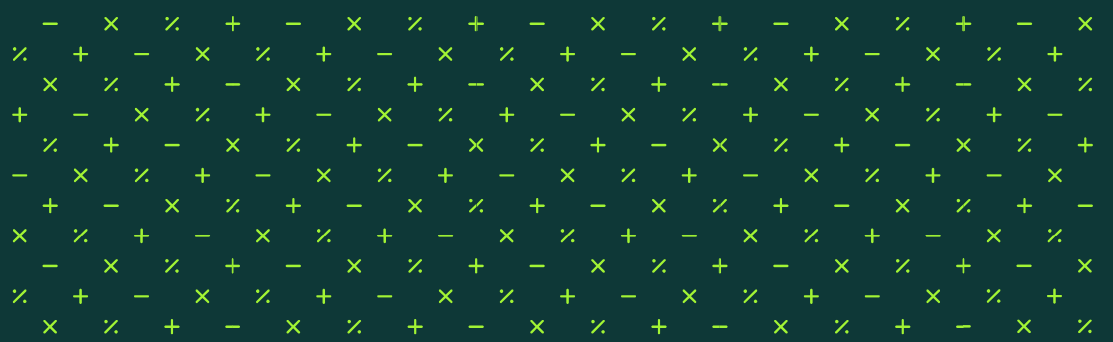




MA UNIVERSITY



Tax Reform and Year-End Planning Update

Wednesday, December 13, 2017

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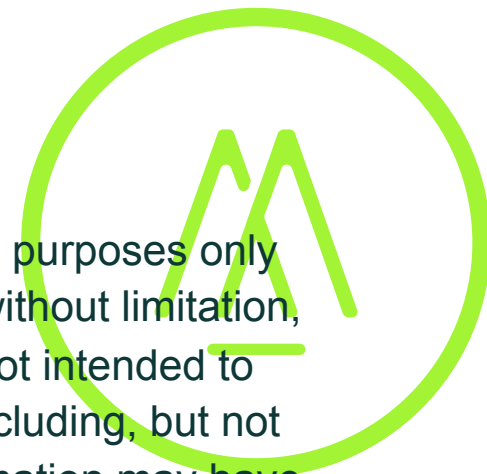
Sacramento, CA



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THANK YOU





What We Will Cover Today

Tax Reform Update

- *Where we are today?*
- *Individual Provisions*
- *Business Provisions*

Questions



Where Are We?

H.R. 1 – Tax Cuts and Jobs Act

- *Nov 2 – Legislative text first released*
- *Nov 9 – Approved by House Ways & Means Committee*
- *Nov 16 – Bill passes House on 227-203 vote*

Senate – Tax Cuts and Jobs Act

- *Nov 9 – “Conceptual mark” released*
- *Nov 16 – Approved by Senate Finance Committee*
- *Nov 21 – Legislative text released*
- *Dec 1 – Bill passes Senate on 51-49 vote under budget reconciliation procedures*



Tax reform bill – Initial reactions

What was expected?

- Rate decrease for corporations and most individuals
- Estate tax and AMT repeal
- Limitations on interest deductibility
- Many other revenue raisers pulled from 2014 Camp proposal

What surprised us?

- Nothing on LIFO and nothing significant on carried interests
- Limits on mortgage deduction
- Bubble tax rate on individuals to claw back the 12% rate (House)
- No change to capital gains / dividend rates
- Last minute negotiations in Senate – AMT, Trusts and Estate owning Pass-through interests

