SOREDI 2018 Moss Adams Tax Seminar: How will the New Tax Law Effect Your Business?

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Agenda

- Background – How we got here
- Business Provisions
  - General provisions
  - New Pass-through deduction
  - Interest deduction
  - Accounting methods
- Individual Provisions
  - Tax Rates
  - Deductions
  - Other Provisions

Background

How we got here

House & Senate	Conference	President
Introduced bills in November House passed its bill Nov 9 Senate passed its bill Dec 2	Conferees released Conference Agreement Dec 15 Senate and House voted and passed on Dec 20	President Trump signed Tax Cuts and Jobs Act (TCJA) into law on Dec 22

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Business Provisions

Business Provisions

Provision	Pre-Reform Law	Reform Act
Corporate Income Tax Rate	35% top rate	21% flat rate; effective 1/1/2018; blended rate for fiscal taxpayers
Corporate AMT	Applies	Repealed
Dividends Received Deduction	• 70% if own <20% • 80% if own between 20% and 80% • 100% if own more than 80%	• 50% if own <20% • 65% if own between 20% and 80% • 100% if own more than 80%

Net Operating Loss

Limited to 80% - Carried Forward Indefinitely

Limited to 80% of taxable income for NOLs arising in years <u>beginning after</u> December 31, 2017

Carryforward period made indefinite, no carryback (except farms) for years <u>ending after</u> December 31, 2017

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 recovery periods for real property

Pass-Through Changes – Interest Deduction Limitation Example

Gross Revenue	$10,000,000	Interest Deduction Calculation:	
Interest Income	300,000	Adjusted Taxable Income (Gross Revenue less Operating Expenses)	$5,000,000
Gross Income	10,300,000	30% of ATI	1,500,000
Interest Expense	2,500,000	Deductible Interest (lesser of Interest Expense or 30% ATI)	1,500,000
Depreciation	2,000,000	Suspended Interest Expense (carried forward)	1,000,000
Operating Expenses	5,000,000	Taxable Income (Net Income plus suspended interest)	$1,800,000
Total Expenses	9,500,000		
Net Income	$ 800,000		

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

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:
  - Form 10-K
  - Certified audited financial statement
  - Financial statement provided to fed/state government or agency (not a tax return)

Bonus Depreciation

Bonus depreciation 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 percentage decreases to 80% for 2023 – 60% for 2024 – 40% for 2025 – 20% for 2027 – None for 2027

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 indicates intention was for QIP to have a 15-year recovery period and be eligible for bonus deprecation
- Actual statute language did not alter QIP's prior 39-year recovery period – and it did eliminate its qualification for bonus depreciation effective with new changes to bonus depreciation rules

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

Like-Kind Exchanges

Limited to Real Property

- Applies only to real property not held primarily for sale

20% Deduction on Qualified Business Income - Section 199A

Qualified Business

- Must be a "trade or business"
- Certain services are excluded*
- Performing services as employee excluded

Qualified Business Income

- 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

W-2 and Property Limitations

- 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"

Taxable Income Limitations

- Deduction cannot exceed 20% of taxable income (less net capital gain)

**Service business may be treated as qualified business if taxpayer's income is under certain threshold amounts

** Limitation does not apply if taxpayer's income is under certain threshold amounts. Importantly, the limitations apply on a business-by-business basis.

- Qualified cooperative dividends, qualified REIT dividends, and qualified publicly traded partnership income also qualify for the section 199A deduction

Pass-Through Changes – QBI Deduction Example

Bill & Joan have $450,000 of pass-through income from three qualified trades or businesses. They also have $200,000 of guaranteed payment income and $100,000 of charitable contribution deductions for net taxable income before the 199A deduction of $550,000. Their QBI Deduction Calculation is as follows:

Activity	QBI	Wages	Property	20% QBI	50% Wages	Alternate Limitation	QBI Deduction
A	500,000	50,000	3,000,000	100,000	25,000	87,500	87,500
B	250,000	300,000	300,000	50,000	150,000	92,500	50,000
C	(300,000)	3,000,000	50,000,000	(60,000)	1,500,000	2,000,000	(60,000)
Total	450,000	3,350,000	53,700,000	90,000	1,675,000	2,180,000	77,500

Bill & Joan's QBI deduction would be $77,500. They are not able to "pool" wages and property to arrive at an overall QBI deduction limitation. QBI calculation is done on an activity-by-activity basis.

