Today’s presenters

**Patti Burquest**  
Principal  
Patti is RSM’s Washington National Tax practice lead and specializes in IRS examination and appeals matters.

**Ed Decker**  
Partner  
Ed is part of RSM’s Washington National Tax practice and leads the office’s S corporation practice.

**Ramon Camacho**  
Principal  
Ramon is a part of RSM’s Washington National Tax practice and specializes in international tax and capital markets issues.

**Karen Field**  
Senior Director  
Karen is a part of RSM’s Washington National Tax practice and specializes in domestic and international compensation and benefits issues.
Today’s presenters (cont.)

Christian Wood
Principal
Christian is part of RSM’s Washington National Tax practice and leads the firm’s accounting methods and periods team.
## Agenda

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<thead>
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<td>Capitol Hill post-election update</td>
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THE IMPACT OF THE 2018 MID-TERM ELECTIONS

What are the prospects for tax legislation in 2018 and 2019?
November mid-term elections 2018

• All 435 seats in the House of Representatives were at issue
  – 115th Congress had 236 Republicans and 193 Democrats
  – 6 seats vacant
  – Not seeking re-election – 38 Republicans and 18 Democrats

• 35 of 100 seats in the Senate were at issue.
  – 10 were held by Republicans, 23 were held by Democrats and two were held by Independents
  – Not seeking re-election – 3 Republicans
# Election results - Congress in 2018 and 2019

<table>
<thead>
<tr>
<th></th>
<th>115th Congress</th>
<th>116th Congress</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>House</td>
<td>Senate</td>
<td>House</td>
</tr>
<tr>
<td>Republican</td>
<td>236</td>
<td>51</td>
<td>198</td>
</tr>
<tr>
<td>Democrats</td>
<td>193</td>
<td>47</td>
<td>227</td>
</tr>
<tr>
<td>Independents</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Undecided</td>
<td>10</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Runoff</td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Vacancies</td>
<td>6</td>
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<td>6</td>
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</tbody>
</table>
What’s on the legislative agenda?

- **Tax Reform 2.0** – House Republicans introduced and approved legislation in three separate bills. (Senate has not voted on it or expressed interest in it.)
  - Protecting Family and Small Business Tax Cuts Act of 2018 (H.R. 6760)
  - Family Savings Act of 2018 (H.R. 6757)
  - American Innovation Act of 2018 (H.R. 6756)

- **Democratic agenda** – focus on ‘fairness’
  - Rolling back the tax decrease given to the top 1 percent
  - Reinstatement of the Affordable Care Act (ACA) individual mandate to ensure that millions do not lose their health insurance

- **President’s agenda** – 10 percent tax cut for middle income taxpayers
What is possible?

• Recent legislative action
  – Opioid legislation passed the Senate on October 3rd. The vote was 98 to 1. House vote was 393 to 8.
  – Appropriations “minibus” funding bill passed the House and Senate in September.

• Proposals?
  – Tax Reform 2.0 passed the House on September 30; no Senate vote
  – No technical corrections bill
  – No action on an extender package
  – No bill or resolution on the 10 percent tax cut for middle-income taxpayers
IS TAX REFORM 2.0 DEAD?
• Three separate bills were passed by the House of Representatives on Sep. 28, 2018
• The bills were sent to the Senate for a vote
• Senate Majority leader McConnell has only said he would consider it – no vote has been scheduled
Legislative considerations

- Some provisions of the Protecting Family and Small Business Tax Cuts Act of 2018 are controversial
  - Democrats have stated that 83 percent of the tax benefits flow to the top 1 percent of individual taxpayers
  - Senators from high tax states are concerned with the limitation on the state and local tax deduction and will not support it
  - Cost estimate of the making the TCJA permanent are estimated to be over $600 billion.
  - Finding additional ‘pay-fors’ could impact the business provisions
Legislative considerations (cont.)

