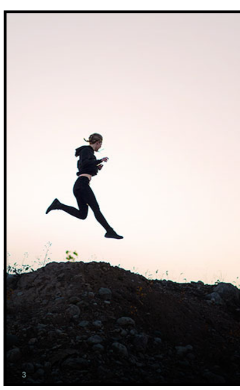
MOSSADAMS

Tax Reform
Key Changes for Businesses

Michelle VanDellen
Tax Partner

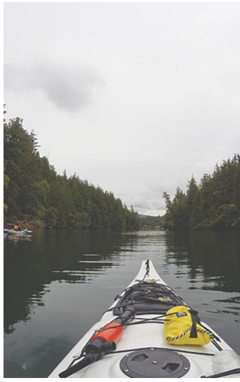
2



Agenda

- General Business Provisions
- Pass-through Entities
- International
- State Tax Issues

3



Highlights of Business Tax Law Changes

- Reduced tax rate on C corporations and income from pass-through entities
- Limitations on the use of NOLs and new limits on excess losses from pass-through entities
- Increased expensing for tangible property
- Changes to income recognition for most accrual-based taxpayers
- Limitations on deductions for fringe benefits – new permanent differences
- Broad changes for multinational businesses

General Business Provisions

Corporate Taxes

Provision	Pre-Reform Law		Reform Act
Corporate Income Tax Rate	35% top rate		**21% flat rate**; effective 1/1/2018; blended rate required or fiscal taxpayers
Corporate AMT	Applies		**Repealed**
Dividends Received Deduction	If own <20%	70%	**50%**
	If own 20%–80%	80%	**65%**
	If own >80%	100%	**100%**

Net Operating Loss

Limited to 80% - Carried Forward Indefinitely

- Limited to 80% of taxable income for NOLs arising in years beginning after December 31, 2017
- Carryforward period made indefinite, no carryback (except farms) for years ending after December 31, 2017

7

Accrual Income Recognition

- An accrual method taxpayer must include an item in income no later than when it is taken into account as a revenue in an "applicable financial statement" (AFS)
- An AFS is:
  - SEC filing (e.g., Form 10-K)
  - Certified audited financial statement
  - Financial statement provided to fed/state government or agency (not a tax return)
- Does not apply to "special methods" (e.g. percentage of completion, installment method)

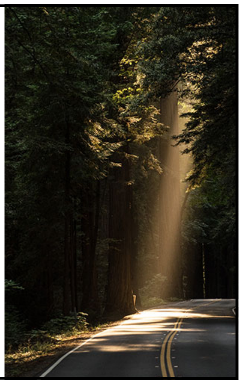
Deferral Method for Advance Payments

- Section 451(c) generally "codifies" the one-year deferral method permitted for advance payments in Rev. Proc. 2004-34 if income is deferred in the taxpayer's AFS
  - Applies to advance payments for goods, services, and other items identified by the Secretary
- Rev. Proc. 2004-34 now applies to taxpayers without an AFS
  - Notice 2018-35 permits continued use by all taxpayers until guidance under Section 451(c) is issued

Consider This…

- Section 451 changes coincide with financial reporting changes under ASC 606
  - ASC 606 effective in 2018 for public companies, in 2019 for private companies
  - Section 451 changes are effective in 2018 for companies with an AFS
- May result in accelerated tax payments when ASC 606 changes are effective
- Pay attention to variable consideration, revenue net of expenses, and multi-year agreements

10



Accounting Methods

Expanded access to simplified accounting methods for businesses with average gross receipts for prior three years of less than $25M

- May use the cash method
- Exempt from requirement to maintain inventories (Sec. 471) – may follow financial statement method or treat as non-incidental materials and supplies
- Exempt from uniform capitalization rules (Sec. 263A)
- Exempt from percentage-of-completion method for long-term contracts expected to be completed within two years

11

Bonus Depreciation

Bonus deprecation is increased to 100% for qualified property acquired and placed in service after Sept 27, 2017 but before Jan 1, 2023

- Pre-reform law: Bonus depreciation set at 50% for 2017 – 40% for 2018 – 30% for 2019
- Qualified property includes:
  - New and *used* property, but must be in an arm's length transaction
  - Film, television, and live theatrical productions
- Phase-outs: Bonus % decreases:

2023	2024	2025	2026	2027
80%	60%	40%	20%	0

12

Improvement Property

Qualified leasehold improvement, qualified restaurant, and qualified retail improvement property categories eliminated – qualified improvement property (QIP) retained

