TAX REFORM ROUNDTABLE

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TAX REFORM
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Together CBIZ & MHM are ranked by *Accounting Today*, *INSIDE Public Accounting* and *Public Accounting Report* as one of the Top Ten accounting providers nationwide. We are also one of the leading providers of tax, audit and consulting services to Southern California's manufacturing, technology and life sciences and real estate industries. With an office in Irvine and six other locations in Southern and Northern California, we provide our clients with timely, personalized local support and unique industry specific insights that can help guide their business. We provide audit, tax and consulting services to a wide variety of public companies, early-stage and growing private companies – focusing on private companies preparing to go public or be acquired.

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Jeffrey M. Verdon Law Group LLP

Jeffrey M. Verdon Law Group LLP is a boutique Trusts & Estates law firm specializing in Comprehensive Estate Planning and Asset & Lifestyle Protection, including Tax-Efficient Portfolio Management, and Probate & Trust Administration, to name a few. For more than 30 years, through our recognized concierge client services program, we work with affluent families and business owners to make sense out of the complex tax code and wealth transfer opportunities available to the well informed, and provide "firewall" asset protection planning to protect the estate against future potential lawsuits.

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RJI is a leading independent full-service public accounting and advisory firm based in Orange County, CA. Established in 1980 and led by former Big-4 professionals, RJI specializes in audit, accounting, corporate and international tax issues for both domestic and international publicly traded corporations, private enterprises and not-for-profit organizations. Selected niche practices include cost segregation studies, I-C Disc's, research and development credits studies, state and local tax, due diligence and forensic/litigation support. RJI is PCAOB registered and the Southern California member firm of DFK International, one of the largest global accounting networks.

Stradling

Stradling represents companies and entities which seek a sophisticated law firm with experienced counsel to guide critical transactions and disputes. Originally founded in 1975 to represent Southern California's most innovative emerging growth companies, Stradling is known today as a leading full-service law firm representing high growth and established organizations across a wide range of industries. The firm has built its practice around its clients' core needs. Stradling's size, structure and culture allow it to provide big-firm representation with small-firm flexibility and responsiveness. Today Stradling serves established and emerging companies, municipalities and global organizations using that very premise.

Whittier Trust

Since our founding as a family office for the Whittier family in 1935, we have been helping highly affluent individuals and families accomplish what's important to them — enriching and enhancing our clients' lives by providing expert guidance, superior investment performance, and exceptionally tailored service. We provide unrivaled investment, wealth management, fiduciary and philanthropic services within the personalized structure of a family office. At Whittier Trust, we consistently protect and grow wealth — one client at a time, from one generation to the next. Whittier Trust Company is the largest multi-family office headquartered on the West Coast with offices in South Pasadena, Costa Mesa, San Francisco, Reno, Seattle, and Portland. It is an independent wealth management company serving high net worth families, individuals and foundations across the United States. We offer a wide array of capabilities to address the full spectrum of wealth management needs. Our services include Investment management and consulting, fiduciary family office, philanthropic, and direct investments in energy and real estate.

There's No Place Like Home

By Jeffrey M. Verdon, Managing Partner, Jeffrey M. Verdon Law Group, LLP

In recent years mature foreign asset protection trusts that reached their 10 year anniversary are being migrated back to the United States. Self-settled asset protection trusts are a type of trust in which the settlor is the person who creates the trust and is a beneficiary of the trust. Thirty-three of the 50 states do not allow self-settled trusts to be protected from lawsuits brought against the settlor. Foreign self-settled trusts with a trust term of more than 10 years are migrating back to the states that recognize self-settled trusts. Moving these trusts back home can save money.

Migrating the foreign trust to certain states, such as Nevada, can reduce the administrative burden and costs of tax compliance because the trust no longer constitutes a "foreign trust" and all of the tax compliance requirements associated with it.

Despite the protections afforded by domestic asset protection trusts formed in one of the 17 states that permit them a Federal Bankruptcy Code, Sec 548(e) supersedes state law. This allows a bankruptcy trustee to challenge "transfers to a self-settled trust or other similar device" as being a fraudulent transfer for up to 10 years following the transfer of the trust. This exceptionally long statute of limitations period was purposely added to the statute by Congress to counter all of the states that have been adopting self-settled asset protection trust laws.

This long period of limitations has forced many parties interested in asset protection to form their trusts overseas where the federal bankruptcy law is not enforceable. Thus, settlors of these trusts who wait the 10 year period will then domesticate their offshore trust to one of the asset protection trust states. The news is that as the ten year waiting period begins to expire, these folks are bringing their trusts home to the domestic self-settled trust states.

So basically, what this all means is that a "mature" 10+ year old self-settled trust may not be challenged by the bankruptcy trustee as being funded by a fraudulent transfer or voidable transaction. This cost savings strategy can be a game changer for many self-settled foreign asset protection trusts.