- The Family Savings Act of 2018 may have broader support because it offers benefits to middle class families.
- The American Innovation Act of 2018 may also have broader support because it is tied to the creation of new start-up businesses.
- Congressional inertia may make these acts dead letters in 2018.
INTERNATIONAL TAX YEAR-END PLANNING CONSIDERATIONS
Tax reform sets the agenda

- Participation regime & repatriation tax
- New *GILTI* rules
- New interest expense limits
- New rules for net operating losses (NOLs)
- What happened and what do you need to know now?
‘TOLL CHARGE’ OR TRANSITION TAX TO NEW TERRITORIAL SYSTEM
## International tax provisions

<table>
<thead>
<tr>
<th>Tax change</th>
<th>Post reform law</th>
<th>Considerations</th>
</tr>
</thead>
</table>
| One-time repatriation tax on foreign deferred earnings (effective for tax years beginning before Jan. 1, 2018) | • Foreign deferred earnings are taxed at 15.5 percent or 8 percent based on balance sheet attributes (cash and cash equivalents vs. non-cash assets, respectively)  
• Election to defer payment over eight years | • Significant diligence item as well as cash flow concern  
  o Need to understand earnings and profits (E&P) on all impacted companies  
• Many states will treat the repatriation as Subpart F income subject to full or partial dividend received deduction |
| Dividends received deduction / participation exemption (effective for distributions made after Dec. 31, 2017) | • ‘Territorial’ aspect of the TCJA  
• Certain foreign dividends non-taxable in the United States  
• Certain gains on sale of foreign subsidiaries will not be subject to U.S. federal income tax | • Applicable to C corporations with foreign corporate subsidiaries  
• Corporate structure may be beneficial due to participation exemptions |
Section 965 transition tax – Current issues

- Tax due at original due date for the relevant tax return (April 17, 2018 for 2017 inclusions for calendar year filers)
- If there’s an overpayment, IRS takes position that it cannot provide refunds or credits of tax while amounts are due and owing under section 965, including by reason of an election to defer payment (either under 965(h) or the 965(i) S corporation election).
- Taxpayers must plan carefully (estimated tax payments, refund claims from prior years are affected)
  - This means that refunds (or credits) based on overpayments of estimated tax, for example, will be applied to reduce any outstanding 965 balance
Taxpayers who make 965(i) election must do so on paper-filed returns, not via e-file

965 liability deferred under S corporation election must be paid upon a ‘triggering event’ including (a) conversion away from S corporation status, (b) sale/disposition of the assets of the S corporation or liquidation of the entity, or (c) sale of shares in the S corporation

− However, may still be able to defer taxation if buyer agrees to assume liability and agreement is filed with IRS, *but this doesn’t seem to apply to contributions of S corporation assets in nontaxable exchange*
Impact of distributions

• Expected that $2 - $3 trillion in E&P was sitting offshore
  − So far, $294.9 billion and $169.5 billion have been repatriated in Q1 and Q2 respectively
• Do actual distributions undermine existing APB 23 assertions?
• 960(c) provides for increased ‘limitation’ upon a distribution of previously taxed amounts (e.g., 965 or other subpart F).
  − As a result distributions could create capacity to claim FTCs so taxpayers should consider whether to make distributions in 2018
Section 965 transition tax – Current issues

• New proposed 965 regulations issued:
  – Special basis adjustment election provided
  – Additional regulations forthcoming prior to year end
  – Treasury has said it expects taxpayers will have to amend their returns

• 965 inclusion subject to net investment income tax (NIIT) upon distribution unless special section 1.1411-10(g) election in place
SECTION 951A: GLOBAL INTANGIBLE LOW-TAXED INCOME (GILTI)
What changed?

