WHAT DOES THE TAX CUTS AND JOB ACTS MEAN FOR LIFE SCIENCE COMPANIES?

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TAX CUTS AND JOBS ACT (TCJA) – CONSIDERATIONS FOR THE LIFE SCIENCES INDUSTRY

Presented by: Matthew Scaliti, Partner, Tax Services
Introduction to Tax Reform

- Lower corporate rates traded for fewer deductions
- Simplification not necessarily achieved
- Interest limitations result in a tax hike for some
- Move to territorial type system is a significant change
  - Overseas earning likely were not coming back at 35%
- Creation of minimum taxes on certain overseas earnings
- What will states do? Which provisions will they adopt?
## Key Provisions for the Life Sciences Industry

<table>
<thead>
<tr>
<th>Tax Change</th>
<th>Post Reform Law</th>
<th>Considerations</th>
</tr>
</thead>
</table>
| Reduced Corporate Tax Rate & Move to Territorial Type System | • Reduced 21 percent flat corporate federal income tax rate, generally effective January 1, 2018  
• Territorial type system allows more tax efficient repatriation | • A reduction in the corporate tax rate is beneficial to life sciences companies overall  
• Retains two levels of tax  
• Blended rate for fiscal year taxpayers |
| Corporate Dividend Received Deduction          | • 100% for 80% to 100% ownership  
• 65% for 20% to 80% ownership  
• 50% for less than 20% ownership | • Changes in the dividend received deduction maintain the effective tax rates prior to tax reform |
| Corporate Alternative Minimum Tax (AMT) & AMT Credit | • Repeals corporate AMT for tax years beginning after December 31, 2017  
• For tax years beginning after 2017 and before 2022, the prior year minimum tax credit is refundable in an amount equal to 50%  
• 100% for tax years beginning in 2021 | • Refundable credit is an unexpected benefit  
• Could remain subject to limitations under Section 383 |
### Key Provisions for the Life Sciences Industry (continued)

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| Research and Experimentation (R&E) Tax Deduction        | • The new law requires that research expenditures eventually be capitalized and amortized over a period between 5 and 15 years  
• The research credit remains permanent                 | • The new law’s requirement that research expenditures be capitalized will have a large impact on life science companies that are invested in these activities |
| Orphan Drug Credit                                      | • The final bill limits the orphan drug credit to 25 percent (current law provides for 50 percent) of qualified clinical testing expenses for the tax year | • Certain life sciences companies may need to rethink their investments in the development of drugs for rare diseases |
### Key Provisions for the Life Sciences Industry (continued)

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| Net Operating Loss (NOL) rules                  | • Limits NOL deduction to 80 percent of taxable income for NOLs arising in years beginning after December 31, 2017  
  • Eliminates NOL carrybacks for NOLs arising in years ending after December 31, 2017  
  • NOLs generally carried forward indefinitely if they arise in years ending after December 31, 2017 | • Pre-2018 NOLs remain eligible for 100 percent income offset  
  • In certain life science companies where earnings fluctuate, the restriction of the NOL carryback could present cash flow issues (especially for emerging companies)  
  • Fiscal year taxpayers with years ending after December 31, 2017 cannot carryback losses |
| Bonus Depreciation                              | • 100 percent bonus depreciation through 2022, then phased out through 2026  
  • Applies to new and used property acquired and retroactive to assets placed in service after 9/27/2017 | • Does not apply to goodwill & intangibles  
  • Adds more importance to purchase price allocation agreements  
  • Asset deals are even more attractive |
| Repeal of Domestic Production Activity Deduction| • Generally the domestic production activity deduction provided for a deduction equal to 9% of qualified production activity income. The new law repeals the section 199 domestic manufacturing deduction (beginning in 2018) |
### Key Provisions for the Life Sciences Industry (continued)

