



Tax reform is finally here. What do you do now?

February 6, 2018

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Learning objectives

1

Develop an understanding of the significant tax reform legislative changes

2

Identify how the legislation may impact your organization

Agenda

1

Overview

2

Detailing the bill

3

Planning considerations

Tax Cuts and Jobs Act

- Now officially entitled: "To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018."
- Enacted!
 - Senate passage: Narrow victory after Byrd rule violations resolved
 - House passage: Approved easily after forced to vote a second time
- Trump signed into law on Dec. 22

When is it official?

- Does it matter when he signed?
 - For tax purposes: Not really, effective dates generally not reliant on enactment date
 - For financial reporting purposes: YES! Because signed in 2017, needs to be taken into account for 2017 financial statements
 - Accounting for tax transition relief made available!

How did they manage to pass it?

- \$1.456 billion tax cut using reconciliation
- How does it comply with reconciliation rules barring revenue loss outside budget window?
 - All individual tax changes expire but two!
 - Individual mandate and slower inflation adjustments made permanent
 - Handful of "sunrise" revenue raising provisions on business side
- Is this bill built to last?!?!?!?

Pages from the Senate Bill as Passed

1 (b) EFFECTIVE DATE.—The amendment made by
 2 this section shall apply to taxable years beginning after
 3 December 31, 2017.

4 **SEC. 13543. MODIFICATION OF TREATMENT OF S CORPORA-**
 5 **TION CONVERSIONS TO C CORPORATIONS.**

6 (a) IN GENERAL.—Section 1371 is amended by add-
 7 ing at the end the following new subsection:

8 “(f) CASH DISTRIBUTIONS FOLLOWING POST-TERMI-
 9 NATION TRANSITION PERIOD.—

10 “(1) IN GENERAL.—In the case of a distribu-
 11 tion of money by an eligible terminated S corpora-
 12 tion after the post-termination transition period, the
 13 accumulated adjustments account shall be allocated

ADD
 (a) adjustments attributable to conversion from S corporation to Corporation - Section 481 is amended by adding at the end the following new subsection:
 (d) Adjustments attributable to conversion for

14 to such distribution, and the distribution shall be
 15 chargeable to accumulated earnings and profits, in
 16 the same ratio as the amount of such accumulated
 17 adjustments account bears to the amount of such ac-
 18 cumulated earnings and profits.

19 “(2) ELIGIBLE TERMINATED S CORPORA-
 20 TION.—For purposes of this subsection, the term ‘el-
 21 igible terminated S corporation’ means any C cor-
 22 poration—

23 “(A) which—

*A corporation - C corporation.
 (1) In general, in the case of an eligible terminated S corporation, any increase in tax under this chapter, by reason of a adjustment required by subsection (a)(2) and which is attributable to such corporation's reversion described in paragraph (A)(ii), shall be taken into account ratably during the 6-taxable year period beginning with the year of change*

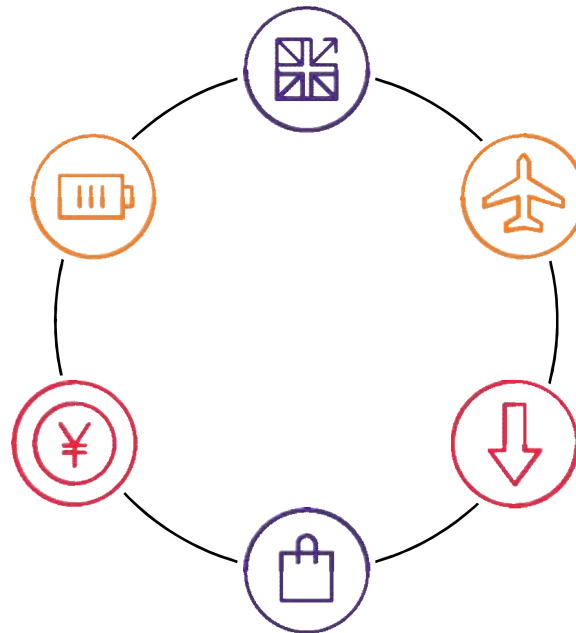
Fixing the issues?