New Loss Limitation Rules - Section 461(l)

- Rule: Non-corporate taxpayer cannot deduct an "excess business loss"
- Excess Business Loss: Effectively, 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)
- Result: Business losses in excess of $500,000 (married) or $250,000 (other) cannot offset non-business income in the year incurred. Suspended losses can be used in subsequent years subject to the 80% taxable income limitation

Pass-Through Changes – Excess Loss Provision Example

Greg, a married taxpayer has the following:

W-2 Wages	$500,000
Interest & Dividends	250,000
Passive Activity A	(150,000)
Passive Activity B	100,000
Nonpassive Activity A	300,000
Nonpassive Activity B	(400,000)
Nonpassive Activity C	(900,000)

His Adjusted Gross Income would be:

W-2 Wages	$ 500,000
Interest & Dividends	250,000
Passive Income/Loss	---
Nonpassive Income/Loss	(500,000)
Adjusted Gross Income	$ 250,000
Passive Loss Carryover	(50,000)
NOL Carryover	(500,000)

First, $50,000 of passive losses are suspended under Sec. 469, resulting in net passive income of zero for the taxable year. Then, he is only allowed to deduct $500,000 of the $1M of net nonpassive losses for the year.

Other Partnership Changes

- After 2017, the basis limitation on the deductibility of partnership losses applies to a partner's distributive share of charitable contributions and foreign taxes
- Repeal of technical termination rules:
  - A partnership is treated as continuing even if more than 50% of interests are sold or exchanged.
- Substantial Built-In Loss:
  - Definition expanded to include a partner-level test – if any partner would be allocated more than a $250,000 loss in a hypothetical disposition of all assets, the partnership is considered to have a substantial built-in loss.

