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

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

  Up to $1 million (indexed) for other qualifying property including roof, HVAC, alarn 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), amout 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

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

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 Tax Benefit

- 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

54 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

55 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