- Bill was written and re-written very quickly, and is all but certain to contain:
 - Technical glitches
 - Ambiguous sections
 - Unintended consequences
- Can they fix it?
 - GOP refused to help Dems fix ACA: Turnabout is fair play and they are unlikely to help fix a bill they oppose
 - Brady: Second reconciliation bill next year? Technical corrections lose in 'Byrd' bath
 - IRS given over 100 explicit grants of reg authority, little funding cuts, and requirement to cut two regs for every one they publish
 - Taxpayers may be on their own in many areas for a couple of years

Any chance of reversals?

- Republicans promising to address expiring provisions:
 - Didn't work out well for 2001 and 2003 tax cuts
 - Democrats will have considerable leverage
- Democrats certain to run in 2018 and 2020 on promises to rollback major parts
 - Both Bush tax cuts and ACA show real difficulty in using partisan bills passed in reconciliation to make permanent and lasting changes

How would the tax bill affect you?



Individual rate cut

- \$1.2 trillion rate cut achieved mostly by preserving existing tax brackets and lowering rates:
 - 10% retained
 - 15% lowered to 12%
 - 25% lowered to 22%
 - 28% lowered to 24%
 - 33% lowered to 32%
 - 35% retained
 - 39.6% lowered to 37%
- No 6% surtax like in house bill
- Top brackets moved to \$500k (single) and \$600k (joint)

Key changes

- AMT retained with ~ 40% increase in exemptions and increase in exemption phase out
 - *Grant Thornton insight: Bigger exemptions plus limits on itemized deductions should narrow impact of AMT, but effect not universal. Lower rates could also make a difference*
- Child credit increased to \$2,000 and phase-out range almost quadrupled
- Phase-out of itemized deductions repealed
- Kiddie tax repealed in favor of taxing kids unearned income at trust rates

Itemized deductions

	HOUSE	SENATE
Mortgage deduction	Capped at \$750,000 in acquisition debt with grandfathering	
SALT deduction	Only allowed for deduction of up to \$10,000 for property and income taxes (can elect sales taxes in lieu of income taxes)	
Charitable deduction	Retained with better AGI limit	
Medical deduction	Retained and AGI limit reduced to 7.5% for 2018 and 2019	
Miscellaneous itemized deduction subject to 2% AGI	Repealed for both unreimbursed employee expenses and expenses for the production of income (such as investment fees)	
Other miscellaneous itemized deductions	Retained if specifically identified as exempt for 2% AGI floor (investment interest)	

Key insights

- *Itemized v. standard:*
 - *Grant Thornton Insight: Over 90% of taxpayers expected to take standard deduction, up from 70% now. Will this dampen effect of incentives from deductions that are retained?*
- *State and local tax:*
 - *Grant Thornton Insight: State and local tax deduction causing controversy. JCT claiming exception for trade or business taxes should be read narrowly to include only property and sales taxes. What about gross receipts taxes paid by entity? Hybrid entities? ESBT trusts?*