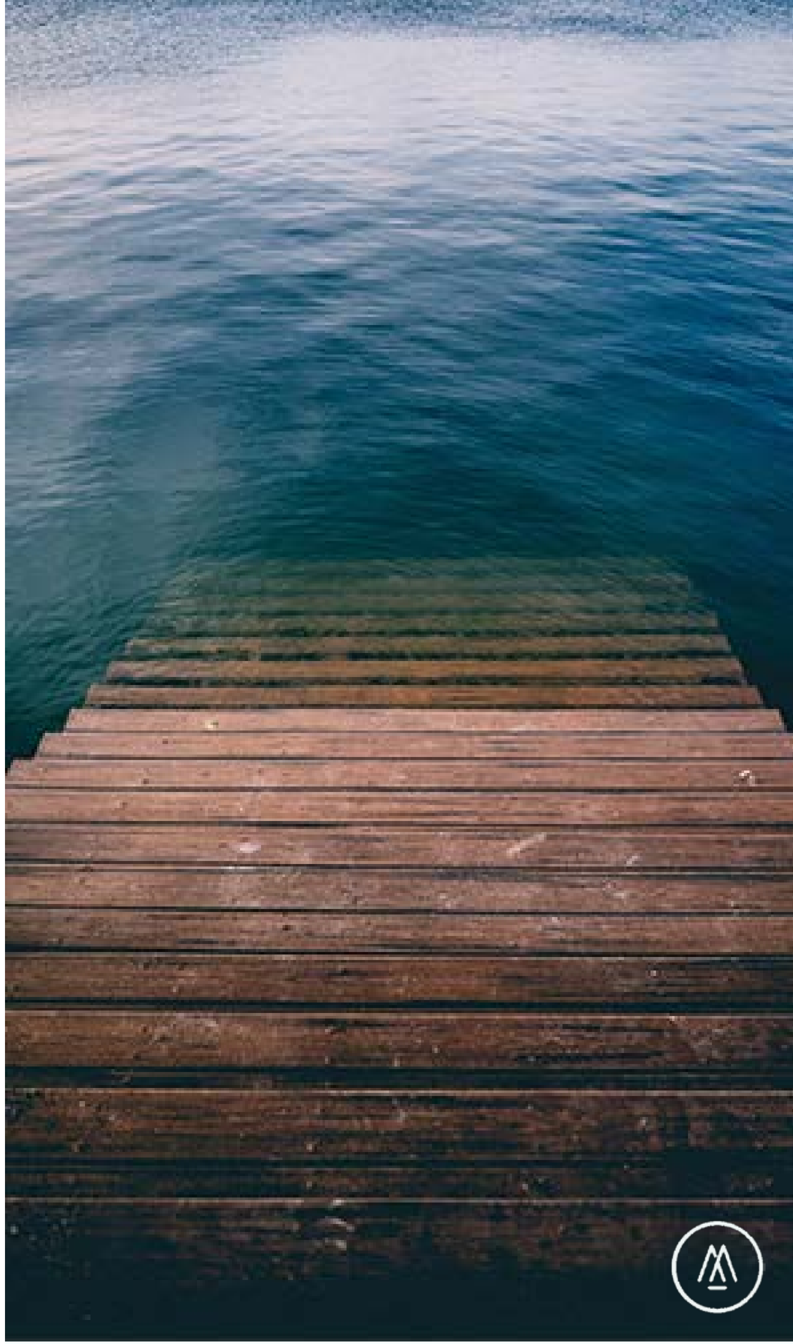
S Corporation Conversion to C Corp

Special Rules During 2-year Period

- S Corporations that revoke S corporation elections during two-year period beginning on enactment date and have the same owners on both enactment date and revocation must:
  - Distribute money during the post-termination transition period (generally one year after S election termination) as if paid from accumulated adjustments account and E&P.
  - Taxpayers are to account for adjustments under 481(a) due to the termination over a 6-year period.

Alternative Minimum Tax

- The Tax Cuts and Jobs Act repeals AMT for corporations in 2018.
- AMT credit is able to offset regular tax liability for any taxable year.
- Refundable between 2018 and 2020 for up to 50% (100% in 2021) to the extent AMT carryovers exceed the regular tax liability.



Other Business Provisions

Provision	Pre-Reform Law	Reform Act
Contributions to Capital	Gross income of a corporation does not include any contribution to its capital.	“Contributions to Capital” redefined to exclude (1) contributions in aid of construction as a customer, and (2), any contribution made by a governmental entity or civic group (other than in capacity as shareholder)
Historic Rehab Credits	Available for rehabilitation of historic, income producing buildings	Retained with some changes

Other Provisions

- DPAD is repealed for tax years beginning after 2017
- Broad changes for multinational companies with shift to a territorial tax regime
- Mandatory deemed repatriation of undistributed foreign earnings

Research & Development Expenditures

- Beginning in 2022, specified U.S. research expenses must be capitalized and amortized ratably over five years.
- Expenses attributable to research conducted outside the U.S. are amortized over 15 years.
- Specified expenses do not include expenditures for land or depreciable property, but do include related depreciation allowances.
- If property is disposed, retired, or abandoned during the amortization period, basis is not recovered – must continue to be amortized over remainder of the period.
- Application is treated as a Sec. 481 change of accounting method.

Other Business Provisions

Provision	Pre-Reform Law	Reform Act
Fines and Penalties	Fines and Penalties paid to a government are non-deductible.	Expands non-deductibility to any amount paid at the direction of a government or regulatory entity for the violation of a law.
Local Lobbying Expenses	Ordinary and necessary expenses in lobbying any local legislation are deductible	Removes the exception for local lobbying.