• Old law
  - U.S. taxation of the earnings of foreign corporations was deferred until earnings were repatriated via a dividend or an income inclusion under Subpart F occurred

• New law - GILTI
  - New section 951A creates new category of ‘Subpart F-like’ income that requires inclusion of foreign earnings in U.S. taxable income on a current basis
  - Effectively allows for only a certain portion of earnings to be exempt from U.S. tax
  - Appears to cast a much broader net than traditional Subpart F rules
  - Complex rules to administer
GILTI overview

• Starting in the 2018 tax year, new section 951A imposes a minimum tax on 10 percent U.S. shareholders (individuals, corporations, partnerships, trusts) of controlled foreign corporations (CFCs) to the extent of such CFCs’ GILTI.

• The inclusion of GILTI is generally treated in the same manner as traditional Subpart F.

• Key difference: **shareholder-level calculation**

• What’s in a name?
  – Global
  – Intangible
    • No direct connection to intangible assets
    • Applies to any CFC with profits regardless of industry
  – Low-Taxed
    • Not necessarily
  – Income
GILTI mechanics

- The calculation of GILTI is formula-based
- It allows for a 10 percent deemed return on the U.S. tax basis of tangible assets
- The residual income is deemed to be intangible income (whether or not that is actually the case) and is subject to current U.S. tax

\[
\text{GILTI} = \text{Net CFC Tested Income} - [(10 \text{ percent} \times \text{QBAI}) - \text{Net Interest Expense}]
\]

Basically 10% of NTV of Fixed Assets

\[
\text{Net CFC Tested Income} = \sum \text{CFC Tested Income} - \sum \text{CFC Tested Loss}
\]
GILTI – C corporation benefits

• **US C corporations** are allowed to take a special deduction on the GILTI amount (new section 250)
  - The deduction is 50 percent of the GILTI amount (subject to TI limits). The 50 percent deduction is reduced to 37.5 percent for taxable years beginning after Dec. 31, 2025
  - Coupled with the 21 percent tax rate for U.S. C corporations, the deduction results in an effective tax rate of 10.5 percent on GILTI for the years 2018-2025 and 13.125 percent starting in 2026

• **US C corporations** are allowed a reduced foreign tax credit against net GILTI income
  - No residual U.S. tax is owed on GILTI inclusion provided foreign effective tax rate is 13.125 percent or higher (assuming no expense allocation)

_Do you note any class of shareholder that is missing here???_
### Partnership + CFC – GILTI (with/without distribution)

<table>
<thead>
<tr>
<th>Tax attribute</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFC taxable income</td>
<td>400,000</td>
</tr>
<tr>
<td>Foreign corporate tax rate</td>
<td>25%</td>
</tr>
<tr>
<td>Foreign corporate tax</td>
<td>100,000</td>
</tr>
<tr>
<td>CFC after-tax cash</td>
<td>300,000</td>
</tr>
<tr>
<td>U.S. partnership GILTI income</td>
<td>300,000</td>
</tr>
<tr>
<td>Partner’s ordinary tax rate</td>
<td>37%</td>
</tr>
<tr>
<td>Partner’s federal tax</td>
<td>111,000</td>
</tr>
<tr>
<td>Total federal + foreign tax</td>
<td>211,000</td>
</tr>
<tr>
<td>After-tax cash</td>
<td>189,000</td>
</tr>
<tr>
<td>Worldwide effective tax rate</td>
<td><strong>52.75%</strong></td>
</tr>
</tbody>
</table>
## C corporation + CFC – GILTI (cash kept at C corporation)

<table>
<thead>
<tr>
<th>Tax attribute</th>
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</tr>
</thead>
<tbody>
<tr>
<td>CFC taxable income</td>
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<tr>
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<td>100,000</td>
</tr>
<tr>
<td>CFC after-tax cash</td>
<td>300,000</td>
</tr>
<tr>
<td>C corporation GILTI income</td>
<td>300,000</td>
</tr>
<tr>
<td>C corporation section 78 gross up</td>
<td>100,000</td>
</tr>
<tr>
<td>C corporation section 250 deduction</td>
<td>(200,000)</td>
</tr>
<tr>
<td>C corporation taxable income</td>
<td>200,000</td>
</tr>
<tr>
<td>C corporation federal tax rate</td>
<td>21%</td>
</tr>
<tr>
<td>C corporation federal tax</td>
<td>42,000</td>
</tr>
<tr>
<td>C corporation foreign tax credit</td>
<td>(42,000)</td>
</tr>
<tr>
<td>Net additional federal tax</td>
<td>0</td>
</tr>
<tr>
<td>After-tax cash</td>
<td>300,000</td>
</tr>
<tr>
<td>Worldwide effective tax rate (deferral)</td>
<td><strong>25%</strong></td>
</tr>
</tbody>
</table>
## C corporation + CFC – GILTI (cash paid to U.S. corporation shareholders)