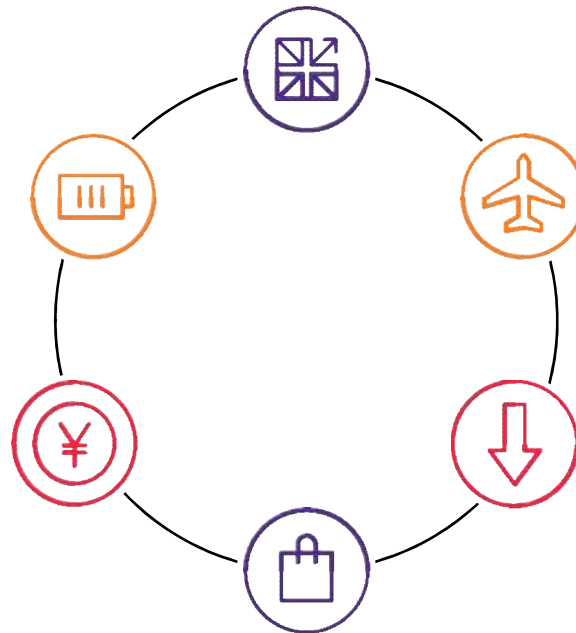
Other key changes

- No casualty losses (unless disaster) or moving expenses (unless military)
- Most other credits and exclusions on the chopping block survive:
 - Gain on the sale of principal residence
 - Employer provided housing, education, and achievement awards
 - Education deductions and credits

Transfer taxes

Issue	Current	2018	2019	2020	2021	2022	2023	2024	2025	2026+
H.R. 1	<ul style="list-style-type: none"> \$5.49M exemption 40% rate 	<ul style="list-style-type: none"> \$11.2M exemption 40% rate 								Current law

Business taxes



Corporate rate cut

- Flat 21% rate:
 - Effective for tax years beginning after Dec. 31, 2017
 - Fiscal year taxpayers use blended rate based on ratio of days in calendar years 2017 and 2018
- Personal service corps get 21% rate

Passthrough tax deduction: §199A

- General rule – deduction equal to lesser of:
 - 20% of qualified business income, or
 - The greater of:
 - 50% of W-2 wages, or
 - 25% of W-2 wages plus 2.5% of the unadjusted basis of qualified property
- The 20% deduction creates effective rate of
 - 29.6% against the 37% top individual rate
 - 28% against the 35% rate

Passthrough tax deduction: §199A

- Qualified business income
 - Income, gain, deduction and losses effectively connected with each qualified business within the United States or Puerto Rico, **BUT**
 - Does not include income or loss from investment items
 - Long-term capital gains and losses
 - Dividends and dividend equivalents
 - Other investment vehicles
 - Interest **UNLESS** properly allocable to the qualified business

Passthrough tax deduction: §199A

- Qualified business income does not include:
 - Payments of reasonable compensation by an S corporation
 - Guaranteed payments for services rendered with respect to the business
 - To the extent provided in regulations (not yet issued) any amount paid or incurred by a partnership to a partner for services if the partner is acting other than in his capacity as a partner
- Specified service business not included: Health, law, accounting, actuaries, performing arts, athletics, financial services, brokerage services, investing, investment management, trading or dealing in financial instruments, or any business where the principal asset is the reputation or skill of one or more employees; except to the extent the owner satisfies an income threshold test
 - Engineering and architecture are NOT specified service businesses

New §199A – Income threshold test

- Specified service businesses NOT excluded from section 199A deduction
- W-2 wage and wage plus asset tests do NOT apply
- Threshold:
 - \$315,000 of taxable income if married filing jointly
 - \$157,000 of taxable income if filing single
- Phase out over next \$100,000 (mfj) or \$50,000 (single) of taxable income.

New §199A – Special considerations

- Section 199A reduces taxable income, but not gross income or AGI
 - Will not affect AGI based phase-ins and phase-outs
 - Not expected to be deductible for state tax in states basing their income tax on Federal measures of AGI
- Section 199A does not itself modify any employment tax rules
- If the sum of all section 199A deductions is negative, the negative amount carries forward to future years
- There is no distinction between passive and active owners

Expensing and cost recovery

- Senate mirrors House by doubling bonus depreciation for five years:
 - 100% for property placed in service after Sep. 27, 2017 and Jan. 1, 2023, and then:
 - 80% in 2023
 - 60% in 2024
 - 40% in 2025
 - 20% in 2026
 - Used property qualifies (if new to taxpayer)
 - Exceptions for public utilities, real estate businesses, and floor-plan financing