Fringe Benefits and 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 and 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
Moving Expenses (Non-military)	Reimbursements excluded from employee wages	Suspends exclusion for 2018 through 2025

Fringe Benefits and 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
Employee Achievement Awards	Excluded from wages awards for "tangible personal property" (not clearly defined) up to certain thresholds	Tangible personal property excludes cash, cash equivalents, gift cards, vacations, meals, lodging, theater/sporting event tickets, stocks, or similar (amounts no longer excludible)

Credit for Paid Leave

- Provision allows a general business credit equal to 12.5% of wages paid to qualifying employees who are on family and medical leave.
- Eligibility:
  - Written policy allowing full-time employees at least two weeks annual leave (and part-time employees a pro-rata amount).
  - Leave not paid for by state or local government.
  - Eligible employee’s compensation is less than 60% threshold for highly compensated employees.
  - Leave wages must be at least 50% of normal wages – credit increases .25% for each percentage point paid above 50% - up to full wage amount.
- Credit is available for wages paid through 2019.

Key Considerations

- Accelerating deductions into 2017 or deferring income into 2018 creates potential for permanent tax benefit due to 2018 rate reduction

- Evaluate reimbursement policies and accountable plan strategies to determine if any changes should be made in light of new rules for entertainment expenses and certain fringe benefits

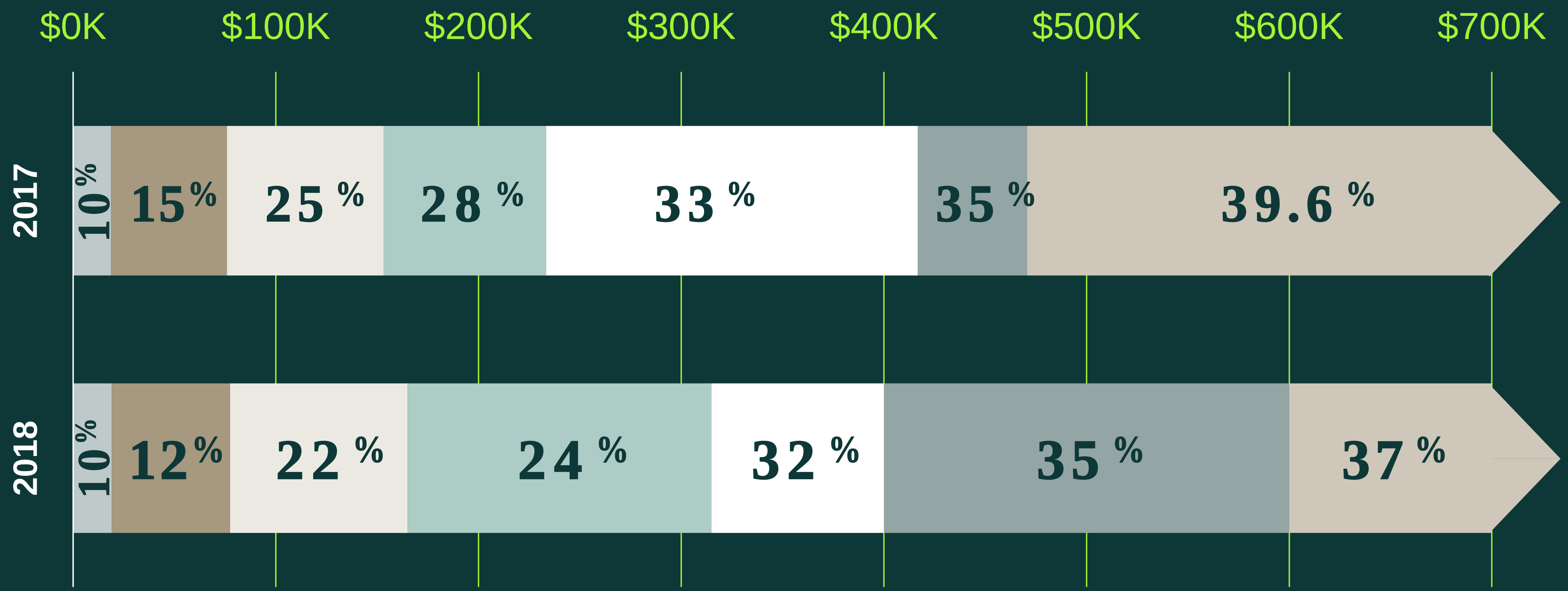
Audience question

Which of the tax changes from the Tax Cut and Jobs Act (TCJA) do you foresee most impacting your business?

