



To our valued Agents:

First of all, HAPPY NEW YEAR!!! We know a majority of you have many questions regarding tax reform and how it affects you. We are working diligently to understand all of the law and how it affects our clients. A large part of the law is fairly straightforward; new individual rates, limits to certain itemized deductions, doubling of the standard deduction, changes to AMT, estate tax changes, etc. A swept under the rug change is the elimination of the entertainment expense. Meals are still eligible for 50% deduction, however entertainment related expenses are now NON-DEDUCTIBLE. Please visit our website www.hjerpecpa.com, newsletters & tax newsletters for updates on these.

The more complicated issues relate to pass-through business owners (Sole Proprietors, LLC's, S Corp's), which all of you are in one form or another. The new law created Section 199A, which on the surface creates a simple 20% deduction against "qualified business income". This is more easily defined as net profit from your Agency. Here is a link to a great article in Forbes from the "tax geek". <https://www.forbes.com/sites/anthonymitti/2017/12/26/tax-geek-tuesday-making-sense-of-the-new-20-qualified-business-income-deduction/#1260d2a344fd>.

It is somewhat satirical, but also very informative, and gets into how extremely non-simplified, ;-), this truly is. This created a whole new level of sophistication and after hours and hours of research have left many unanswered questions with no clarification on the horizon. We want to get to how this affects you at a very elementary level.

To "service" or not to "service", that is the question. This is the biggest question regarding each and every one of your Agencies. Bottom line is there is no clarification if an insurance Agent is considered a specified "service" business under the new Section 199A. I have gotten contradictory answers and have several educators and tax attorneys currently looking into some clarification, the problem is there really is no clear cut answer. I am going to quote a section from the article:

The definitional debate has already gone crazy on the interwebs. For example: what do we do about an insurance business? Section 1202(e)(3)(B)

included "insurance" among its disqualified businesses, but then Section 199A chose to link its definition of disqualified businesses only to Section 1202(e)(3)(A). Does this mean that insurance businesses are good to go under Section 199A?

Maybe, but wait...what type of "insurance" business is Section 1202 referring to? The business of selling insurance, or the business of actually creating an insurance package? I honestly have no idea, and I doubt many others do either. But we're going to have to find out.

We believe your contract further complicates the above issue, due to the fact that you do not own your book of business. We think this helps your cause, however we cannot be absolute certain.

Why is any of this important to you? The easy answer is, if you are NOT considered a specified service business you are going to get the 20% deduction of business profit regardless of your level of income. There are limitations, but we are not going to go through those, they are complicated and the gist is if an insurance Agent is NOT a service business, the net profit of your business (defined in the new code) will generate a 20% deduction on your personal return. For example, the net profit from my Agency is \$200,000, I will get a \$40,000 deduction on my tax return. There are a number of various rules regarding this, however this is the easy way to look at this.

If you ARE considered a specified service business the level of complications are off the charts, however that is only if your income exceeds a certain level. We recently did a survey for our Agent clients that consisted of over 400 Agents. Over 60% are incorporated and the average net income is approx. \$160,000. If your total taxable income (all areas of income) exceed certain thresholds the deduction will be phased-out for any specified service business deduction. Those levels are \$315,000-\$415,000 for married filing joint and \$157,500-\$207,500 for all other taxpayers. If your income will be below this level, the service vs. non-service question doesn't matter and you will get the 20% deduction. The complications are for those within and above this range, IF you are considered a specified service business.

Bottom line to each of you:

If your Agency IS NOT considered a specified service business - you are going to get a 20% deduction of your net Agency profit (sole prop, LLC, or S Corp) no matter taxable income level. This will be great for you should this be the case.

If your Agency IS considered a specified service business:

If taxable income (again all income, including spouses' income) is below the thresholds listed above you are likely going to get a 20% deduction of your net Agency profit.

If taxable income is above the thresholds listed above - we will need to develop strategies for those at these levels that best suit each individual situation, however it is likely you do NOT get a deduction and the new law did nothing for you.

Those thinking of moving to the C corporation model to get the flat rate of 21% should reconsider. In almost all instances I have reviewed the pass-through approach is still the best tax strategy for you. Again, the same shoe does not fit each taxpayer and these rules have made that more apparent. We have to develop a strategy for each client, so one that is suggested to you may not fit your Agent colleague. Those with other businesses, rental properties, spouse situations are going to get different advice than others, so compare notes at your own risk.

We are working feverously to find an answer to the BIG question regarding the specified service business issue, however we are unsure of when we will get real clarification. This may not be what everyone is looking for, however this is where things stand.

The changes with the new reform have created some complicated layers that need to continue to be worked through. Please rest assured, we will continue looking for the answers and when we know them, will pass along. Again, this will take time to work through the kinks, and unfortunately as you can see above the largest variable in your specific situation is yet to be defined, making an already complicated situation even more so.

As always, we appreciate the trust you have placed in our Firm.

HAPPY TAX SEASON

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