Interest deduction

- Net interest limited to 30% of adjusted taxable income:
 - Adjusted taxable income:
 - 2018 – 2021: Roughly equivalent to EBITDA
 - 2022+: Roughly equivalent to EBIT
 - Unlimited carryforward
 - Exceptions: Utilities, electing real estate, and businesses with <\$25 million in receipts
- *Grant Thornton Insight: Think this is painful now? Could be even worse in future years when interest rates are higher of taxable income is depressed by an economic downturn*

AMT and NOL

- Corporate AMT repealed!
 - Can use your unused credits over the next four years as refundable if needed!
- NOLs!
 - Can offset only 80% of taxable income in any year
 - NOL carrybacks eliminated but carryforwards are indefinite
- *Grant Thornton Insight: AMT repeal somewhat hollow. The AMT limit on NOLs to 90% of taxable income is most common AMT preference. AMT repealed, but even worse limitation added independently. Silver lining: Pre-2018 NOLs grandfathered so avoid 90% AMT limitation in future years and new 80% limitation*

R&D expensing

- 5-year amortization of R&D costs
 - Scheduled to take effect in 2022
 - Includes software development
- *Grant Thornton Insight: Creates compliance burden. Most taxpayers do not currently identify all of the Section 174 expenses because Section 174 is broader than GAAP R&D. Companies will need R&D studies to identify and capitalize R&D expenses not identified under GAAP. Provision also discourages internal software development becomes cost can be recovered over 3 years if purchased*

Contributions to capital

- Income inclusion limited significantly in final bill to apply to:
 - State and local government incentives
 - Incentives received from customer or potential customer

Compensation deduction for public companies

- Strengthen restrictions on deduction for public company pay under §162(m)
 - Repeal exception for performance-based compensation or commissions
 - Now limited to \$1 million deduction each tax year regardless of type
 - Deduction limit applies to all domestic corporations, foreign companies publicly traded through ADRs, and large private C and S corporations that are required to be registered or file reports under the Securities Exchange Act of 1934
 - Applies to CEO, CFO, and top three: Once covered, always covered, so can have more than 5 if continue to employ (or pay) executives no longer meeting thresholds
 - Changes do not apply to vested compensation paid in the future that is provided for under a contract that was in effect on Nov. 2, 2017

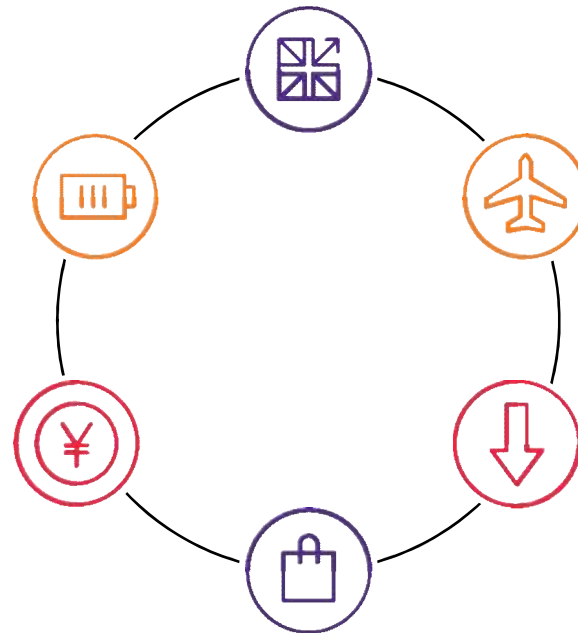
Carried interests

- Half-hearted attempt to go after carried interest:
 - Carried interest is a right given to a fund manager to receive a percentage of profits
 - Income from a carried interest takes the form of a capital gain as the fund sells investment assets
 - For investment and real estate businesses, the asset holding period would be increased to three years for long-term capital gain treatment for tax years beginning after Dec. 31, 2017
 - Doesn't apply to capital interests

