Summary of 2017 Tax Law Changes

1 2017 Tax Law: Massive Changes
HR 1, as passed by Congress

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2 Overview
• Major corporate provisions, including rate cut to 21%
• Standard deduction up, exemptions gone
• Deduction for 20% of business income
• 100% first year expensing of assets
• Business interest deduction limited
• State & local tax deductions very limited

3 Overview: International
• Most impactful changes since 1962
• 100% deduction for corporations receiving dividends from foreign subs
• 2017 and/or 2018 inclusion of all prior E&P of foreign subs, with 77% or 55% deduction
  – Elections due by return due date(s)
    • Pay in installments
    • S Corps defer indefinitely

4 Overview: International
• 50% deduction for corporations for export and foreign services net income
• New Subpart F inclusion with deduction reducing effective rate for income of foreign subs in excess of 10% ROI
• Source rule: 100% to place of production
• Deemed paid FTC limited to Subpart F
• New Base Erosion Tax on U.S. subs of large foreign groups

5 Effective Dates
• Generally 2018 tax year

6 Tax Rates
• Corporations: flat 21%
• Individuals: small changes in graduated rates, generally reducing marginal rates by 2 percentage points but decreasing bracket income
  – Examples later in video
• “Kiddie tax” now at trust rates except on earned income

7 Individual Deductions
• Standard deduction: $18,000 married, $12,000 single
• No more personal exemption
• Phase out of itemized deductions gone
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8 New limits on Itemized Deductions
   • Taxes limited to $10,000, beginning 2017
   • Interest on other than purchase mortgage not deductible
     – Debt limited to $750k for debt after 12/15/17
   • Contributions limited to 60% AGI (was 50%)
   • Medical begins at 7.5% AGI (was 10%)
   • No misc. itemized deductions
   • Casualty loss only for disaster areas

9 Wage Withholding Rules Changed
   • When IRS issues regs, new rules will reflect changes in exemptions and deductions
   • New requirement to advise employer within 10 days of any change in marital status or eligibility for allowances

10 Child Credit
   • $2,000 per child
     – Only U.S. citizen or resident kids count
   • $1,400 of which is refundable
     – Phased down above $400k AGI joint ($200k other)
   • $500 per other dependent
   • Social security number of child must be issued before due date of return

11 Comparison for Individuals

12 NOL Deduction
   • Non-corporate: limited to 80% of taxable income (AMT income for AMT)
   • No carryback (except farming and insurance company losses), unlimited carry forward

13 Alimony
   • Not deductible
   • Not taxable to recipient
   • Effective for decrees or agreements after 2018
     – But can modify agreement to explicitly make this apply

14 Various Expenses
   • Entertainment expenses not deductible
   • Meals deduction limited to 50% in all cases
   • Moving expenses not deductible to employee or employer
   • Moving expense reimbursements are taxable income
   • Certain lawsuit settlements considered fines and penalties
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15 □ AMT
- Corporate AMT repealed
  - Conforming items for AMT credit carryovers
- Individual exemption increased & indexed
  - $109,400 joint, $70,300 single

16 □ Business Changes
17 □ Deduct 20% of Business Income
- DPAD Replaced
- Deduct lesser of 20% of business income or 20% of income subject to regular tax rates
  - Limited to (a) 50% of W-2 wages or (b) 25% of W-2 wages plus 25% of depreciable asset unadjusted basis
- Includes flow-through income (p/s, S Corp, co-ops)
- Business income excludes income of service businesses (doctors, accountants, house cleaners, but not engineers or architects)

18 □ Deduct 20% of Business Income, cont.
- W-2 wage limit and service business exclusion don’t apply if income below threshold ($157,500/$315,000 for 2018)
- Deduction NOT allowed in computing AGI or self employment tax, but is allowed for those not itemizing deduction
  - Expect major 1040 form change
- §6662 penalty threshold is 5% for this

19 □ Depreciable Assets
- First year expensing: §168(k)
  100% (no $ limit) for non-realty and some types of realty in service after 9/27/17
  - Except luxury automobiles: separate limits
  - Including used property acquired from unrelated parties,
  - May elect 50%,
  or

20 □ Depreciable Assets, cont.
- First year expensing: §179
  100% (indexed) for other qualifying property including roof, HVAC, alarm and security systems (§179)
- Faster depreciation for real property
- Luxury auto limits raised:
  $10,000 / 16,000 / 9,600 / 5,760
- Also, computer equipment no longer listed property

21 □ Interest Deductions
- Business deduction for interest limited to 30% of taxable income from trade or business BEFORE interest & depreciation
  - Applies to all types of taxpayers, except electing real property, farming, or utility businesses
- Any nondeductible treated as paid next year
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22  Interest Deductions, cont.
    • Applied at partnership or S Corp, but with carryover at partner level and with basis adjustments
    • Excludes floor plan financing interest of vehicle, boat, and farm equipment dealers
      – But they can’t get 100% depreciation