Individual Provisions

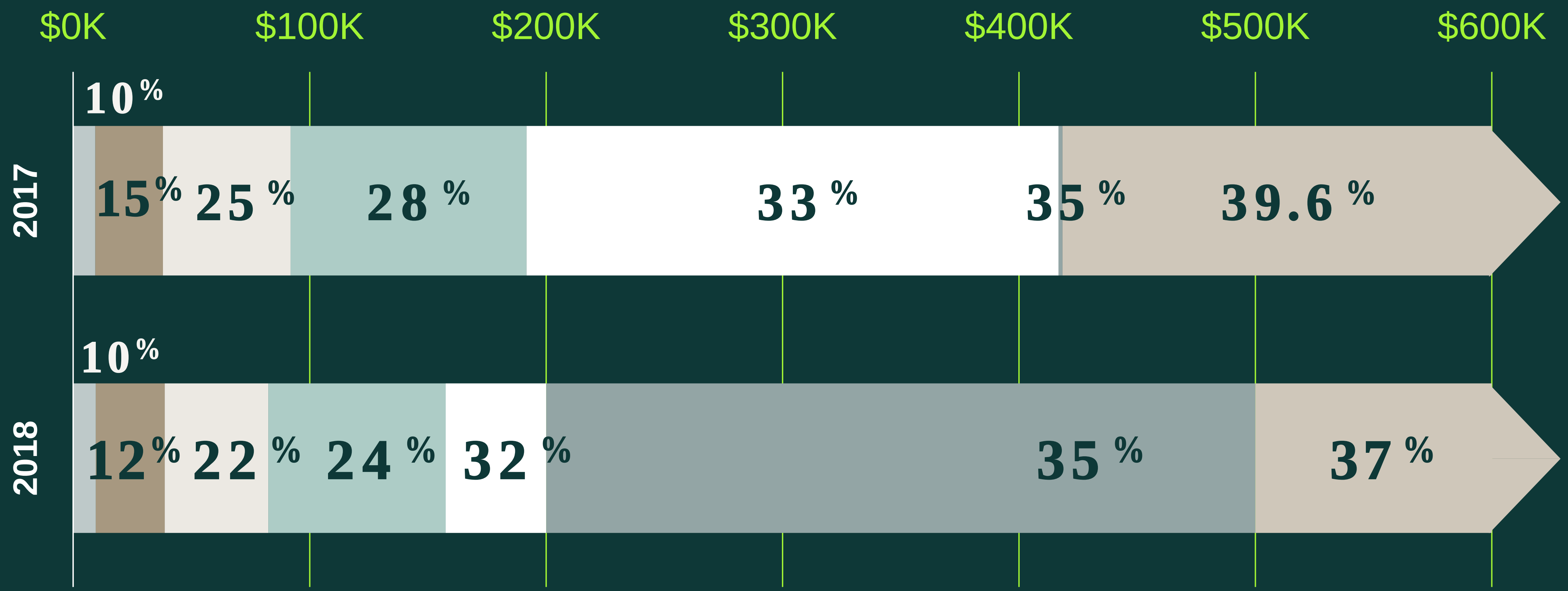
Income Brackets & Tax Rates

MARRIED FILING JOINTLY



Income Brackets & Tax Rates

SINGLE



Individual changes

- Personal Exemptions – Suspended until 2026

- Standard Deduction – Raised until 2026

Married Filing Joint	$24,000
Head of Household	$18,000
Individual	$12,000

  - Retains enhanced deduction for blind and elderly

- AMT Exemption – Raised until 2026

	AMT Exemption	**Exemption Phaseout**
Married Filing Joint	$109,400	$1,000,000
Other Taxpayers	$70,300	$500,000

