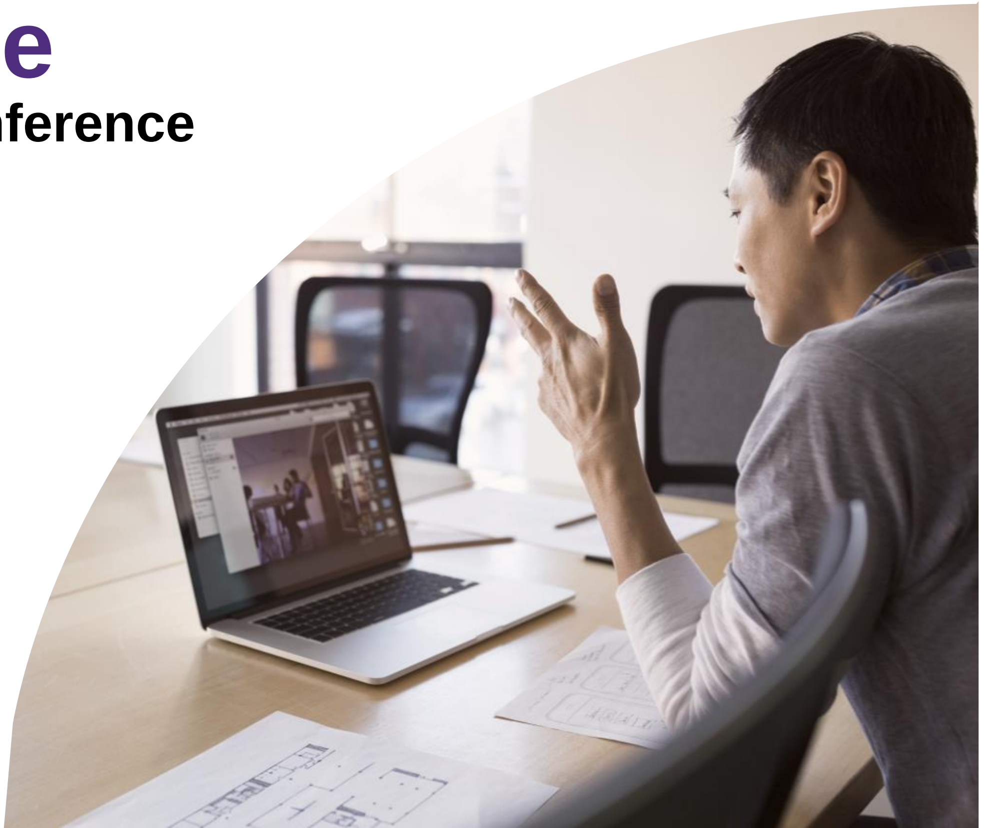
Federal Tax Update

WSU Accounting & Auditing Conference

May 16, 2018



Learning Objective

The learning objectives for this discussion are to:

- Identify **highlights** of tax reform changes for individuals and businesses
- Describe strategies to address tax law changes
- Discuss recent news in legislation

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Tax reform. It's Here!

- Passed by both the House and the Senate
- Signed into law by President Trump – December 22nd
- Provisions effective for tax years beginning after December 31, 2017 (unless otherwise noted)
- Planning opportunities exist

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Compensation and fringe benefits

Executive compensation issues Section 162(m)

- Background:
  - Section 162(m): Annual taxable compensation to individual covered employees in excess of $1million is not deductible
- Reform Changes:
  - Expands group of publicly held companies
  - Expands the group of covered employees
  - Repeals performance based compensation exception with limited grandfathering

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Entertainment expenses – Section 274

- No deduction with respect to an activity generally considered to be entertainment, regardless of its connection to the employer's trade or business (previously was 50% deductible)

- Effective for amounts paid or incurred after Dec. 31, 2017

Meals & Entertainment deduction changes

Type of expenses	Old law	New law
Client entertainment Client entertainment-event tickets	50% deductible 50% face value	0% deductible 0% deductible
Client business meals	50% deductible	50% deductible
Employee travel meals	50% deductible	50% deductible
Sec. 274(e) Recreation	100% deductible	100% deductible
Meals provided for convenience of employer	100% deductible	50% deductible *0% after 2025
Employer provided on-site eating facility	100% deductible	50% deductible *0% after 2025
Sec. 132 De minimus fringe benefits	100% deductible	50% deductible

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Employee achievement awards – Sections 74 and 274

- The bill creates a new category related to employee achievement awards entitled “tangible personal property.” Employees will not be able to exclude from taxable income cash, cash equivalents, gift cards, gift certificates, vacations, meals, lodging or tickets to theater or sporting events, stock, bonds, and other securities.