23  R&E Expenses: 60 Months
    For expenses after 2021 only:
    • Won’t be immediately deductible
    • Must be capitalized and amortized over
      – 5 years for domestic research
      – 15 years for foreign research
    • R&E expenses won’t include land, depreciable assets, or oil/mineral exploration
    • Software development = R&D
    • No deduction on abandonment

24  Cash Method for Under $25 Million
    • Individuals, partnerships, and S corporations can now use pure cash method if gross receipts under $25 million
      – Recognize income when received
      – Recognize deductions when paid
      – Expense inventory when bought & paid for
      – BUT: can’t use if using accrual on financial statements
    • Also: §263A & % completion no longer apply
    • Retested annually
    • No impact on depreciable asset expensing

25  Recognizing Income
    • Accrual method taxpayers must include income in taxable income no later than when reported on applicable (audited) financial statement
    • Include advance payments in income in
      – Year received, or
      – If elected (by category), amount required under above and balance in following year
    • 6 year pickup of 481 amount

26  Like Kind Exchanges
    • Now include only real property
    • U.S. and non-U.S. are not like kind

27  Compensation
    • High salaries: limits or excise tax
    • Stock options: possible earlier income recognition; very complex
    • No more recharacterizing Roth IRA conversion
    • Several employee benefits now taxable and/or non-deductible by employer
      – Commuting, meals, service awards, etc.
    • Qualified (pension, 401(k)) plan loans
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28 Sick Pay Credit for Employers
   • Very complex provision
   • Credit in lieu of deducting wages; may elect out of credit
   • 12.5% to 25% of sick pay/family leave pay
   • Maximum 12 weeks
   • Excludes pay required by state law
   • Excludes pay for highly compensated employees (defined in retirement rules)
   • Requires written policy meeting certain requirements

29 U.S. Is Now a Tax Haven

30 2018 Inclusion & Deduction
   • All post-1986 E&P for CFCs recognized as income by each U.S. Shareholder in 2018
     • 10% or more owned foreign corporation for C or S Corporation US Shareholders
       – Except amounts previously taxed under Subpart F
     • Reduced by deficits of other 10% FCs of such shareholder; those deficits reduced
     • Inclusion before deficits is PTI for §959

31 2018 Inclusion & Deduction, cont.
   • Deduction allowed for inclusions
     – 15.5% equivalent rate percentage of aggregate cash position part of inclusion
       • Sum of all cash positions
       – Plus 8% equivalent rate percentage of other
     • Equivalent rate percentage is % that would result in amount being subject to tax at that rate as if taxpayer were corporation
       – Taking into account §15 rate blending

32 2018 Inclusion & Deduction, cont.
   • Cash position = cash + equivalents + net receivables
     – Includes foreign currency, etc
     – Net receivables = A/R – A/P (US tax basis)
     – Lesser of amount at last day of year before 2018 or average of beginning of last year and 11/2/17
   • 77.1%/55.7% reduction to deemed paid tax
   • Partner/S Corp shareholder basis adjustment for pre-deduction amount

33 Installments for Additional Tax
   • May elect to pay additional tax in installments:
     – 8% first 5 years, then 15%, 20%, and 25%
     – MUST elect and pay first installment by due date of return for year of inclusion. NO EXTENSIONS
   • Effective for last taxable year of 10% foreign corporation beginning before 2018
     – One U.S. Shareholder may have multiple effective dates and returns
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34 Installments for Additional Tax
   • S Corporations:
     – Shareholders each make their own installment elections, including
     – Election to defer installments until triggering event (liquidation, non-S, transfer of shares)
   • Several elections for REITS
   • Any U.S. shareholder may elect to defer NOL deduction

35 Deduction for Foreign Dividends Received by Corporations
   • 100% deduction for dividends received by a corporation from a 10% or more
     owned non-PFIC foreign corporation
     – Foreign source portion only
     – Including gain recharacterized under §1248
   • Gain on lower-tier sub sale treated as Subpart F income, but eligible for deduction
   • Basis in shares reduced by deduction

36 Deduction for Foreign Dividends Received by Corporations, cont.
   • No foreign tax credit or deduction allowed
   • No deduction for hybrid dividend (dividend for US, deductible somewhere else)
   • 1 year holding period required for deduction

37 Transfer of Foreign Branch
   • Gain recognized on transfer of foreign branch to foreign corporation. §367(a)(3) repealed
   • US corporation must recapture post 2017 loss of branch if branch transferred to 10% or more
     owned foreign corporation
     – Less any branch profits after the loss incurred and
     – Less any gains on transfer
   • Source is U.S.