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RJI INTERNATIONAL CPAs

International Tax Provisions Under the New Tax Act

Background
Prior to enactment of the tax reform bill, U.S. individuals and businesses generally were taxed on their worldwide income with significant caveats (e.g. repatriation regime).

One-Time Repatriation Tax on Accumulated Foreign Earnings
This tax reform imposes a one-time tax on a 10 percent or greater U.S. shareholder's share of most accumulated and previously untaxed foreign earnings and profits after 1986 of a controlled foreign corporation (CFC)—or of another foreign corporation with at least 10 percent ownership. U.S. shareholders may elect to pay this one-time tax in installments over a period of eight years. Special provisions for S-corporations were also enacted.

The portion of the E&P comprising cash or cash equivalents is taxed at a reduced rate of 15.5%, while any remaining E&P is taxed at a reduced rate of 8%. Since the first tax installment generally is due April 17, 2018, U.S. businesses and other shareholders have a very short time to determine the proper payment.

Territorial System
As a fundamental change from prior law, U.S. corporations will no longer be taxed on certain non-U.S. income, under rules similar to the so-called participation exemption used in a number of foreign countries.

More specifically, a U.S. corporation that owns 10 percent or more of a foreign corporation (other than a passive foreign investment company that is not also a CFC) is entitled to a 100 percent deduction for the foreign-source portion of dividends received from such a corporation. This deduction is only available to C corporations that are not regulated investment companies (RICs) or real estate investment trusts (REITs).

A U.S. corporation remains taxable on income from its foreign branches, Subpart F income of its CFCs, and certain intangible low-taxed income.

A U.S. individual, partnership or S Corporation is *not* eligible for the exclusion of non-U.S. income or for the foreign corporation dividends-received deduction even if the 10 percent ownership threshold is met. For such persons, pre-reform U.S. tax planning for foreign income—such as use of an IC-DISC—may be useful.

Global Intangible Low-Taxed Income – GILTI
A new provision designed to reduce a multinational business's incentive to shift profits to CFCs taxes the GILTI of a CFC currently to its U.S. corporate and other shareholders. GILTI is defined as the excess of the U.S. shareholder's "net CFC-tested income" over the shareholder's "net deemed tangible income" return.

U.S. corporate shareholders of CFCs (but ***not*** individuals, partnerships or S corporations) can deduct 50 percent of GILTI income for tax years beginning in 2018 through 2025 and 37.5 percent of GILTI thereafter.

Foreign-Derived Intangible Income - FDII
In contrast to adding the GILTI tax to dis-incentivize U.S. persons moving intangible profits abroad, the new law also provides an incentive to keep intangible assets in the U.S. and to encourage U.S. exports. A 37.5 percent deduction of its FDII for taxable years beginning in 2018 through 2025 and 21.875 percent thereafter was instituted. FDII of a U.S. corporation is generally income from the sale of property to a non-U.S. person for a foreign use or from services provided to any person or with respect to property located outside the U.S. and, to the extent considered U.S. income, will otherwise be fully taxable to the corporation.

U.S. Base Erosion Provisions
Provisions (BEAT tax rate of 5%) were instituted applicable to companies with income in excess of $500 million.

Our international tax planning team at RJI CPAs is available to assist you in navigating the complexities of your international tax needs.

Manuel J. Ramirez, CPA, MST, FABFA
Manuel J. Ramirez is the Chairman and a tax partner at RJI CPAs. He specializes in tax planning and M&A work for multi-national organizations, Internal Revenue Service representation, expert witness testimony and forensic examinations. He can be reached at 949-852-1600 or mramirez@rjicpas.com.

Cost Segregation and Depreciation Under the New Tax Act

Background
The passage of the TAX CUTS and JOBS ACT (TCJA) provides the most significant and comprehensive overhaul of the US tax Code since the Reagan Administration. Though not mentioned specifically by name, the TCJA impacts cost segregation studies, in particular, how assets are either depreciated or expensed.

During a cost segregation study, engineers specifically trained in tax depreciation identify assets embedded in a building's construction or acquisition cost that can be depreciated for tax purposes over 5, 7 or 15 years, rather than the standard 39 years (27.5 years for residential rental property). The costs associated with these assets are then reclassified, allowing the building owner to accelerate depreciation of the property for tax purposes. For commercial real estate owners and investors, cost segregation is still viable under the new tax act and some highlights are as follows:

Bonus Depreciation
Bonus depreciation allows faster depreciation of assets with class lives of 20 years or less. The new law permits 100% expensing of property that qualifies for bonus depreciation, so long as the property is acquired and placed in service after September 27, 2017 and before January 1, 2023. After December 31, 2022, expensing of such property placed in service is as follows: 80% in 2023, 60% in 2024, 40% in 2025 and 20% in 2026.