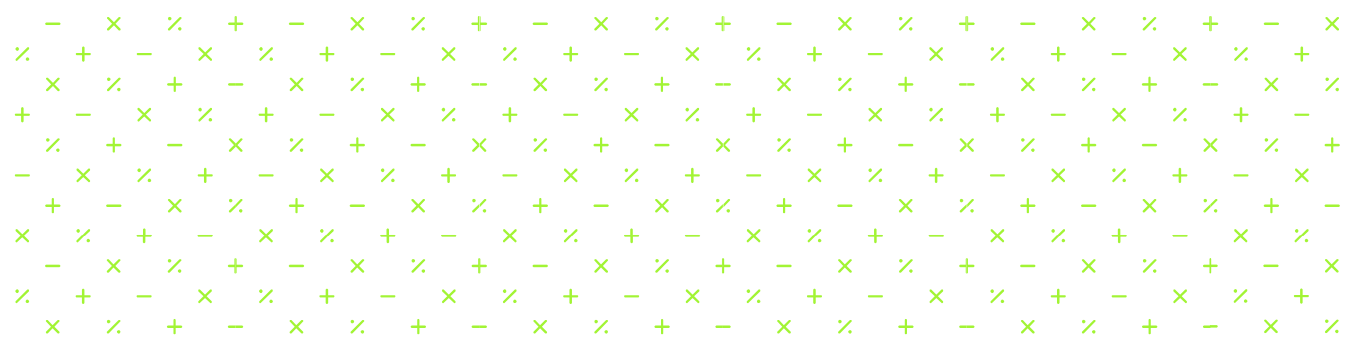




Tax reform bill – Initial reactions

What were the challenges?

- State and Local Tax Deduction
- Deficit Hawks – Senate bill would fall \$1 Trillion short of paying for itself
- Pass-through concerns – too much of the benefit going to C corporations
- Byrd rule compliance – Must not increase deficit beyond the \$1.5T allowed in the first decade



Individual Provisions

AICPA Construction and Real Estate Conference

Individual Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Tax rates	7 brackets; top rate of 39.6% on income > \$418.4K/\$470.7K (single/joint); Plus 0.9% Medicare tax on income >\$200K/\$250K	4 brackets; top rate of 39.6% on income > \$500K/\$1M; (“bubble tax” of 6% on income \$1M - \$1.2M); No change on Medicare tax	7 brackets; top rate of 38.5% on income > \$500K/\$1M; Rates sunset 12/31/25; No change on Medicare tax
Capital gain / qualified dividend rates	Maximum 20% rate for LT Capital gains and dividend	Same as current law	Same as current law
Standard deduction	\$6,500 / \$13,000 (2018)	\$12.2K / \$24.4K	\$12K / \$24K through 12/31/25
Personal exemptions	\$4,050 exemption for each member of household; phased out for higher AGIs	Repealed	Repealed through 12/31/25



Individual Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
AMT	26% / 28% on alternative minimum taxable income	Repealed	Preserves AMT but increases exemptions through 12/31/25
Estate tax, GST, and gift tax	40% after exemption of \$5.5M/\$11M; \$14K annual exemption per gift donee	40% estate and GST through 2023; both repealed in 2024; gift tax lowered to 35%; exemptions increased to \$10M / \$20M	40% after exemption of \$10M / \$20M; increased exemption sunsets 12/31/25
SALT deduction	State and local income or sales taxes deductible; property taxes fully deductible	Property taxes up to \$10K deductible; other SALT generally non-deductible	Property taxes up to \$10K deductible; other SALT generally non-deductible; Repealed through 12/31/25



Individual Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Itemized deduction limitation	Itemized deduction phase out begins at \$320K MFJ; \$266K Single (2018)	No limitation	No limitation through 12/31/25
Affordable Care Act	Those who fail to maintain health coverage owe penalty of 2.5% of AGI, or \$695 per adult/\$347.50 per child in 2017	N/A	Penalty lowered to \$0
Carried interest	Taxed as LT investment income	Adds holding period requirement of 3 years for gains on carried interest in an investment	Same as H.R. 1



Individual Tax Reform Proposals



Provision	Current Law	House Bill (HR 1)	Senate Bill
Child tax credit	\$1,000 credit per child under age 17. Phase outs begin at modified AGI of \$110K MFJ.	Increased credit to \$1,600 per child; Plus \$300 credit for non-child dependents. Phase out increased to \$230K MFJ.	Increased credit to \$2K per child and increases age to include those under 18. Reverts to under 17 again in 2025. Expires 12/31/25. Increases phase out to \$500,000 MFJ.
Mortgage interest	Deduction on first \$1M of debt used to secure primary or secondary residence, or first \$100K of home equity debt	Interest deductible on first \$500K of debt (effective for debt incurred after 11/2/17) and limited to primary residence only	Same as current law but suspending the deduction for home equity interest. Applies until 12/31/25.

Individual Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Tax prep fees	Deductible	Repealed	Repealed
Casualty losses	Deductible	Repealed unless it is related to 2017 Hurricanes	Limited to federally-declared disasters – limit expires 12/31/25
Moving expenses	Deductible	Generally repealed	Repealed through 2025
Teacher expenses	\$250 deductible	Eliminates deduction	Increases to \$500 – expires after 2025
Gain on sale of principal home	Gain of \$500K (MFJ) excluded. Must lived in home 2 of 5 years.	Must live in home 5 of last 8 years. Gain excluded once every 5 years.	Same as house bill, but expires 12/31/25.
Medical expenses	Deductible to extent exceeds 10% of AGI	Repealed	Lowers 10% threshold to 7.5% for tax years 2017 and 2018





Year end individual tax planning strategies - Income

In general, it is best to defer income to 2018...