<table>
<thead>
<tr>
<th>Tax attribute</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualified dividend</td>
<td>300,000</td>
</tr>
<tr>
<td>Qualified dividend tax rate (+NIIT)</td>
<td>23.8%</td>
</tr>
<tr>
<td>Federal tax</td>
<td>71,400</td>
</tr>
<tr>
<td>Total tax</td>
<td>171,400</td>
</tr>
<tr>
<td>Total after-tax cash</td>
<td>228,600</td>
</tr>
<tr>
<td>Worldwide effective tax rate (all-in)</td>
<td>42.9%</td>
</tr>
<tr>
<td>Worldwide effective tax rate (partnership + CFC)</td>
<td>52.75%</td>
</tr>
<tr>
<td>Tax savings</td>
<td>9.85%</td>
</tr>
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GILTI and the foreign tax credit (FTC)

- **GILTI foreign tax credit significantly limited**
  - GILTI has a special FTC limitation ‘basket’ effective for 2018
  - Prior year FTC carryforwards may be lost because they are in general basket even though underlying income is same
  - Same issue for new foreign branch basket created by TCJA
  - No statutory transition rules unlike in prior tax changes
  - Not clear whether taxpayers must treat prior year taxes as lost for financial statement purposes before guidance released
  - No carryforward or carrybacks for GILTI FTCs
  - Allocation of interest expense to GILTI basket is unclear (is it more appropriate to use CFC gross income?)
Further Observations on GILTI

- GILTI will impact almost every taxpayer that has ownership in a foreign corporation, including individuals, trusts, partnerships, S corporations and C corporations.

- Individuals and trusts taxable at ordinary income rates unless a section 962 election is made but Section 250 deduction is **NOT** available.

- Section 250 deduction not allowable in calculating NOL.

- **MUST use ADS depreciation to calculate GILTI**, not optional; may need two sets of books (one for GILTI and existing set).

- GILTI may apply even if a client has no low-taxed foreign earnings.

- State impact may vary from federal.
Other observations

- Proposed GILTI regulations were issued on Sep. 13., 2018; two more sets of regulations are expected by year end
- Proposed GILTI Form 8992
- Schedule I-1 on Form 5471
- Financial statement presentation
Managing GILTI

- GILTI planning opportunities may include:
  - Converting to a C corporation
  - Inserting a C corporation to hold foreign operations
  - Making section 962 elections
  - Check-the-box planning
  - Planning into the high tax exception
  - Planning for a potential exit of a controlled foreign corporation investment
  - Section 338 planning
  - Consolidated group planning
  - Maintaining ADS tax depreciation of CFC fixed assets
  - Transfer pricing
  - Accounting methods review for CFCs
SECTION 163(J): NEW INTEREST LIMITATIONS
Caps net interest deduction at 30 percent of an amount based on earnings before interest, tax, depreciation and amortization (EBITDA) for four years, then limits the deduction to 30 percent of earnings before interest and taxes (EBIT) for subsequent years.

Taxpayers with average gross receipts of $25 million or less and car dealers using floor plan financing loans to fund their inventory are excluded from the interest limitation.

Allows ‘limited’ deductions to carry forward indefinitely.

Various exceptions for real estate, utilities, farming and certain small businesses.

