COVID-19 FAMILY OFFICE WEBCAST SERIES

Digesting the financial impact to family offices with operating businesses

June 16, 2020
Today’s speakers

Art Yonowitz
Tax Partner
Email: Art.Yonowitz@rsmus.com
Phone: +1 410 246 9488

Don Susswein
Principal, Washington National Tax
Email: Don.Susswein@rsmus.com
Phone: +1 202 370 8216

Christian Wood
Principal, Washington National Tax
Email: Christian.Wood@rsmus.com
Phone: +1 202 370 8218
COVID-19 response framework

**RISK & UNCERTAINTY**
- Deploy COVID-19 internal response team
- Perform revenue analysis, including worst-case scenarios for sustainability and liquidity
- Understand and adapt to immediate changes in consumer behaviors
- Leverage the RSM COVID-19 Resource Center for updated insights

**LIQUIDITY**
- Forecast P&L and balance sheet impacts
- Develop multi-phase cost reduction measures, prioritizing flexibility and the ability to scale back up rapidly
- Optimize working capital and cash flow with a focus on inventory
- Identify any discount initiatives that will help maintain cash flow
- Manage credit lines, identify loan obligations, negotiate debt relief strategies

**WORKFORCE**
- Follow CDC employee safety guidance as it evolves
- Communicate support resources to employees
- Provide technologies to equip employees for remote work
- Design a retention strategy for key employees
- Execute near-term staffing changes and workforce reductions

**SUPPLY & DEMAND SHOCK**
- Focus on securing supply while prioritizing customer fulfillment
- Perform inventory optimization modeling that factors in expected supply and demand shocks
- Leverage supplier and customer relationships to minimize inventory impact and share burden

**POLICY & LEGISLATION**
- Monitor and comply with local, state and federal mandates for business operations, including workforce reduction rules
- Monitor and manage any economic stimulus and tax incentive programs
CARES and FFCRA - Summary of government relief: Tax and lending provisions for businesses

- Lending programs - Paycheck Protection Program (PPP) and Main Street Lending
- Payroll tax credit programs for employers
- Other CARES and FFCRA provisions
- Easing of limitations on charitable donations
Tax law changes under CARES Act

- Net operating loss (NOL) carryback
- Section 163(j) changes
- Qualified Improvement Property
- Opportunities
  - Tax Rate Arbitrage
  - Liquidity
Any NOL planning should be done carefully to include the assessment of the impacts to other provisions such as section 163(j), section 179, and other limitations based on current year income.
The CARES Act amends section 172(b) to allow for the carryback of losses arising in a taxable year beginning after Dec. 31, 2017, and before Jan. 1, 2021, to each of the five taxable years preceding the taxable year of the loss. For calendar year taxpayers that generally means NOLs incurred in tax years ending Dec. 31, 2018, 2019 and 2020 are eligible for a five-year carryback.
There are three ways that the CARES Act amends section 163(j):

1. Increasing the limitation to 50% of taxpayer’s adjusted taxable income (ATI)
2. Providing a special rule for a partnership’s 2019 section 163(j)-disallowed interest expense
3. Allowing an election to apply 2019 ATI to the 2020 section 163(j) computation
Qualified improvement property (QIP)

Area of opportunity

• QIP is now recovered over 15 years (20 years under ADS) and eligible for bonus depreciation

• QIP placed in service in 2018 or 2019 may have been depreciated over 39 years (40 years under ADS) and no bonus depreciation allowed

• Accelerate or shorten recovery of basis

• May require accounting method change
Section 165(i)

- Any loss occurring in a disaster area and attributable to a federally declared disaster may, at the election of the taxpayer, be taken into account for the taxable year immediately preceding the taxable year in which the disaster occurred.
- First pandemic fact pattern to be tested under section 165(i).
- Liquidity versus rate arbitrage.
## Accounting methods review

### Find ways to accelerate deductions
- Prepaids
- Software development costs

### Find ways to defer income recognition
- Advanced payments
- Disputed income
## Accounting methods review (cont.)

### Fixed asset reviews

- Right classification/recovery period
- Cost segregation study
- Bonus eligible
- Ghost assets/discard assets
Cash liquidity recap

• NOL carryback and tax rate arbitrage
• 2019 refund claim
• 2020 reduction in quarterly tax payments
• It is important to model out all of your options
  - Cash needs
  - State tax implications
  - International tax implications (GILTI, etc.)
Entity choice in 2020
When do entity choice issues arise?

- Family office that continues to own historical family business as corporation, S corporation, or partnership
- Family office that invests in other businesses, as corporation, S corporation, or partnership
  - Generally not an issue for “portfolio” type investments
Why now? Why not now?

- Entity choice analysis is heavily depending on economic projections.
- The pandemic may have changed our view of future of the economy, as well as many specific businesses or industries.

- At the same time, corporate tax rates, the special tax rate for pass-throughs, individual rates, capital gains rates, and estate tax rates and exclusions could be dramatically changed in the near future.
Two types of business affected by COVID

Business 1: Well-run car rental business focused on travelers, subject to general risks of a fluctuating economy but unlikely to become a “superstar.”

Business 2: Zoom – or other provider of virtual meeting facilities – projected future earnings of industry – and the value of the leader’s brand -- may suddenly and dramatically exceed prior expectations.
Types of business and entity choice

- What kind of business or venture stands to get the greatest potential benefit from the reduced 21% corporate tax (until earnings are distributed there is a sale of stock or assets)

- What kind of business or venture stands to get the greatest potential benefit from the fact that the sale of the “goodwill” of a partnership is taxed at capital gains rates (as compared to a higher rate if it is a corporation selling its assets)
Thinking about the 21% corporate tax rate

- Ultimately, there is generally a second 23.8% tax on corporate dividends (or the sale of corporate shares) – a total rate higher than the top individual rate.

- *Deferring* the second level of tax can be valuable, but only to the extent earnings are reinvested in the business; if you need to use the earnings for living expenses, you cannot reinvest those.

- The second level of tax might be excused if a decedent holds the shares at death.

- But at certain levels the estate tax on assets valued and transferred at death will be costly.
Thinking about pass-throughs

• Ordinary operating income taxed currently at 37%, but no added tax on distributions if you need to live on the cash.

• For certain business, under Section 199A, only 80% of income is taxed by means of a 20% deduction, resulting in a tax rate of 29.6%.

• Capital gains from the sale of business goodwill are taxed at 20%.
  - In contrast, if business goodwill is a corporate asset, sale of assets and distribution of cash will be taxed at 21% plus a 23.8% tax on distributions.
Conclusions

• If you hold multiple businesses, or can restructure businesses into segments that have less, or more, speculative upside, it may make sense for some to be C corporations and others to be partnerships, with different estate planning considerations for both.
  - The holder of goodwill might be a partnership licensing it to a related corporation doing work-a-day manufacturing for a good, arm’s length, but not stellar return, taxed at only 21 percent, reinvested in the business, and possibly held until death.
  - The partnership might be gifted, when it is low value, to the next generation in grantor trust. If the goodwill sky-rocks in value the capital gain on its sale will be 23.8% (possibly paid by the grantor) while the gain proceeds are held the next generation.
Webcast #3 - Strategic planning in a low interest rate, depressed value environment

Tuesday, June 30 | 1 p.m. EDT

The CARES Act has brought important tax relief provisions and these, coupled with sophisticated tax planning techniques, are more effective now as asset values and interest rates have dropped. Our discussion will focus on key COVID-19 programs and wealth and tax planning ideas that may benefit your family.

Coronavirus Family Office Resource Center

Managing your family office’s response to COVID-19