/shareholders at higher income levels, the deduction cannot exceed 50% of applicable employee wages paid, or 25% of applicable wages plus 2.5% of capital assets, whichever is greater
- Two paths to qualify for the deduction:
 - Minimum income exemption
 - Business is not a “specified service trade or business” exemption

Section 199A – Minimum Income Exemption

- If any pass-through business owners/shareholders fall below income threshold (\$157,500 single; \$315,000 joint), then entitled to a 20% deduction
- Phase out for owners/shareholders of specified service trade or business if above income threshold but below “phase-out” amounts (\$207,500 single; \$415,000 joint)
- If owner/shareholder of a specified service trade or business has annual taxable income above the “phase out” amounts, then no deduction

Section 199A – Minimum Income Exemption

Taxable Income	Specified Service Trade or Business	Other Businesses
Taxable income less than \$157,500 (single) or \$315,000 (joint)	Deduction = 20% of QBI	Deduction = 20% of QBI
Taxable income <u>greater than</u> \$157,500 (single) or \$315,000 (joint) but <u>less than</u> \$207,500 (single) or \$415,000 (joint)	Deduction subject to phased-in specified service trade or business limitation and phased-in wages and capital limitation	Deduction limited to 20% of QBI minus phased-in wages and capital limitation
Taxable income greater than \$207,500 (single) or \$415,000 (joint)	No deduction	Deduction limited to the <u>lesser</u> of (1) 20% of QBI or (2) the <u>greater</u> of 50% of applicable employee wages paid <u>or</u> 25% of applicable wages plus 2.5% of the tax basis of certain tangible property used in the production of QBI

Section 199A – “Specified Service Trade or Business”

- A **specified service trade or business**: any trade or business:
 - (A) which falls within a modified version of **section 1202(e)(3)(A)** (excluding engineering, architecture); or
 - (B) which involves the performance of services that consist of certain investing or investment management activities, trading, or dealing in securities, partnership interests, or commodities
- A **specified service trade or business** includes any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, **brokerage services**, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees
- Section 199A does not cross-reference the four other subparagraphs in section 1202(e)(3), which include, among other things, any **insurance business** (or similar business)

Section 199A – The Issue

- Whether insurance brokerage firms are covered under section 1202(e)(3)(A) or (B)
- Ambiguity creating problems for members as they file quarterly estimated tax payments

Section 199A – Council’s Position

- Insurance businesses are expressly not included in definition of specified service trade or business
- Definition broadened to explicitly include investing businesses, but not insurance businesses
- Nature of producers’ businesses distinguishes them from the business that Congress did exclude from the provision

Section 199A – Council’s Position

- Entities that engage in the sale and servicing of insurance are insurance businesses and are not brokerage services because:
 - Regulatory regime for insurance producers is separate from the governing regime for broker-dealers and treats producers as insurance businesses (e.g., licensing, examination, and compensation)
 - Unlike broker-dealers, insurance producers have a unique legal agency relationship with the insurance companies for which they sell products
 - The plain-language meaning of “brokerage services” is generally understood to refer to broker-dealers and investment services, not insurance
- **Bottom Line:** Any implementing guidance/regulations should recognize that entities engaging in the sale and servicing of insurance should be eligible for the 199A deduction

Section 199/199A – Architects and Engineers

- Replaced section 199 – **domestic production activities deduction** (“qualified production activities” entitled to deduction of 9% of related income)

- Explicitly included “engineering or architectural services”

- Congress had three options:
 - (1) Repeal section 199; enact section 199A
 - (2) Retain section 199; enact section 199A
 - (3) Retain section 199

Section 199A – Past Actions and Next Steps

- April 23: Sent letter to relevant Treasury officials on the appropriate interpretation of Section 199A and their pending guidance/regulations
 - April 25: Met with relevant Treasury officials to discuss interpretation of Section 199A
 - May 15: Sent follow-up letter to Treasury answering questions posed by officials
 - May 31: Submitted a statement for the record to the House Ways and Means Committee on Congress' intent when drafting the provision
 - June 20: Submitted a statement for the record to the House Financial Services Committee on the effect of TCJA
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- **Up Next?** Proposed rules from Treasury