- Effective for amounts paid or incurred after Dec. 31, 2017

Employer-paid moving expenses – Sec. 132(a)(6)

- The bill suspends the exclusion from gross income for qualified moving expense reimbursements for tax years beginning after Dec. 31, 2017 and before Jan.1, 2026
- Deduction for an employee's relocation for work regardless of whether employee or employer bears the cost, other than for active duty members of the military

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Transportation fringe benefits – Sec. 132

- The bill disallows deductions for expenses associated with providing any qualified transportation fringe to employees (i.e., commuting via mass transit, parking, and bicycle costs), and except for ensuring employee safety, any expense incurred for providing transportation (or any payment or reimbursement) for commuting between the employee's residence and the place of employment
- Employee can still exclude a portion of the transportation fringe other than for qualified bicycle commuting expenses
- Effective for amounts paid after Dec. 31, 2017

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Affordable Care Act individual mandate - Sec. 5000(a)

- The bill reduces the amount of the individual shared responsibility payment enacted as part of the Affordable Care Act (“the individual mandate”) to zero.

- Applicable to months beginning after Dec. 31, 2018

Individuals and Estates

Basic changes

- Overall rate reduction
- No change to capital gain/qualified dividend rate
- AMT changed, but retained for individuals
- Doubled standard deduction, repealed personal exemptions

Section 199A Pass-through deduction

- Individual taxpayers generally may deduct up to 20% of combined qualified business income from partnership, S corporation or sole proprietorship that is **not** engaged in specified service activities
  - Deduction not permanent
  - The deduction does not reduce net investment income
  - It is a partner/shareholder level deduction and does not decrease basis
  - Losses from a previous year are netted with current year income when determining qualified business income

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Section 199A Pass-through deduction

- Qualified business income
    - Effectively connected with a trade or business within the US.
        - Does *not* include:
            - investment type income (i.e. capital gains and dividends)
            - Individuals' share of S corp reasonable compensation and partnership guaranteed payments
            - Income from specified services trade or business

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Section 199A Pass-through deduction

- Special service activities – Section 1202(e)(3)(A)
  - Any activity involving performance of services including: investing, trading or dealing in securities, commodities or partnership interests.
  - Any trade or business <u>involving</u> the performance of services in the fields of:
    - Health, law, 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,

- Activities **not** included in 199A:
  - Engineering
  - Architecture

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Section 199A Pass-through deduction

- How the deduction is calculated
  - Full 20% deduction for taxpayers with taxable income under $157,500 (single) and $207,500 (MFJ)
  - W-2 wage limit phases in for taxpayers between $157,500(single)/$315,000(MFJ) and $207,500/$415,000, respectively
  - Taxpayers above $207,500/$415,000, the deduction is capped at the greater of:
    - 50% of the W-2 wages paid with respect to qualified trade or business
    - The sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property

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Individual tax deduction

- State and Local Tax – limit of $10,000 of sales/property/local income taxes*
- Medical Expense deduction – reduce floor to 7.5% from 10% - *2017 and 2018 only*
- Suspend Moving Expense deduction*
- Suspends all miscellaneous deductions subject to 2% floor*
- Removes overall limitation on itemized deductions*
- Mortgage interest deduction limited to mortgages up to $750,000 (down from $1M) on debt incurred after 12/15/17*

* ***Unless otherwise noted provisions expire after 2025***

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Individual tax deductions

- Increase in Standard Deduction to $12,000 Single / $24,000 Joint (indexed for inflation) - will reduce taxpayers who itemize (complete Schedule A) from 30% to potentially less than 10%. *Provision expires after 2025*.

- Taxpayers allowed to offset up to 60% of Adjusted Gross Income with Charitable Cash Contributions; Up from 50% - expires after 2025

- Athletic Event Seating Rights – Repeal the 80% charitable deduction if the taxpayer receives in return the right to purchase tickets or seating to an athletic event

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Estate and gift tax

- Lifetime exemption was doubled to $11.18 million per person
- Step up at death still in effect
- Current gift tax annual exclusion increased to $15k per donee

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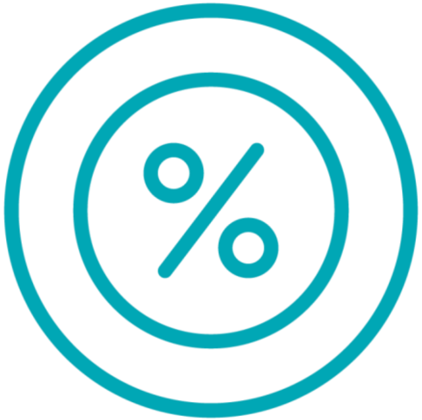
General Corporate