Other key business provisions

Provision	Treatment in H.R. 1
Section 199	REPEALED
Like kind exchanges	Limited to real property
Work opportunity tax credit	RETAINED
New markets tax credit	RETAINED
Rehabilitation credit	Retained for historic buildings repealed for pre-1936 buildings
Private activity bonds	RETAINED
50% deduction for entertainment	REPEALED
Orphan drug credit	Reduced from 50% to 25%
Deduction for achievement award	Repealed for cash, gift cards, vacation, meals, lodging, tickets, stock
Deduction for transportation fringe	REPEALED

International tax



International highlights

- The Conference Agreement includes the following significant changes from previous legislative proposals:
 - The tax rates applicable for purposes of the one-time deemed repatriation tax were increased to 15.5% for cash and cash equivalents and 8% for non-cash
 - The conference agreement did not repeal Section 956 which deals with "Investments in US Property" by controlled foreign corporations
 - Adopted the House provisions which liberalizes the ability to utilize E&P deficits in determining the one-time deemed repatriation tax
 - The interest limitations applicable to domestic corporations who are members of a worldwide group were removed from the final legislation
 - Provisions which would have allowed the repatriation of certain intangible property in a tax advantaged manner were removed from the final legislation
 - Adopted the Senate Base Erosion Tax and not the House Excise Tax

International overview

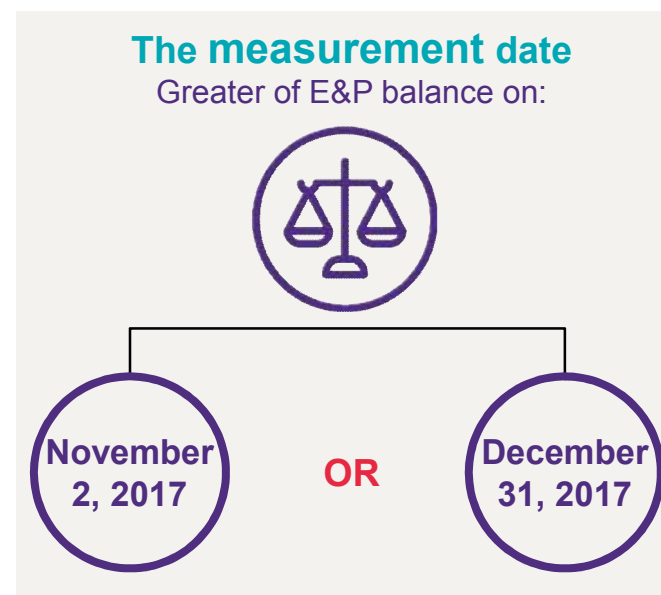
- Move to quasi-territorial system with 100% dividends received deduction
- One-time tax on previously unrepatriated earnings as transition and pay-for
- 3 very significant anti-base erosion provisions:
 - Minimum tax on "global intangible low-taxed income"
 - Base erosion payment minimum tax

Dividends Received Deduction (DRD)

- Who qualifies for the DRD?
 - Domestic C-Corporations only
- What dividends qualify?
 - Foreign subsidiaries in which taxpayers own at least 10%
 - Disallows DRDs for “hybrid dividends” inclusions don't apply
 - Subpart F inclusions do not qualify for the DRD – included as taxable income
- What about foreign tax credits?
 - Generally not available to the extent DRD applies