- Contribution to qualified retirement plans
- Harvesting capital losses
- Stock options – if feasible, delay exercise until 2018
- Utilize installment sales or LKEs
- Timing of billings / collections for cash basis sole proprietors
- Defer retirement plan / IRA distributions (other than RMDs)



Year end individual tax planning strategies - Deductions

In general, it is best to accelerate deductions to 2017...

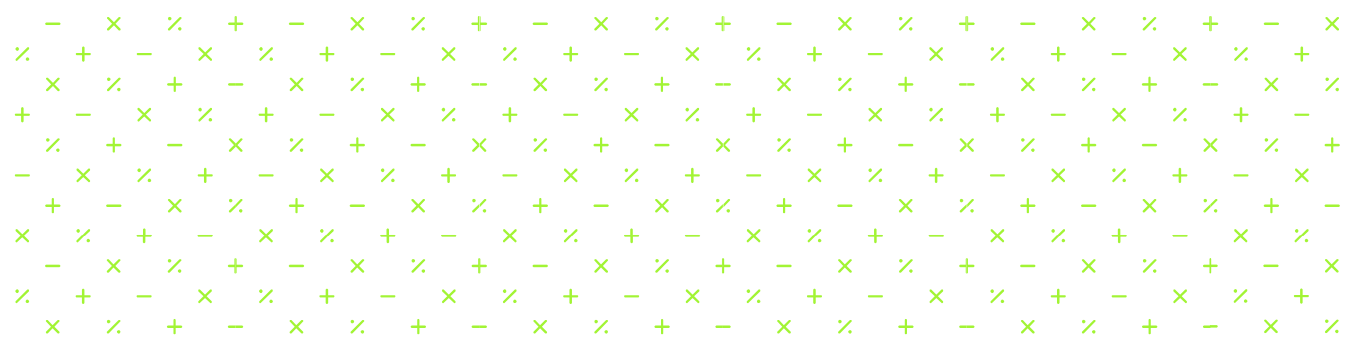
Accelerate those deductions that are slated to be cut...

- State income taxes
- Tax prep fees
- Miscellaneous itemized deductions and medical expenses (House bill)
- Real property taxes

Take into account the AMT and the 3% haircut on itemized deductions

Accelerate sizable charitable contributions





Business Provisions

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Business Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Corporate income	35% top rate	20% flat rate; 25% for PSCs; effective tax years after 12/31/17	20% flat rate; effective for tax years after 12/31/18
Corporate AMT	20% on Alternative Minimum Taxable income	Repealed	Same as current law
Net operating loss	2- year carryback and 20-year carryforward allowed to offset taxable income	NOL use limited to 90% of taxable income deductible; carryforward period made indefinite; NOL increased by interest factor	Limited to 90% of taxable income deductible through 2022, then 80% carryforward period made indefinite; no carryback



Business Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Pass-through income	Taxed at owner's individual rate	<p>25% rate on business profits, with assumed 70/30 split of wages to business profits</p> <ul style="list-style-type: none"> • May elect to prove capital percentage >30% • 0% capital percentage assumed for personal services • 9% rate for smaller firms that wouldn't otherwise qualify for 25% rate (on first \$75K if taxable income is less than \$150K) 	<p>23% deduction for business profits; limited to 50% of W-2 wages; sunsets 12/31/25.</p> <ul style="list-style-type: none"> • Personal service businesses not eligible, except for taxpayers with taxable income <\$250K/\$500K • Includes Qualified REIT Dividend and Qualified Cooperative Dividend in Business income • Excludes estates and trusts



Business Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Pass-through losses	Passed through to individual.	No change	Excess business losses disallowed. Excess loss is aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer, over the sum of aggregate gross income or gain of the taxpayer plus \$500,000 (MFJ). Excess loss will be carried over. Expires after 2025.
Domestic Producers Activity Deduction (DPAD)	9% dedx on domestic construction related activity income subj to 50% W-2 wage limitation	Repealed	Repealed



Business Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Capital expensing	MACRS/ADS with 50% bonus depreciation phasing down in future years. Section 179 expensing limits of \$500K / \$2M.	100% full expensing for investments made after 9/27/17 and before 1/1/23. Extends to used property. Enhances Section 179 expensing to \$5M with phase-out starting at \$20M.	Generally the same except does not expand expensing to used property. Enhances Section 179 expensing to \$1M, with phase-outs starting at \$2.5M.
Like-kind exchanges	Applies to both real and tangible property.	Applies only to real property.	Applies only to real property.
Real property depreciation	Depreciable over a 39 year life.	No provision.	Depreciable life reduced to 25 years. Qualified improvement property reduced to 10 year life.