- Pre-reform law: QIP with a 39-year recovery period, but eligible for bonus depreciation
- Conference Agreement – intent was for QIP to have a 15-year recovery period and be eligible for bonus deprecation
- Not reflected in final statute
- Until corrected, QIP is 39-year property and is not eligible for bonus deprecation starting in 2018
- QLIP, QRP, and QRIP eliminated after 2017

13

Section 179

Section 179 Deduction Expanded

- Increases the amount a taxpayer may expense to $1,000,000 (from $510,000 for 2017) and increases the phase-out threshold to $2,500,000 (from $2,030,000 for 2017)
- Expands eligibility of Section 179 to include:
  - Qualified improvement property (QIP)
  - Certain nonresidential real property improvements – specifically, roofs; heating, ventilation, and air-conditioning (HVAC) property; fire protection and alarm systems; and security systems
  - Personal property used predominantly in lodging

14

Like-Kind Exchanges

Limited to Real Property

- Applies only to real property not held primarily for sale
- Personal property no longer eligible for like-kind exchange treatment

15

Business Interest Deduction

Limited to sum of:

1) 30% of "adjusted taxable income"

2) Business interest income

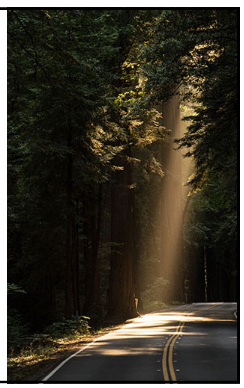
3) Floor plan financing interest

- Interest limited is carried forward indefinitely
- Adjusted taxable income:
  - Cannot be below zero
  - Computed without regard to:
    - Non-business income or expenses
    - Business interest expense or income
    - NOL deduction
    - Pass-through deduction
    - For years before 2022, deductions for depreciation, amortization, and depletion
- Businesses with average gross receipts of $25M or less would be exempt
- Real property trade or business may elect out, but must use ADS for certain real property

16

Consider This…

- Depreciation provisions permit increased expensing and are excluded from "adjusted taxable income" for purposes of the limitation on the deduction of business interest
- That changes in 2022, meaning more businesses will be subject to the limitation at that point



17

Fringe Benefits & Entertainment Expenses

Provision	Pre-Reform Law	Reform Act
Entertainment or Recreation Expenses	50% deductible to the extent directly related to, or associated with, an active conduct of a trade or business	**Repealed** – no deduction allowed for expenses even if directly connected to the business (meals still 50% deductible)
Food & Beverage Expenses for Employees (on-site cafeteria or de minimis meals)	100% deductible, if considered a de minimis fringe benefit	50% deductible if de minimis and for convenience of employer – **after 2025**, expenses related to on-site cafeteria not deductible

18

Fringe Benefits & Entertainment Expenses

Provision	Pre-Reform Law	Reform Act
Transportation Fringe Benefits	Deductible to employer ($260/mo. per employee) – excluded from employee wages	**Repeals** employer deduction (unless to ensure safety of employee) – exclusion from employee wages retained
Bicycle Commuting Reimbursement	Excluded from employee wages – up to $20/month	**Repeals** employee wage exclusion for 2018 through 2025

Observations
- Transportation benefits include parking reimbursements and transit passes
- Taxable income impact is immediate and may impact payroll reporting
- Consider local laws before making changes – many require companies to offer certain transportation benefits to employees

19

Employee Achievement Awards

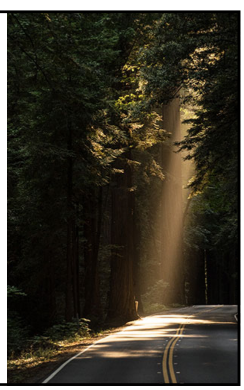
- Employers may deduct the cost of an employee achievement award up to $400 for awards of “tangible personal property”
- Tangible personal property defined by new law to exclude cash, gift cards, vacations/lodging, theater or sporting tickets, and stock

Observations
Since a clarification to the existing law, consider if you have any exposure in prior years

20

Consider This…

- These changes to the permitted tax deduction will create new permanent differences as the deduction is either limited or disallowed
- It will be important to make sure accounting policies segregate these items to properly compute taxable income
- Companies may also want to reevaluate their accountable plan strategies in light of the new rules