Special rules for partners and partnerships.
Interest Limitation Using EBITDA

Company worth $3 million
Debt of $2 million @ 5 percent
Equity of $1 million

Earnings before interest and depreciation = $500,000
Depreciation = $200,000
Interest = $100,000
Taxable income before limitation = $200,000

Base for limitation = $500,000

30 percent of base = $150,000
No limitation applies
Interest Limitation Using EBIT

Company worth $3 million
Debt of $2 million @ 5 percent
Equity of $1 million

Earnings before interest and depreciation = $500,000
Depreciation = $200,000
Interest = $100,000
Taxable income before limitation = $200,000

Base for limitation = $300,000

30 percent of base = $90,000
$10,000 interest is ‘limited’

Carryforward allowed indefinitely
What should taxpayers do?

- Time to re-evaluate debt placement and acquisition debt
- Reduce debt levels?
- Should you move debt offshore where it can offset higher taxed income?
- BEPS could be an issue – many counties have adopted BEPS like limits on interest (cap between 10 and 30 percent of EBIDTA)
CHANGES TO NOL RULES
Corporate tax – Net operating loss changes

<table>
<thead>
<tr>
<th>Post reform law</th>
<th>Considerations</th>
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<tbody>
<tr>
<td>• Limits NOL deduction to 80 percent of taxable income for NOLs arising in years beginning after Dec. 31, 2017</td>
<td>• Pre-2018 NOLs remain eligible for 100 percent income offset</td>
</tr>
<tr>
<td>• Eliminates NOL carrybacks for NOLs arising in years ending after Dec. 31, 2017</td>
<td>• Immediate expensing benefit is reduced to the extent it generates an NOL</td>
</tr>
<tr>
<td>• NOLs generally carried forward indefinitely if they arise in years ending after Dec. 31, 2017</td>
<td>• Fiscal year taxpayers with years ending after Dec. 31, 2017 cannot carryback losses</td>
</tr>
<tr>
<td></td>
<td>• NOLs created by M&amp;A transaction costs cannot be carried back</td>
</tr>
<tr>
<td></td>
<td>− Consider how this impacts cash flows</td>
</tr>
<tr>
<td></td>
<td>• Limited impact on state NOLs as many states have their own NOL deduction provisions</td>
</tr>
</tbody>
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IMPACT ON PASS-THROUGHS
Should I restructure?

Number of Returns Filed
1980 – 2012

Source: IRS
Tax Cuts and Jobs Act – what changed?

- Corporate tax rate reduced from 35 percent to 21 percent
- Maximum individual tax rate dropped from 39.6 percent to 37 percent
- Income from flow-through entities eligible for a 20 percent deduction
  - Effective tax rate on flow-through income of 29.6 percent, plus potential 3.8 percent net investment income tax
- Elimination of certain common deductions, including domestic manufacturing deduction, and new cap on deduction for state income taxes
Two Brothers Manufacturing, Inc.

• Adam and Bob own and operate an S corporation
• Annual taxable income is $1,000,000 and is derived from a labor intensive activity
• Adam and Bob have other sources of income, therefore company income is effectively taxed at top rates
• In addition to federal taxes, Adam and Bob pay state taxes of 6.5 percent
Pass-through entity—without 20 percent deduction

**Old rules**
- $1,000,000 of income
- Less $65,000 in state taxes
- $935,000 taxable at 39.6 percent
- Federal tax of $370,260
- Effective federal rate of 39.6 percent on net income after state taxes

**New rules**
- $1,000,000 of income
- $65,000 in state taxes (not deductible)
- $1,000,000 taxable at 37 percent
- Federal tax of $370,000
- Effective federal rate of 39.57 percent on net income after state taxes
Same entity as a C corporation

- Old rules
  - $1,000,000 of income
  - Less $65,000 in state taxes
  - $935,000 taxable at 35 percent
  - Federal tax of $327,250
  - Effective federal rate of 35 percent on net income after state taxes