Prior to TCJA, bonus depreciation only applied to newly constructed or original use property. TCJA includes used property acquired after September 27, 2107 through 2022 as well.

Section 179
Under the new law, qualified improvement property, defined as improvements made to the interior portion of a nonresidential building AFTER the building is placed in service, will be eligible for immediate Section 179 expensing. Additionally, the allowable expense has been increased from $500,000 to $1,000,000 in 2018, with the phase-out deduction increased to $2.5M. These rules now include tangible personal property acquired for rental properties, furniture and appliances and add another benefit and increased value to a cost segregation study.

In addition, the new law extends this deduction to cover improvements related to roofs, HVAC, fire protection and security systems of nonresidential buildings placed in service after the date the building was first placed in service.

Qualified Improvement Property (QIP)
As of January 1, 2018, there are no longer separate requirements for Qualified Leasehold Improvement Property (QLIP), Qualified Restaurant Property (QRP) and Qualified Retail Improvement Property (QRIP), leaving only Qualified Improvement Property (QIP). QIP comprises work done to the interior of a commercial building and placed in service any time after the date the building was first placed in service. QIP, as historically defined, had a 15-year life and was eligible for bonus depreciation.

The new law was intended to describe the class lives of QIP, but it did not. Because of the major oversight in failing to grant QIP the reduced 15-year class life, QIP is currently not available for 100% bonus deprecation, and must be depreciated over 39 years.

Based upon the clear Congressional intent to include appropriate class lives of QIP as expressed in the Joint Explanatory Statement of the final bill, Congress is likely to pass a technical correction bill that will be retroactive to at least January 1, 2018.

Our cost segregation team at RJI CPAs is available to help you navigate the new law and its impact on your real estate property.

Fernando R. Jimenez, CPA, MST
Fernando Jimenez is the Chief Executive Officer and tax partner of RJI CPAs. Fernando has specific experience in corporate re-organizations, buy/sell transactions, representation before the IRS and state agencies, succession planning, operations planning and transactional analysis. Fernando can be reached at 949-852-1600 or fjimenez@rjicpas.com.


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"The newfound advantages of a C corporation are clear: the top federal rate dropped to 21% and the cash method of accounting is now available until average gross receipts exceed $25 million. Add to these benefits 100% asset expensing and the ability to provide tax-free fringe benefits to shareholder/employees, and it is easy to see why C corporations are going to be more attractive at all stages of the business life cycle."

Ryan C. Gaglio
Shareholder

Stradling
Attorneys at Law

The Topsy-Turvy World of Post-Tax Cuts and Jobs Act Planning

As a tax lawyer, I've gotten used to a lot of things, but cocktail-hour popularity isn't usually one of them.

However, beginning just in time for last year's holiday parties and continuing through to today, I've found myself in the unusual position of at least *appearing* to be popular, and I've got the Tax Cuts and Jobs Act (TCJA) to thank for it. The TCJA has renewed everyone's focus on taxes and tax planning – in many cases upending decades of bedrock tax advice.

What type of entity should I use to operate my business?
My answer was almost always the same: S corporation or partnership (technically, an LLC taxed as a partnership). Why? Simple: The "double tax" inherent in operating as a C corporation was just too punitive for most profitable businesses.

Pre-TCJA law meant that a C corporation paid taxes on corporate-level income at a rate of nearly 35%. A subsequent distribution of cash is then taxed to shareholders at a top rate of 23.8%. Distributions of appreciated assets are treated as if the corporation sold those assets for their fair market value, which means that selling shareholders of C corporations are always going to sell stock and thus unable to negotiate higher selling prices based on buyers' basis step-up because buyers won't get one.

Meanwhile, owners of S corporations and LLCs taxed as partnerships pay taxes on the income earned by the business only once – at the owner level – at a top federal tax rate of 39.6% under pre-TCJA law. Compare this to the two-level tax rate on owners of C corporations and throw into the mix the ability of buyers to obtain a basis step-up in the assets and thus a potential willingness to pay higher prices in sales of flow-through businesses, and it's easy to see why C corporations have long been relegated to the entity choice of last resort for most of my clients.

But in the topsy-turvy world of post-TCJA planning, C corporations are going to be more popular than ever.

The newfound advantages of a C corporation are clear: the top federal rate dropped to 21% and the cash method of accounting is now available until average gross receipts exceed $25 million. Add to these benefits 100% asset expensing and the ability to provide tax-free fringe benefits to shareholder/employees, and it is easy to see why C corporations are going to be more attractive at all stages of the business life cycle.

Don't forget about Section 1202.
Because C corporations are going to enjoy a post-TCJA jump in popularity, you'll also want a refresher on the benefits of Section 1202, which is exclusively available to C corporations and their shareholders.