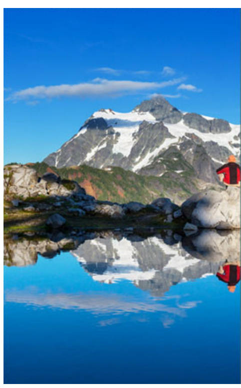
21

Qualified Opportunity Zones (QOZs)

Real estate investors may defer capital gains upon the sale of property through 2026 if the proceeds are reinvested in a qualified opportunity fund (a fund that invests in QOZs)

- New provision encourages long-term investment in QOZs
  - Defer gains until December 31, 2020, unless disposed earlier
  - Partial step-up in basis if investment held more than 5 years
  - No tax on appreciation if investment held 10+ years
- Approved QOZs located in almost all states

22



Other Business Provisions

- Beginning in 2022, specified U.S. research expenses must be capitalized and amortized ratably over five years (15 years if foreign research)
- DPAD is repealed for tax years beginning after 2017

Pass-through Entities

24

Pass-through Income

Allows 20% deduction of "qualified business income" (QBI) – sunsets in 2026

- QBI is qualified income, gain, deduction & loss from a partnership, S corporation, or sole proprietorship
  - Does not include reasonable compensation paid to a shareholder or partner
- Does not include income from "specified service trade or business"
  - Law, health, consulting, financial services, or any trade or business where the principal asset is the reputation or skill of one or more of its owners or employees (excluding engineering and architecture)
  - *Exception*: income is less than $315K (MFJ)/$157.5K (other) (phased out over next $100K)

Observation
For taxpayers subject to top individual rate of 37% and eligible for QBI deduction, the effective tax rate on such qualifying income will be 29.6%

25

Qualified Business Income

SECTION 199A

Qualified Business	Qualified Business Income	W-2 & Property Limitations	Taxable Income Limitations
– Must be a "trade or business"* – Certain services are excluded** – Performing services as employee excluded	– Income that is "effectively connected" to a trade or business in US – Certain investment items excluded (including capital gains) – Compensation excluded – Special loss recapture rule	– Limitation applies if 20% of qualified trade or business income exceeds:*** • (A) 50% of W-2 wages; or • (B) 25% of W-2 wages and 2.5% of "qualified property"	– Deduction cannot exceed 20% of taxable income (less net capital gain)

*Qual ed cooperative div dends qual ed REIT d v dends and qual ed publ c y traded partnersh p ncome also qual y for he sec on 199A deduction
**Serv ce bus ness may be treated as qual ed bus ness f taxpayer s ncome is under certain hreshold amounts
***Lim ation does not apply f taxpayer s ncome s under cer ain threshold amounts mportantly, the m ations apply on a bus ness by bus ness bas s

26

New Loss Limitation Rules

SECTION 461(l)

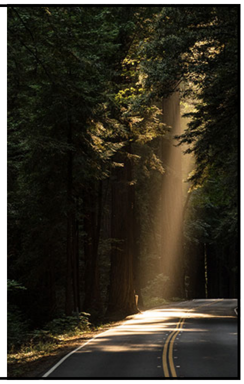
Rule	Non-corporate taxpayer cannot deduct an "excess business loss"
Excess Business Loss	Equals a taxpayer's net loss from all trades or businesses in excess of $500,000 (married) or $250,000 (other)
NOL Treatment	Excess business loss becomes treated as an NOL in subsequent year
Relationship to Other Loss Limitation Rules	The excess business loss rule applies after other loss limitation rules (e.g., basis limitations, "at risk" rules, passive activity rules)

Observations
- Business losses in excess of $500,000/$250,000 cannot offset non-business income in the year incurred. Suspended losses can be used in subsequent years subject to the 80% taxable income limitation.
- This rule may limit the immediate deductibility of passive activity losses that are "freed up" in the disposition of a passive activity because they are considered non-passive loss upon disposition.

27

Consider This…

- Evaluate current entity structure given new rules
- When evaluating a choice of entity change consider:
  - Accounting methods
  - State and local tax
  - International tax
  - Succession planning and transitions
  - Future law and rate changes
  - Additional tax filings



28

International

29

Move to Territorial System of Taxation

- **Old law**
  - U.S. taxed U.S. Companies on worldwide income. Companies receive a tax credit for taxes paid to other countries
  - While foreign subs not generally subject to U.S. tax, dividends from subs trigger U.S. tax and credit
  - Subpart F regime intended to address abuses
- **New law**
  - U.S. companies taxed only on U.S. earnings, with exceptions
  - Cash-repatriated tax free
  - Subpart F regime retained and expanded
- **Transition – Deemed repatriation**

30

Additional Updates

- Certain stock of a foreign corporation owned by a foreign person will be attributed to a related U.S. person for purposes of determining application of the CFC rules. Additional 5471 reporting will be required due to new attribution rules, particularly for foreign owned U.S. corporations.
- Application of Subpart F income will now apply to 10% shareholders by vote AND value and there will no longer be a minimum holding period.