- New rules
  - $1,000,000 of income
  - $65,000 in state taxes
  - $935,000 taxable at 21 percent
  - Federal tax of $196,350
  - Effective federal rate of 21 percent on net income after state taxes
Pass-through entity—with 20 percent deduction

**Old rules**
- $1,000,000 of income
- Less $90,000 in domestic manufacturing deduction
- Less $65,000 in state taxes
- $845,000 taxable at 39.6 percent
- Federal tax of $334,620
- Effective federal rate of 35.79 percent on net income after state taxes

**New rules**
- $1,000,000 of income
- Less $200,000 pass-through deduction
- $800,000 taxable at 37 percent
- $65,000 in state taxes (no deduction)
- Federal tax of $296,000
- Effective federal rate of 31.65 percent on net income after state taxes
Same entity as a C corporation

• Old rules
  – $1,000,000 of income
  – Less $90,000 in domestic manufacturing deduction
  – Less $65,000 in state taxes
  – $845,000 taxable at 35 percent
  – Federal tax of $295,750
  – Effective federal rate of 31.63 percent on net income after state taxes

• New rules
  – $1,000,000 of income
  – $65,000 in state taxes
  – $935,000 taxable at 21 percent
  – Federal tax of $196,350
  – Effective federal rate of 21 percent on net income after state taxes
Analysis is critical – nothing is straight forward

• Major factors that have the potential to affect the entity choice analysis include:
  – Owner’s exit strategy (sale or passing on to future generations)
  – Owner’s eligibility for the pass-through deduction
  – Owner plan for business earnings (distribution or reinvestment)
  – Rate of return on reinvested business earnings
  – Presence of a large international footprint
  – High effective state tax rate
  – Presence of tax carryforwards and other tax attributes (AAA, suspended losses, etc.)
  – Estate planning considerations
Two Brothers Manufacturing, Inc.

- Adam and Bob own and operate an S corporation that manufactures widgets
- Annual taxable income is $1,000,000 and is derived from a labor intensive manufacturing activity
- Adam and Bob have other sources of income, therefore company income is effectively taxed at top rates
- In addition to Federal taxes, Adam and Bob pay state taxes of 6.5 percent
- A buyer wishes to purchase all of the assets of the company for $6,000,000 – which will generate a gain of $3,000,000
Sale

• Pass-through (new rules)
  – $3,000,000 of income
  – $3,000,000 taxable at 20 percent
  – $195,000 in state taxes
  – No tax on distributions
  – Federal tax of $600,000
  – Effective federal rate of 21.39 percent on net income after state taxes

• C corporation (new rules)
  – $3,000,000 of income
  – Less $195,000 in state taxes
  – $2,805,000 taxable at 21 percent
  – $2,215,950 of dividends taxed at 23.8 percent
  – Federal tax of $1,116,446
  – Effective federal rate of 39.80 percent on net income after state taxes
Qualified business income deduction - Section 199A

- A 20 percent deduction that effectively reduces the top rate on certain business income from 37 percent to 29.6 percent
- Does not apply to ‘specified service’ businesses
  - Exception when taxable income below a threshold
- Additional limitations based on wages paid or tangible assets
  - Exception when taxable income below a threshold
- Proposed regulations released August 2018
Qualified business income details

• Pass-through deduction limited to the greater of:
  - 50 percent of W-2 wages (employees and owners), or
  - 2.5 percent of original cost of depreciable, tangible property plus 25 percent of wages

• Passive vs. active status of owner does not impact eligibility

• Wage/asset and service business limitations do not apply to taxpayers with taxable income < $157,500/$315,000

• Certain income doesn’t qualify – investment income, capital gain, guaranteed payments, wages to S corporation shareholders
Highlights from the proposed regulations

• Helpful guidance regarding ‘specified service trades or businesses’

• New aggregation regime – similar to (but different from) passive activity grouping rules

• Taxpayers will need to analyze their revenue streams looking for ‘good’ income and ‘bad’ income
  – De minimis rule and related ‘cliff effect’ can wipe out the deduction