Corporate tax rate

- Section 11(b) is amended to provide that the corporate tax rate is 21%
- No longer a graduated scale
- Applies to taxable years beginning after December 31, 2017



Net operating loss deduction

- NOL deduction is limited to 80% of taxable income for losses arising in taxable years beginning after December 31, 2017
- Repeal of a 2 year carryback of NOL and 20 year carryforward for NOLs arising in taxable years ending after December 31, 2017
- Unused NOLs arising after December 31, 2017 carry forward indefinitely

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Business interest deduction

- Business interest expense is limited as a deduction (if otherwise deductible)
- It may not exceed the sum of:
  - Business interest income for such taxable year
  - Floor Plan Financing Interest for such taxable year
  - 30% of the "adjusted taxable" income for such taxable year
- The amount of any disallowed business interest expense is treated as business interest paid or accrued in the succeeding taxable year

Business interest deduction

- Special rules apply for partnerships an S corporations
- Generally, the deductibility of business interest is determined at the entity level
- If disallowed at the entity level, the disallowed interest is allocated to the owners and may only be deducted in a successive year if there is excess Adjusted Taxable Income from such entity

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Other corporate items

- Corporate Alternative Minimum Tax is repealed
  - Prior AMT credits may be refundable for tax years beginning in 2018, 2019, 2020 and 2021
- Corporate Dividend Received Deduction reduced:
  - from 80% to 65% for "20% owned" – Section 243(c)
  - from 70% to 50% for "Less than 20% owned" – Section 243(a)

International Changes

Dividends received deduction (DRD)

- Provides a 100% DRD to domestic corporations for foreign-source dividends received from 10%-or-more owned foreign corporations

- Includes a 365-day holding period

- Expands the exemption by also allowing a DRD on certain deemed income inclusions resulting from the disposition of lower-tier controlled foreign corporations

Transition tax on unrepatriated income

- Generally applies to U.S. persons that hold "Specified Foreign Corporations":
  - CFCs; or
  - any foreign corporation with respect to which a domestic corporation holds at least 10%
- Unremitted foreign earnings are taxed at the following rates:
  - 15.5% to the extent such earnings are allocable to cash or cash equivalents
  - 8% for remainder
- Calculation done in aggregate, losses at one entity may offset income at another
- Taxpayers can elect to pay transition tax over 8 years on a graduated basis

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Base Erosion and Anti Abuse Tax (BEAT)

- Beginning in 2018, U.S. corporations that make excessive "base erosion payments" (BEPs) will be subject to a 10% minimum tax (5% for 2018 and 12.5% for years after 2025) on modified taxable income (computed without regard for certain BEPs and NOLs attributable to BEPs) if the U.S. corporations have both:

  - $500 million in average gross receipts (of U.S. corp. or branch) over 3 years, and
  - a base erosion percentage (a ratio of base erosion deductions compared to total deductions) of 3% or higher for the taxable year

- BEPs are generally amounts paid or accrued to a foreign-related party (related party is broadly defined) which results in a deduction (including depreciation and amortization)

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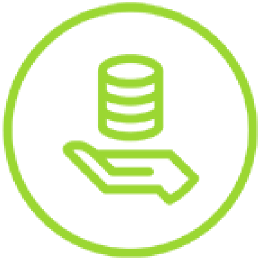
Global Intangible Low Tax Income (GILTI)

- U.S. shareholders owning 10% or more (vote or value) of a CFC must include in income the GILTI
- GILTI is the excess of the CFCs' income (subject to exceptions) over a 10% return on its adjusted basis in depreciable assets

- U.S. corps can obtain a deduction equal to 50% of the GILTI inclusion
  - Through 2025 and then 37.5% thereafter
  - Foreign tax credit is available up to 80% of foreign taxes



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Foreign Derived Intangible Income (FDII)

The law provides an incentive for domestic corporations that earn foreign intangible income (includes, sales, leases, licenses and services).

- Allows a deduction of 37.5% of the lesser of
    1. the sum of its foreign-derived intangible income (FDII), or
    2. its taxable income, determined without regard to this law
- Results in a 13.125% effective tax rate on excess returns on foreign sales and services
- Complex set of definitional rules
- The deduction for foreign-derived intangible income is reduced from 37.5% to 21.875% for taxable years beginning after December 31, 2025

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Final Thoughts

Planning the way forward

Questions?

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