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| New Interest Deduction Limitation | • Limits net interest expense deduction to 30 percent of adjusted taxable income (ATI)  
  • For 2018 through 2021, ATI approximates earnings before interest, taxes, depreciation and amortization (EBITDA)  
  • After 2021, ATI approximates earnings before interest and taxes (EBIT)  
  • Disallowed interest generally may be carried forward indefinitely | • “Net interest expense” so back to back loans remain viable for intercompany  
  • Limitation does not apply to businesses with an average gross receipts of ≤$25 million and certain agricultural, farming and real estate businesses  
  • Limitation applies to both related party and unrelated party debt | • Life sciences companies will need to analyze opportunities to move debt around the worldwide group to best utilize interest deductions  
  • Could have a significant impact on cost of capital and could lead to more life sciences companies pursuing equity investments and potentially more IPOs in the industry |
## Interest Deductions: Example

### Example of Net Interest Deduction Limitation

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Income</td>
<td>2.00</td>
<td>2.50</td>
<td>3.00</td>
<td>4.00</td>
<td>5.00</td>
<td>6.00</td>
</tr>
<tr>
<td>Addback: Interest Expense</td>
<td>3.00</td>
<td>3.00</td>
<td>3.00</td>
<td>3.00</td>
<td>2.00</td>
<td>1.00</td>
</tr>
<tr>
<td>Addback: Depreciation &amp; Amortization</td>
<td>2.00</td>
<td>2.00</td>
<td>2.00</td>
<td>2.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Adjustable Taxable Income (EBITDA or EBIT for 2022)</strong></td>
<td>7.00</td>
<td>7.50</td>
<td>8.00</td>
<td>9.00</td>
<td>7.00</td>
<td>7.00</td>
</tr>
<tr>
<td>Multiply by 30% of Adjustable Taxable Income</td>
<td>0.30</td>
<td>0.30</td>
<td>0.30</td>
<td>0.30</td>
<td>0.30</td>
<td>0.30</td>
</tr>
<tr>
<td><strong>Net Interest Deduction</strong></td>
<td>2.10</td>
<td>2.25</td>
<td>2.40</td>
<td>2.70</td>
<td>2.10</td>
<td>2.10</td>
</tr>
</tbody>
</table>

**Taxable Income (before Interest Expense)**

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.00</td>
<td>5.50</td>
<td>6.00</td>
<td>7.00</td>
<td>7.00</td>
<td>7.00</td>
<td>7.00</td>
</tr>
</tbody>
</table>

**Net Interest Deduction**

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>-2.10</td>
<td>-2.25</td>
<td>-2.40</td>
<td>-2.70</td>
<td>-2.10</td>
<td>-2.10</td>
<td>-2.10</td>
</tr>
</tbody>
</table>

**Estimated Taxable Income/(Loss) before NOL**

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.90</td>
<td>3.25</td>
<td>3.60</td>
<td>4.30</td>
<td>4.90</td>
<td>4.90</td>
<td></td>
</tr>
</tbody>
</table>

**Deferred Net Interest Deduction Carryforward**

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.90</td>
<td>1.65</td>
<td>2.25</td>
<td>2.55</td>
<td>2.45</td>
<td>1.35</td>
<td></td>
</tr>
</tbody>
</table>
## Changes to section 162(m): Excessive employee compensation

<table>
<thead>
<tr>
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</table>
| Compensation in excess of $1M to executives (including CFO) of “publicly held” corporations is not deductible | • Expands employees considered “covered” employees  
  • At least CEO, CFO & 3 other highest  
  • Expands “publicly held” definition to include a company required to file reports under section 15(d) of the Exchange Act  
  • Includes debt and equity  
  • Does not require that securities are listed  
  • Generally eliminates performance based compensation exception from disallowance of deduction and therefore many publicly held life sciences companies will no longer benefit from the tax relief previously provided under Section 162(m) |
INTERNATIONAL TAX

Presented by: Eytan Burstein, Senior Manager, International Tax Services
## International Tax Provisions

<table>
<thead>
<tr>
<th>Tax Change</th>
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</table>
| One-time repatriation tax on foreign deferred earnings (effective for tax years beginning before January 1, 2018) | • Foreign deferred earnings are taxed at 15.5% or 8% based on balance sheet attributes (cash & cash equivalents vs. non-cash assets, respectively).  
• Election to defer payment over 8 years |
| Life Science Considerations; If US company has NOL’s (R&D center), consider using NOLs to offset repatriation tax |                                                                                                  |
| Dividend Received Deduction/Participation Exemption (effective for distributions made after December 31, 2017) | • Certain foreign dividends non-taxable in the US  
• Certain gains on sale of foreign subsidiaries will not be subject to U.S. federal income tax |
# International Tax Provisions: GILTI Minimum Tax