31

State Tax Issues

32

State Tax Issues

- For corporate income tax purposes, most states use “federal taxable income” – IRC Section 63 – as the starting point for computing the state tax base. Consequently, changes to federal taxable income by Congress can have carry-over effects on the states.
- Conversely, changes to federal tax rates and tax credits do not – generally – impact state taxation because the state tax codes have their own rate and credit structures.
- All states have the ability de-couple from select federal tax statutes (i.e. IRC Section 168(k) bonus depreciation and the IRC Section 199 Domestic Production Activities deduction).

33

TCJA of 2017 – Impacts to Multistate Taxation

- Full Expensing – 100% bonus depreciation for property acquired after 09/27/2017 and before 01/01/2023 (up from current 50%) for "qualified property."
  - Many states already have specifically de-coupled from IRC Section 168(k). De-coupling will create greater differences in basis in the depreciable asset that will need to be tracked.
  - For states that currently conform, future decisions on whether to continue conformity will occur.
- IRC Section 179 – small business expensing. Limitation on amount that can be expensed is increased to $5 million (from current $500,000) and the phase-out amount increased to $20 million (from $2 million) for tax years beginning after 2018 and before 2023.
  - More states conform to IRC Section 179 expense limitations than to federal bonus depreciation. Will increasing the limitation amount 10x cause the state to consider de-coupling from the federal law?

34

TCJA of 2017 – Impacts to Multistate Taxation

- Interest expense limitation – replaces IRC Section 163(j) and limit interest expense deductions to 30% of adjusted taxable income. IRC 163(n) is created to limit interest deduction of US corporations (and foreign corporations with US business) that is part of international financial reporting group to the extent the U.S. corp.'s share of the group's net interest expense exceeds 110% of EBITA. Disallowed interest expense can be carried over for 5 years.
  - State conformity to these new provisions would allow opportunity to limit interest deduction for state purposes. Will states allow 5-year carryforward. State conformity to IRC Section 381 and 382 would have to be considered.
- NOLs – eliminate NOL carryback and limit application of carryforwards to 80% of taxable income. Could be an issue in those states that determine state NOLs based on IRC Section 172.

35

State Approaches – a sampling

California	California conforms to the IRC as of 01/01/2015. Since California has not moved up its conformity date, none of the changes to the IRC due to the TCJA are in effect for California income tax purposes.
Idaho	IRC conformity shifted to 12/21/2017 (day before TCJA enactment) *except* that state adopts the IRC as of 12/31/2017 for purposes of IRC Section 213 (medical expenses)and 965. Additionally, Idaho specifically disallows deductions attributed under IRC Sections 965. Subsequent legislation moved IRC conformity up to 02/09/2018 for IRC Sections 108, 163, 168(i), 179D, 179E, 181, 199, 202, & 451.
Oregon	Rolling conformity state.

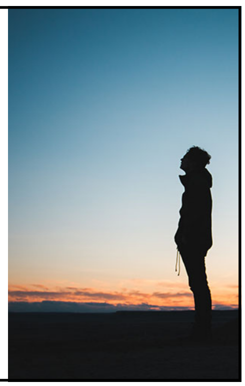
36

Next Steps and Planning Opportunities

37

Next Steps and Planning

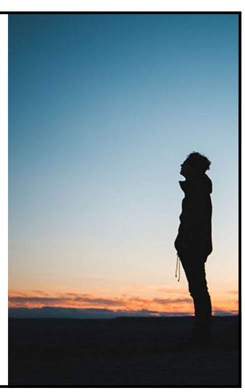
- Model impacts of tax law changes to evaluate potential new planning opportunities
- Consider impact of changes on state and local taxes – depends on degree of conformity to federal code
- Revisit entity structure



38

Next Steps and Planning

- Evaluate reimbursement policies and accountable plan strategies
- Consider need for accounting procedure changes for any new permanent differences (e.g., de minimis meals)
- Evaluate accounting method implications (e.g., accrual revenue recognition, simplified methods), including impact on ASC 606 adoption
- Evaluate international rule changes



39