• Unless changes are made in final regulations, businesses and owners may see increased reporting complexity
Impact on estimated taxes

- Return filing position controls when determining whether sufficient estimated taxes have been paid
- Taxpayers that change their method of calculating tax as a result of these proposed regulations may wish to revisit calculations from prior quarters
- Many unknowns remain and it is uncertain when additional guidance will be issued
Year-end planning

- The proposed regulations would confound several strategies that might have generated a benefit
- Opportunities still exist to impact the potential deduction
  - Wage and asset limitations
  - Income limitations
  - Aggregation opportunities
  - Planning around the ‘cliff effect’
    - Separate trades or businesses
    - Considering expense allocation methodology
  - Analyzing other income streams
YEAR-END COMPENSATION & BENEFITS ISSUES
Universal savings accounts – contributions of up to $2,500 to special account. Tax free growth and penalty-free distributions. Contributions by employee for non-working spouse allowed
  - Essentially emergency savings

Association retirement plans – allowing certain associations to offer multiple employer retirement plans with the association handling administrative and fiduciary duties
  - Intended to make retirement plans more available to smaller employers

Retirement plan changes
  - IRA contributions would be allowed past age 70 1/2
  - No minimum required distribution if aggregate retirement plan balances for an individual are under $50,000

Section 529 plans -- tax-free distributions for home schooling, apprenticeships, elementary/secondary school expenses, also education loans
New HRA proposed guidance (IRS/DOL)

- Significant changes for some employers
- HRA (Health Reimbursement Account)
  - Employer-only contributions, generally
  - Current general prohibition from using old rules
  - New changes allow certain employers may be able to offer to reimburse employees, pre-tax, on the employees’ purchase of individual health coverage, including Exchange health coverage
2017 TCJA changes and IRS guidance

• Section 162(m) – Public company $1 million deduction limitation on top executive compensation
  - TCJA eliminated performance based compensation exception and exclusion for payments made after separation from service, also pulled CFO compensation into section 162(m) limits. Expanded covered employee list – once in, always subject to $1 million limit
  - IRS Notice 2018-69 Clarifications
    • Transition rules – protects some contracts from new 162(m) limits, protects deferred tax assets already on the books, IF benefit was in place and under written binding contact by Nov. 2, 2017. State law rules may assist in the “binding contract” determination
    • Getting away from Securities and Exchange Commission definitions of officer and probably compensation (may not just rely on summary compensation table)
    • Expand section 162(m) testing to short tax years, year in which company goes private
    • Expand covered employees to pull in ‘predecessor’ company covered employee – awaiting further guidance
Section 274: Loss of deduction changes

• Several changes within section 274 eliminate or reduce tax deductions for entertainment, meals and certain fringe benefits

• The effect on corporations is milder because of lower tax rates

• The effect on partnerships, especially service partnerships with many employees, can be substantial, creating significant ‘phantom’ income for partners
Section 274: Meals and entertainment changes

- Entertainment expenses – Effective Jan. 1, 2018, such expenses are generally 0 percent deductible, even if expense was for business purposes
- Meals expenses – Effective Jan. 1, 2018, most meal expenses are 50 percent deductible. TCJA eliminated ‘de minimis’ exception to the 50 percent deduction limit for food and beverage expenses
  - Administrative issues – Difficult to find meal expenses in invoices (e.g., a bill for copy paper, office supplies, coffee and other beverages). Company must determine amount of food and beverage costs from these bills. Work with suppliers to require separate reporting
  - Charity sporting events - Work with charity to indicate advertising expenses, food expenses (50 percent deductible if identifiable), charitable donations, and actual entertainment cost (0 percent deductible)
- Notice 2018-76 clarified that where business meal and entertainment expenses are together (e.g., a meal consumed with a client at a ball game), the meal is still 50 percent deductible SO LONG AS the meal amount is separately identified or separately billed
Awaiting further IRS guidance, but the IRS has generally clarified that:

- Employee wage elections to pay for parking or mass transit passes on a pre-tax basis remain excluded from income under section 132(f), but the amounts excluded under section 132(f) are NOT DEDUCTIBLE.