Interest Deduction

Every business would be subject to a disallowance of the interest deduction for net interest expense in excess of 30% of an adjusted income amount

- House proposal uses EBITDA
- Senate uses taxable income without NOLs, interest, or pass-through deduction

Any excess would be carried forward to the succeeding five years.

Businesses with average gross receipts of \$25M (House) or \$15M (Senate) or less would be exempt and House provision would not apply to real property trades or businesses.



Accounting Methods

- Several thresholds used for accounting methods would be raised to expand use for small businesses – House would increase threshold to \$25M and Senate to \$15M for:
 - Availability of cash method for corporations and partnerships with corporate partners
 - Businesses eligible for cash method would account for their inventories using book method
 - Requirement to compute UNICAP
 - Required use of percentage of completion for long-term contracts – businesses below threshold could use any exempt contract method
- Senate provision requiring (accrual) taxpayers to recognize income no later than when recognized in AFS

S versus C Example – House Plan

1. \$2M of construction business income
2. California activity – 100%
3. 1 shareholder
4. No other income

	S Corp – today	C Corp - today	S Corp - reform	C Corp - reform
Business inc.	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000
Less: CA Tax	(223,860)	(176,800)	0	(176,800)
Less: DPAD	<u>(180,000)</u>	<u>(164,088)</u>	<u>0</u>	<u>0</u>
Taxable inc.	\$1,596,140	\$1,659,112	\$2,000,000	\$1,823,200
Tax	\$577,302	\$564,098	\$632,700	\$364,640
Tax rate	31.72%	34.00%	31.64%	18.23%
Tax on dividend	\$0	\$251,820	\$0	\$291,712
Tax rate overall	31.72%	49.18%	31.64%	36.00%



S versus C Example – Senate Plan

Same facts as previous example

	S Corp – today	C Corp - today	S Corp - reform	C Corp - reform
Business inc.	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000
Less: CA Tax	(223,860)	(176,800)	0	(176,800)
Less: DPAD	(180,000)	(164,088)	0	0
Less: S corp dedx	<u>0</u>	<u>0</u>	<u>(460,000)</u>	
Taxable inc.	\$1,596,140	\$1,659,112	\$1,540,000	\$1,823,200
Tax	\$577,302	\$564,098	\$509,379	\$364,640
Tax rate	31.72%	34.00%	25.47%	18.23%
Tax on dividend	\$0	\$251,820	\$0	\$291,712
Tax rate overall	31.72%	49.18%	25.47%	36.00%



Business Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
R&D Credit	Credit allowed on qualifying activities. Expenses can be deductible or may be amortized over a period of not less than 60 months.	Retained. After 2022, capitalize/ amortize expense over 5 years (or 15 yrs if outside US)	Retained. After 2025, capitalize/ amortize expense over 5 years (or 15 yrs if outside US)
WOTC and New Markets Credit	Credits available for qualifying business activities	Repealed	Retained
Historic rehab credits	Available for rehabilitation of historic, income producing buildings	Repealed	Retained with some changes.





Other Provisions

- Broad changes for multinational companies with shift to a territorial tax regime in both bills, but very different
- Mandatory deemed repatriation of undistributed foreign earnings
- Senate proposed repeal of IC-DISCs, but these were reinstated for pass-throughs in final amendments
- Private Activity Bonds – repealed tax exemption (House plan)
- Various changes included to compensation and benefits, including transportation and parking benefits
- Repeals 50% deduction of business-related entertainment expenses

Year-end planning considerations

Defer Recognition of Revenue

- Accounting method changes
- Installment sales
- Like-kind exchanges
- Advanced payments





Year-end planning considerations

Accelerate Deductions

- Maximize depreciation up to the current 179 limits
- Cost segregation studies
- Accrued bonuses
- More to qualified plans
- Prepaid expenses
- Bad debts





Questions?