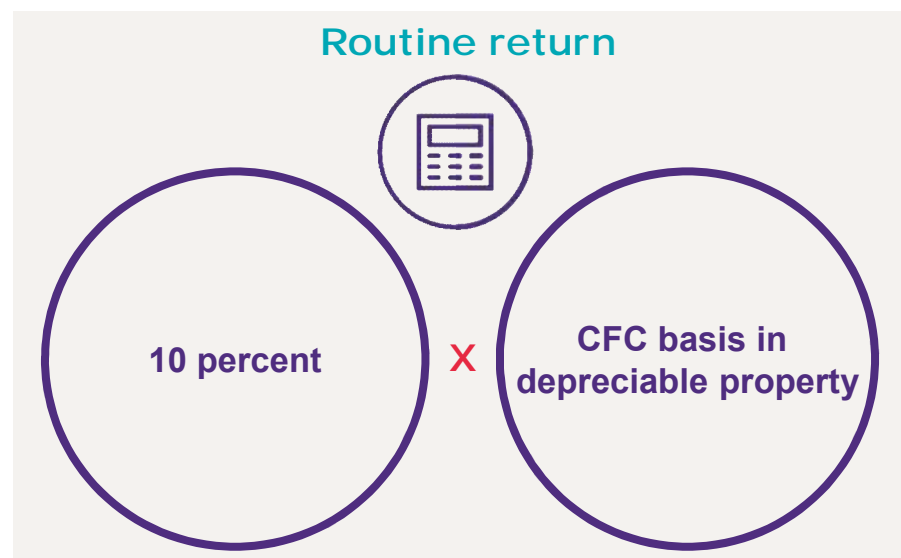
One-time tax on unrepatriated earnings of CFC's

- Rate of tax:
 - 15.5% on cash and cash equivalents
 - 8% non cash assets
- Foreign tax credits allowed after a haircut
- Election available for tax to be payable in escalating installments over 8 years. Deficits are taken into account
- Applies to all US persons (not just domestic corporations) – but deferral of payment for S-Corps
- Election available to preserve NOLs



Minimum tax and incentives

- Applies to tested income of a CFC means the excess (if any) of the gross income of the corporation determined without regard to certain exceptions to tested income:
 - 1) the corporation's ECI;
 - 2) subpart F income;
 - 3) income excluded under high-tax exception;
 - 4) any dividend received from a related person; and
 - 5) foreign oil and gas extraction income and foreign oil related income, over deductions allocable to such gross income
- Allows deduction of 37.5% of "foreign-derived intangible income" plus 50% of global intangible low-taxed income (subject to taxable income limit)



Deduction for foreign-derived intangible income

FDII

- The Senate bill provides an incentive for domestic corporations that earn foreign intangible income
- The proposal allows a deduction of 37.5% of the lesser of
 - (1) the sum of its foreign-derived intangible income (FDII) (2) its taxable income, determined without regard to this proposal
- Results in a 13.125% effective tax rate on excess returns on foreign sales and services
- Complex set of definitional rules
- The deduction for foreign-derived intangible income is reduced from 37.5% to 21.875% for taxable years beginning after December 31, 2025

Why is this a global minimum tax?

The calculation (by operation) would result in a full credit against U.S. tax if the foreign effective rate is above ~13.125%. The table below illustrates the approx. U.S. effective tax rate based on the respective foreign effective tax rate

U.S. ETR	0%	2.5%	6%	10.5%
Foreign ETR	13.125%	~10.3%	~6.1%	0%

Insight: The foreign effective rate is calculated using U.S. tax principles to determine the "taxable income" but uses foreign principles to determine tax amount. Caution should be used as odd results could occur!

Limit on net interest expense

- Deduction for domestic corporation's share of net interest expense of worldwide group limited by the product of net interest expense multiplied by the "debt-to-equity differential percentage" of the worldwide affiliated group
- Applies to multinationals which are members of an affiliated group (substituting 50% for 80% and including foreign corporations)
 - No gross income limitation
- Applies in conjunction with the general (i.e. Taxable income based) interest limitation introduced in the bill
- Disallowed interest could be carried forward indefinitely

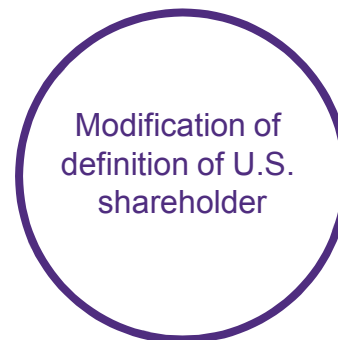
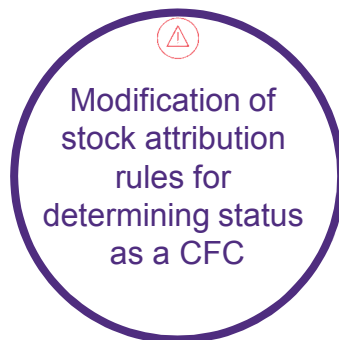
ELIMINATED