<table>
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| Global Intangible Low Taxed Income (GILTI) (effective for tax years beginning after December 31, 2017) | • Targeted at foreign corporations that earn a high rate of return on their intangible assets  
  - Much broader than intangible holding companies  
  • Calculates tax on amount over net deemed tangible income  
  • GILTI applies to any CFC  
  • C corporations receive a deduction against GILTI equal to 50%  
  • Effectively a 10.5% minimum tax CFC is owned by a domestic C Corp  
  • Eligible for partial foreign tax credit offset |

**Life Science Considerations:**  
- If US company has offshored IP to foreign CFCs, GILTI likely to have a major impact;  
- Consider bringing IP back to the US
International Tax Provisions: BEAT Minimum Tax

<table>
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| Base Erosion and Anti Abuse Tax (BEAT) (effective for tax years beginning after December 31, 2017) | • Applies to U.S. corporations not treated as flow-through  
• $500mm of domestic gross receipts if base erosion percentage is 3 percent or higher  
• 10 percent minimum tax on U.S. corporations (5 percent for 2018) where 10 percent of ‘modified taxable income’ (MTI) exceeds regular tax  
• Base erosion payments include any deductible amount paid/accrued to a foreign related party  
• Includes payments for depreciable property or insurance payment but excludes items that reduce gross receipts (like cost of goods sold) |

**Life Science Considerations;**
- How to determine gross receipts of US corporation, Gross to Net;
- Carve out for certain services paid under the service cost method.
- Targeting licensing payments made to non-US related parties.
<table>
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| Foreign Derived Intangible Income (FDII) (effective for tax years beginning after December 31, 2017) | • Deduction results in an effective 13.125%  
• Applicable for Domestic C corporations with gross income generated by revenues to foreign customers for foreign use  
• Products & services revenue with respect to property not located within the US  
• Requires base calculations of “tangible” income and intangible income  

**Life Science Considerations;**  
- Benefits Life Science companies who had retained IP in the US and is receiving licensing fee payments for foreign use |
TCJA – State Tax Considerations for the Life Science Industry

Presented by: Jerry Brisbois, Principal, Tax Services
Federal reform impact on Life Science businesses? – General Observations

• Federal tax reform will have a wide-ranging impact on Life Science businesses
• Often Life Science businesses have a footprint in many states
  – Headquarters, research, manufacturing, supply chain, collaboration agreements, licensing arrangements, clinical trials, CRO’s, sales, etc.
  – Multiple jurisdictions – some known hotspots
• Federal reform tax law changes will flow down to states or at least “trickle down”
• What is the status of adoption of federal changes by states from a macro perspective?
  – Many states are beginning to address with legislation – still early
  – Lag due to uncertainty over budget effect and grappling with technical issues
  – Expect change
  – Will changes be revenue neutral? (e.g., will states adopt interest expense limitations but decouple from depreciation rules, etc.)
State Corporate Tax Conformity

- **Rolling Conformity**
- **Static Conformity**
- **No Conformity**
- **Gross Receipt Tax State**
Federal reform impact on the states – worldwide versus territorial system

- Shift to territorial system coupled with rate reduction encourages repatriation of earnings and investment in United States operations!
- The Life Science industry is generally favored by states
- Many states have aggressive incentive programs for locating activities and creating jobs in this sector
  - NY Excelsior Jobs Program
  - NY Life Science R&D Tax Credit
  - MA Life Science Institute
  - NJ Technology Business Tax Certificate Transfer Program
  - CA Competes Incentive Program
- However, state and local incentives may now be included in federal taxable income
- See addendum A – Workflow State and Local Credits and Incentives
Addendum A - Business Incentives Opportunities

Common Credits and Incentives

Tax Incentives
- Sales & Use tax exemptions/refunds
- Federal and state EZ Credits
- Federal and state research and development credits
- Capital investment tax credits

Hiring Incentives
- Wage rebates, job creation grants and credits, employment related tax incentives
- WOTC/
- State point-of-hire credits
- Hiring and employee screening assistance