38 Global Intangible Income
   • Subpart F inclusion for low taxed tested income less tested loss of CFCs in excess of
     – 10% of average adjusted basis in depreciable tangible property used in business over
     • Basis determined under ADS - §168(g)
     – Interest expense allocable to Subpart F
   • Tested income is income of a CFC excluding
     – U.S. source, high-tax, related person dividend, or oil/gas

39 Global Intangible Income, cont.
   • Inclusion determined for shareholder on aggregate basis, netting incomes and losses
   • High/Low tax means over/under 90% of top tax rate for U.S. shareholder
     – Thus 18.9% for corporations, 33.3% for others
   • Deemed paid credit for corporations reduced by 20%
   • Separate FTC basket
   • Effective for tax years of CFC beginning after 2017 and years of US Shareholders in which or
     with which such FC year ends
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40 Deduction for Foreign Intangible Income
   • New §250: U.S. corporation gets deduction for
     – 37.5% of foreign-derived intangible income plus
     – 50% of Subpart F inclusion & grossup, plus grossup, for global intangible income
     – Limited to taxable income
   • APPLIES ONLY TO CORPORATIONS
   • Does not affect NOL

41 “Intangible Income”
   • Excess (if any) of deduction eligible income over
   • 10% of adjusted basis in depreciable tangible property used in business
   • Times % of foreign-derived deduction eligible income
   • Limited to taxable income

42 “Deduction Eligible Income”
   • Gross income of corporation (or consol. group), but excluding:
     – Subpart F inclusions other than under §956
     – Financial services income
     – Dividends from CFCs
     – U.S. oil and gas income
     – Income of foreign QBUs
   • Less deductions allocable to such gross income

43 “Foreign-Derived”
   • From sale of goods to a foreign person for use or consumption outside the U.S.
     – Excludes goods subject to further manufacture in U.S.
     – Includes sales to related foreign parties only if the party sells to unrelated party who is not a U.S. person
   • From services provided outside the U.S. to a person (other than a related party) who is outside the U.S.
   • Related = 1504(a) but using 50%

44 Source Rule: 863(b)
   • Sale of goods produced by taxpayer (or consol. group) now sourced 100% to place of production activities

45 Other Subpart F Changes
   • 10% test now vote or value after 2017
   • 30 day rule eliminated: can be a CFC if U.S. controlled for only 1 day after 2017
   • Foreign person shares attributed to related U.S. person for determining if CFC, potentially effective for 2017

46 Modifications to Deemed Paid FTC
   • §960 revised to be what §902 was, plus
   • Deemed paid credit for foreign tax on Subpart F inclusion for global intangible income is 80% of taxes, limited as usual
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47 Changes to Foreign Tax Credit
• §902 repealed: the income that would have given rise to positive limitation is now exempt
• §960 enhanced to include the things that were in §902, plus conforming §78
• Reduction of creditable tax pro-rata for income excluded from Subpart F (inc. new §951A)
• No fair market value method for interest apportionment

48 Changes to FTC, cont.
• Non-passive income of foreign QBUs is one separate basket
• May elect to apply more than 50% of overall domestic loss to reduce foreign source income

49 Hybrid Transactions, Entities
• No deduction for interest or royalty paid to related party in hybrid transaction or to a hybrid entity
• Includes amounts not included in income of payee for income tax in payee’s country
• Includes transactions treated as interest or royalty for U.S. tax and something else for foreign tax

50 Inbound Changes

51 New Base Erosion Tax
• Separate minimum tax on corporations (other than S Corp, RIC, REIT) with:
  – Over $500 million gross receipts and
  – Base erosion payments exceed 3% of deductions
• Tax is excess (if any) of 10% of modified taxable income over regular tax (net of §38 credits)
• Modified taxable income is TI before base erosion tax benefit, foreign DRD, Global Intangible Income deduction, and NOL deduction

52 Base Erosion TaxBenefit
• Deduction for payment to 25% or §482 related foreign party (with attribution at 10% instead of 50%)
• Depreciation deduction on property purchased from related foreign party
• Reinsurance premiums paid to related foreign party
• Payments to §7874 expatriated entities
• BUT: payment not counted if U.S. tax withheld and item not tax exempt under treaty

53 Gain on Sale of Partnership Interest
• Gain or loss on disposition of interest in partnership engaged in U.S. trade or business treated as effectively connected income
• Causes U.S. tax on gain, or deduction for loss on sale by foreign persons
• Rules on determining share, and coordination with FIRPTA rules
• Clearly overrides treaties
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Industry or Entity Specific Items
- No more technical termination of partnerships
- 6 year recognition for gain on conversion from S Corporation to C corporation within 2 years
- Partnership distributions
- Insurance changes
- Banking changes
- Opportunity zone rules: big changes
- Puerto Rico credit changes

Non-Income Tax Items
- Estate & gift tax exclusion now $10 Million inflation indexed ($11.2M for 2018)
- Penalty for not having health insurance repealed for months AFTER 2018
- Excise taxes on private foundations and non-public colleges
- Reduced excise taxes on alcoholic beverages
- Arctic National Wildlife Region oil drilling allowed