Base Erosion Anti-Abuse Tax (BEAT)

- Starting in 2018, companies that make excessive "base erosion payments" (BEPs) will be subject to a 5% minimum tax (10% for 2019 through 2025 and 12.5% for years after 2025) on modified taxable income (computed without regard for certain BEPs and NOLs attributable to BEPs) if:
 - The entity is a corporations other than a RIC, REIT, or S corporations, with both:
 - \$500 million in average gross receipts over 3 years, and
 - A base erosion percentage (a ratio of base erosion deductions compared to total deductions) of 3% or higher for the taxable year
- BEPs are generally amounts paid or accrued to a foreign-related party (related party is broadly defined) which results in a deduction (including depreciation and amortization)
- Limited exceptions for withholdable payments (but only to the extent tax is not reduced under an income tax treaty), and intercompany services charged at no markup
- Cost of Goods sold are NOT considered a BEP. Therefore the reduction to gross receipts for COGS should not impact the calculation of the BEAT.

Modification to existing Subpart F rules

Section



Summary

- Makes the "look-thru" exclusion from foreign personal holding company income permanent

- Amends section 958(b).
- Allows stock of a foreign corporation owned by a foreign person to be attributed to a USP

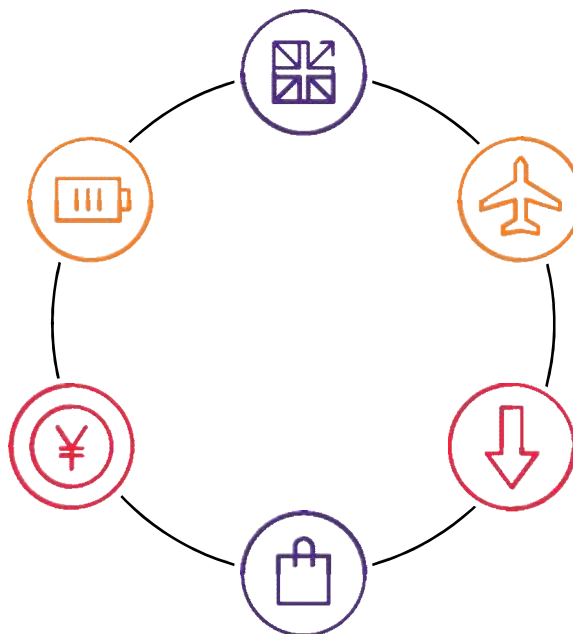
- Eliminates the "uninterrupted period of 30 days" requirement for Sub F

- Expanded to include any U.S. person who owns 10% or more of the total vote or value of a foreign corporation (previously vote only)



Stock attribution rules and U.S. shareholder definitional changes would be retroactively effective for all tax years beginning before 1/1/2018

Planning considerations



Planning considerations short-term?

- Immediate need to assess the Financial Statement Implications under ASC 740
 - Pricing deferred items, international tax, valuation allowance changes, disclosures
 - Period of enactment considerations
- Use deductions now against higher rates, defer income into future years when rates might be lower:
 - Consider planning around the corporate rate cut to 21%
 - Bonuses, benefits, and other compensation
 - Accounting methods
 - Fixed assets
- Defer earnings in CFCs

Planning considerations short-term?

- Attribute Utilization planning
 - Depreciation vs. NOL in light of changes to usage rules
 - Foreign Tax Credits vs. NOL for deemed repatriation

Planning considerations long-term?

- Entity choice
 - Pass-through vs. C-Corp – what makes sense in the new world?
- International restructuring
 - Global effective tax rate strategies?
 - DRD, Subpart F, Base Erosions taxes
- Debt v. equity investment
 - Limited ability to use leverage in US
 - Geographic debt placement strategies

Questions?



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