Message to Conferees

- **Support of efforts to clarify that the tax relief extended to American businesses was also intended for insurance producers and intermediaries organized as pass-through entities.**

- **Please reach out to the U.S. Treasury Department and ask them to clarify that firms engaged in the business of insurance should be entitled to the pass-through relief of the Tax Cuts and Jobs Act.**
 - The legislation left room for regulatory interpretation as to whether or not insurance producers and intermediaries organized as pass-through entities would be able to claim the tax relief afforded to other pass-through entities.

 - We firmly believe that extending tax relief to the insurance producer community was the intention of this Congress.

 - The legislation as written puts my company directly in the middle of a very gray zone when it comes to identifying our eligibility for the tax relief.

 - IRC section 199a states that service industry pass-through entities engaged in “brokerage services” are excluded from the tax relief for pass-through entities, while the same section also states that companies engaged in “the business of insurance” are in fact eligible for the relief.

 - Dialing in on the definitions for “business of insurance” and “brokerage services,” it becomes clear that insurance producers and intermediaries are in fact engaged in the legal definition of the business of insurance.

Call for Action

- CALL GOP CONFEREES AND URGE THEIR SUPPORT FOR EQUITABLE TAX TREATMENT FOR INSURANCE BROKERAGE PASS-THROUGH FIRMS
- Capitol Switchboard: 202-225-3121

House GOP Conferees

- Rob Bishop (R-UT-01)
- Diane Black (R-TN-06)
- Kevin Brady (R-TX-08)
- Kristi Noem (R-SD-AL)
- Devin Nunes (R-CA-22)
- Peter Roskam (R-IL-06)
- John Shimkus (R-IL-15)
- Fred Upton (R-MI-06)
- Don Young (R-AK-AL)

Senate GOP Conferees

- John Cornyn (R-TX)
- Mike Enzi (R-WY)
- Orrin Hatch (R-UT)
- Lisa Murkowski (R-AK)
- Rob Portman (R-OH)
- Tim Scott (R-SC)
- John Thune (R-SD)
- Pat Toomey (R-PA)

Or Send a Letter

- **Download your copy at**
ciab.com/taxequity

DATE

The Honorable _____
The United States House of Representatives
Washington, DC 20515

The Honorable _____
The United States Senate
Washington, DC 20510

Dear Congressman/Senator ____:

I am writing to thank you for your leadership on the Tax Cuts and Jobs Act of 2018 and to ask for your support of efforts to clarify that the tax relief extended to American businesses and jobs producers was also intended for insurance producers and intermediaries organized as pass-through entities. Questions have arisen as to whether or not insurance producers and intermediaries organized as pass-through entities would be able to claim the tax relief afforded to other pass-through entities. We firmly believe that extending tax relief to the insurance producer community was the intention of this Congress.

IRC section 199a states that service industry pass-through entities engaged in “brokerage services” are excluded from the tax relief for pass-through entities, while the same section also states that companies engaged in “the business of insurance” are in fact eligible for the relief. Dialing in on the definitions for “business of insurance” and “brokerage services,” it becomes clear that insurance producers and intermediaries are in fact engaged in the legal definition of the business of insurance. We believe this for the following reasons:

1. The regulatory regime for insurance producers is separate from the governing regime for broker-dealers (the common legal reference meant by the term “brokers”) and clearly treats producers as insurance businesses for licensing, examination, and compensation purposes;
2. Unlike broker-dealers, insurance producers have a unique legal agency relationship with the insurance companies (i.e., product manufacturers) for which they sell products; and
3. The plain-language meaning and everyday connotation of “brokerage services” is generally understood to refer to broker-dealers and investment services, not insurance.

Thank you

Questions?

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