Training Benefits
- Training grants for prospective training expenditures
- Development and implementation of training programs through state agencies
- Training tax credits (retroactive or prospective)

Non-Tax Incentives
- Infrastructure grants/assistance
- Low cost financing for capital expenditures
- Utility discounts
- Waiver of permit fees
- Expedited permits
- Free or discounted land/building

Property Tax Relief
- Negotiate real and personal property tax exemptions
- Structure Industrial Revenue Bonds (IRBs) for favorable property tax treatment
- Secure Tax Increment Financing (TIF) arrangements
- Property tax abatement

Green Incentives
- Energy efficiency/GHG reduction incentives and credits
- Incentives for LEED-certified buildings
- §179D deductions
- R&D and Manu. incentives for green products
- Incentives for production of green products

Non-Tax Incentives
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- **Transition tax on deemed repatriation of foreign E&P**
  - Treated as Subpart F income!
  - Assuming state adopts repatriation provision, under existing rules states may exclude or allow DRD, presumably, net of participation exemption?
  - State DRD may be limited to a percentage of deemed dividend (not 100%) – e.g., OR proposal that 80% DRD applies
  - NY proposal that transition income is excluded from tax base; adds back participation exemption.
  - Unlikely 8 year deferral will apply
  - Contrast CA law that does not adopt IRC Subpart F income provisions, generally, 75% DRD on actual distribution
  - Special considerations (apportionment, gross receipts, etc.)
100% federal DRD for Qualified Foreign-Source Dividend
- Majority of states do not adopt federal DRD even if taxable income is determined under the current IRC.
- Consider state DRD limitations on ownership and deduction percentage
- For example, MA adopts current IRC but allows a DRD of 95% for 15% or more owned investments
- States that do not adopt current year IRC will likely default to historic state specific DRD or Subpart F exclusion
- At minimum, states will need to be consistent with their own domestic DRD rules.

• **Global Intangible Low-Taxed Income ("GILTI") and Foreign Derived Intangible Income ("FDII")**
  - Likely included in state tax base if state conforms to TCJA.
  - As a matter of fairness, deductions for GILTI and FDII are likely to be adopted (GA proposal adopts – IL proposal disallows GILTI deduction, NY adopts through conformity)
  - GILTI may be treated as a deemed dividend and DRD allowed
  - Consider state apportionment sourcing rules for income such as milestones and royalty payments (e.g., market sourcing or location of use of intellectual property)

• **Base Erosion Anti-Avoidance Tax ("BEAT")**
  - This is a separate provision of the IRC not tied to federal taxable income
  - Similar to AMT
  - Likely not automatically adopted and would require legislative action in most states
• **Corporate rate reduction**
  - No impact on states other than state rate becomes higher percentage of overall tax rate.

• **Net operating loss deduction**
  - Little impact since most states NOL provisions do not tie directly to the code (GA proposal to adopt 80% income limitation)

• **Business interest deduction limitation**
  - Likely to be adopted by many states – (GA proposal to decouple)
  - How will rule be applied in separate filing states?
  - Interaction with related party intangible income add back, if applicable.

- **Full bonus depreciation deduction and increased 179 expense limitation**
  - Majority of states have elected out of IRC section 168(k) – this is unlikely to change
  - Current adoption of IRC section 179 by states is mixed
  - Consider effect on state investment tax credits when electing additional 179 expense

- **Amortization of research and experimental expenditures**
  - Likely to be adopted by most states

- **Pass through deduction**
  - 20% deduction in computing taxable income
  - Likely not applicable in many states

- **Reaction to SALT deduction limitation**
Federal reform impact on the states – Observations

- Many open questions – state legislatures likely to address in 2018
- Revenue neutrality?
- Increased state compliance
  - Deviations from federal taxable income – increased complexity
  - Timing of state conformity legislation affects estimated payments
  - Retroactive application of rules, penalty and interest considerations
- Opportunities to generate state and local benefits through favorable location of research, manufacturing and headquarters operations
- Consider other planning including apportionment treatment of income from collaboration, milestone and licensing arrangements
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QUESTIONS AND ANSWERS?
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