Free parking where parking clearly has a value will be subject to a section 274 loss of deduction:

- Value of the "loss of deduction"?
- Tax exempt entity Unrelated Business Income Tax on tax-free parking and transit - not yet clear how this is determined

- Van pool or commuting bus costs are subject to a loss of deduction
  - American Institute of Certified Public Accounts (AICPA) has asked for clarification of how the value of the deduction will be determined – as above, possibly based on employer’s cost

Section 274(l) commuting costs are nondeductible unless provided for safety reasons:

- May need security studies to support safety arguments
- AICPA has asked for clarification that if commuting costs are included in employee compensation they are deductible as compensation
• Qualified moving expenses used to be deductible by an employee and excludible if paid or reimbursed by an employer for an employee’s work-related move to another work location
• TCJA eliminated both employee deduction and employer exclusion, effective Jan. 1, 2018
• New IRS guidance clarified that if a move was completed in 2017, but the employer did not reimburse the moving expenses until 2018, the 2017 qualified moving expenses paid or reimbursed by the employer in 2018 are still excluded from employee compensation
  – Some employers taxed employees on these 2018 reimbursements; consider correcting before 2018 Forms W-2 are issued
ACCOUNTING METHODS
Bonus depreciation – Effective date

- In general, shall apply to property which—
  - is acquired after Sep. 27, 2017,
  - is placed in service after such date, and
  - which is placed in service by the taxpayer before Jan. 1, 2027

- For purposes of the preceding sentence, property shall not be treated as acquired after the date on which a written binding contract is entered into for such acquisition
Bonus depreciation – Binding contract

• A contract is binding only if it is enforceable under state law and does not limit damages to a specified amount.
• A contractual provision that limits damages to an amount equal to at least 5 percent of the total contract price will not be treated as limiting damages to a specified amount.
• Contract date.
Bonus depreciation – Used property

• Now subject to bonus depreciation
• Applicable to Rev. Ruls. 99-5 and 99-6?
• Original use requires ownership
Depreciation

Recovery periods—real property:

- **MACRS**—no change—still 27.5 year for residential and 39 year for nonresidential
- **ADS** – favorable change for residential (30 year instead of 40 year); no change for nonresidential (still 40 year)
- **Qualified improvement property (QIP)** intended to be eligible for 15 year recovery but left out of final bill—39 year recovery period maintained (40 year ADS)
Accounting standards initiatives

• ASC 842 – The effective for public business entities for annual periods beginning after Dec. 15, 2018 (i.e., calendar periods beginning on Jan. 1, 2019), and interim periods therein. For all other entities, ASC 842 will be effective for annual periods beginning after Dec. 15, 2019 (i.e., calendar periods beginning on Jan. 1, 2020)

• ASC 606 – The standard already applies to public business entities, certain not-for-profit entities, and certain employee benefit plans. The effective date for all other entities is annual reporting periods beginning after Dec. 15, 2018, and interim reporting periods within annual reporting periods beginning after Dec. 15, 2019
Revenue recognition under section 451

• Generally the earlier of:
  - Earned
  - Due
  - Received

• Additional test of no later than recognized on the taxpayer’s applicable financial statement
  - Audited
  - Accrual requirement
  - Does not apply to special methods
Small taxpayer designation

- Increased availability of the cash receipts and disbursement method of accounting
- Relaxed requirements to account for inventory
- More availability of the completed contract method
- Interest expense limitations and exceptions
Section 448(b)(3)

- Allows corporations, and partnerships with corporate partners, to use the overall cash receipts and disbursements method of accounting for those entities with average annual gross receipts of such entity for the 3-taxable-year period ending with the taxable year which precedes such taxable year does not exceed $25,000,000
- Adjusted for inflation
- Certain aggregation rules
- Tax shelter rules
Thank you

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