Itemized Deductions

Provision	Pre-Reform Law	Reform Act
Itemized Deduction Limitation	Total itemized are reduced by 3% of AGI for taxpayers over a threshold	Suspends limitation for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026
Charitable Contributions	Limitation of Charitable deduction is 50% of AGI	AGI limitation on deduction increases to 60% of AGI in tax years beginning after 2017 and before 2026

SALT Deduction

The state and local tax (SALT) itemized deduction is limited through 2025

State and Local Tax Deduction

- Sales Tax *or* Income Tax and
- Property Tax

Combination of sales tax *or* income tax and property tax cannot exceed $10,000 per taxpayer ($5,000 if married filing separately)

$10,000 limitation goes away after 2025

Itemized Deductions

Provision	Pre-Reform Law	Reform Act
Mortgage Interest Deduction	Deduction on first $1 million that secures primary or secondary residences, plus $100k of home equity indebtedness	Suspends deduction for home equity indebtedness and reduces limitation to $750k (for debt incurred after 12/15/17) until 2026
Medical Expenses	Awards of tangible personal Deductible to extent exceeds 10% of AGI	Lowers 10% threshold to 7.5% for tax years 2017 and 2018

Suspended Itemized Deductions

2% Miscellaneous Itemized Deductions – suspended for tax years beginning before Jan. 1, 2026

- Expenses for production of income
    - Investment fees
    - Hobby expenses
    - Safe deposit boxes
- Tax Preparation Expenses
- Unreimbursed Employee Expenses
    - Home office deduction
    - Educator expenses
    - Union dues

Repeal of Above the Line Deductions

- Alimony Paid
- Moving Expenses

Alimony Paid

- Eliminates deduction for payor
- Excluded from income by payee
- Effective for divorces executed after 2018

Moving Expenses – suspended for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026

Child Tax Credit

Child Tax Credit Expansion

Increased to $2,000 per child under age 17

- Up to $1,400 refundable per child
- Expires Jan. 1, 2026

Family Credit

- New $500 nonrefundable credit for non-child dependents
- Expires Jan. 1, 2026

Credit begins to phase out at AGI of $400,000 for MFJ filers and $200,000 for all other taxpayers

Other Provisions

Provision	Pre-Reform Law	Reform Act
Gain on Sale of Principal Home	Gain of $500K (MFJ)/$250K (all others) excluded – must have lived in home 2 of 5 years	Same as pre-reform law
Estate Tax, GST, and Gift Tax	• 40% after exemption of $5.5M / $11M • $14K annual exemption per gift donee	40% after exemption of $10M / $20M increased exemption sunsets 12/31/25

Education

- §529 Plans
- Qualified ABLE Accounts

529 Plans:

- Distributions from a Section 529 plan of up to **$10,000 per student**, tax-free, can now be used for public, private or religious elementary or secondary school.

Qualified ABLE Accounts:

- Temporarily allows additional contributions, until 2026
- Taxpayers may roll amounts from 529 education accounts to ABLE accounts (sunsets after 2025)

Key Considerations

- AMT planning (ISO exercises)

	AMT Exemption	Exemption Phaseout
Married Filing Joint	$109,400	$1,000,000
Other Taxpayers	$70,300	$500,000

- Pending divorce agreements with alimony component
- State response to limited state income and property tax deduction
- Narrowed IRC 1031 provisions

Key Considerations

- Expansion of Section 529 plan uses
  - $10,000 per student, tax-free, can now be used for public, private or religious elementary or secondary school
- Roth IRA conversions and re-characterizations
  - Conversion still allowed; re-characterizations only valid through 12/31/2017
- Estate and gift tax planning
  - Revisit estate planning documents
  - Additional gifting opportunities
  - Increased emphasis on income tax v. estate tax ramifications of transfers

THANK YOU