Section 1202 provides an exclusion from gains upon the sale of stock in a "qualified small business" (QSB). This is nothing new; it's just that until fairly recently, the benefits weren't all that great. Before 2010, if you sold QSB stock, 50% of the gain was excluded. As attractive as that sounds, the remaining 50% of the gain was taxed at 28%, meaning the federal tax rate on the total gain was 14%, which was a one percent benefit over the long-term capital gain rate of 15% at the time. Also, seven percent of the gain was treated as a preference under the Alternative Minimum Tax, thereby rendering Section 1202 mostly useless.

In 2010, Section 1202 was amended to provide that QSB stock acquired after September 27, 2010 would be eligible for a 100% exclusion when sold. In the world of taxes, that's about as good as it gets.

To qualify, the corporation and its shareholders have to jump through a handful of hoops – many of which they were probably going to sail through anyway:

- ▶ The stock must be originally issued by a business that does not have aggregate assets in excess of $50 million and is engaged in an active trade or business that isn't a service business, such as health, law or engineering, or a financial business, *i.e.*, banking, insurance or financing.
- ▶ The shareholder must acquire the stock at its "original issuance" in exchange for money, property or services.
- ▶ At least 80% of the corporation's assets must be used in the active conduct of one or more qualified businesses.
- ▶ The corporation must not have engaged in certain redemptions from the shareholder or other shareholders during various periods of time beginning two years before the issuance of stock to the shareholder and ending two years after the issuance.

If you meet these along with a few additional requirements, and hold the stock for at least five years before selling, then upon sale you can exclude 100% of the gain up to the greater of $10 million or 10 times the basis of the stock.

By now the popularity of C corporations should start to make sense. If the new federal corporate rate is 21%, and there is the potential to sell C corporation stock after five years without paying tax, then C corporations – and perhaps their tax lawyer advisers – start looking a lot better than they used to. Sure, C corporations still have to deal with two levels of tax, and so on a year-by-year and cash-flow basis, a flow-through entity may still come out ahead (and TCJA includes some added benefits for businesses structured as flow-throughs). However, the benefits of Section 1202 in a sale of a C corporation can potentially overwhelm the year-by-year benefits of a flow-through entity. With some prior planning, it may even be possible to multiply the $10 million exclusion for trust beneficiaries by gifting QSB stock to one or more irrevocable trusts sufficiently in advance of a sale.

The popularity of tax lawyers following the enactment of TCJA won't last long. The resurgence of C corporations, however, will likely prove to be one of TCJA's more enduring legacies.

Ryan C. Gaglio
Ryan Charles Gaglio is a shareholder in Stradling's Corporate and Tax practice groups. Ryan focuses on tax planning, tax controversy and transactional matters. He advises clients on the federal, state and local tax consequences of mergers and acquisitions, bankruptcies and workouts, and executive compensation, as well as on sales, use and property tax matters. Contact him at 949-725-4042 or rgaglio@sycr.com.


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“The bottom line is that a business owner with a successful company could have the potential of saving substantial federal tax dollars starting this year with this new QBI deduction. For example, a business with $8 million in profit would qualify for a $1.5 million deduction, as long as the W-2 wages of the business were at least $3 million. At a top tax rate of 37 % this translates into almost $600,000 in tax savings.”

Bradford L. Hall
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The Qualified Business Income Deduction

A brand-new federal tax deduction takes effect this year and it will provide a substantial tax benefit to most closely held business owners (both big and small) along with real estate investors. The deduction will be available to businesses in manufacturing, construction, retail, distribution, wholesale, restaurants, and many, many more. The Tax Cuts and Jobs Act of 2017, introduced “The Deduction for Qualified Business Income of Pass-through Entities—IRC Sec. 199A,” or “Qualified Business Income” (QBI) deduction for the first time. This deduction will effectively permit pass-through businesses to be taxed on only 80% of its income. The QBI deduction allows most closely held businesses (S corps, LLCs, trusts, partnerships and sole proprietorships), including real estate investors (Schedule E), to deduct up to 20% of their net qualified business income for federal tax purposes. The deduction takes effect in 2018 and lasts through 2025.

QBI excludes investment income such as dividends, interest income and capital gains. Typically, the deduction applies to 20% of the net income from the business or real estate rental. The deduction is a below the line deduction off taxable income (not Adjusted Gross Income) and is limited to 20% of taxable income not including capital gains. It brings the top federal effective tax rate for business owners with QBI down to 29.8%, lower than 2018’s 37% and a significant improvement on the 39.6% rate prior to 2018.

The new law also differentiates between businesses that build goods versus service-based businesses. During negotiations the U.S. Senate added a limitation for high income earners (taxable income between $157,500 to $207,500 for singles or heads of household and $315,000 to $415,000 for married couples filing jointly) in specified service industries in the health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services and brokerage services fields, investing and investment management, trading or dealing with securities, partnership interests, or commodities. Additionally, any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees is excluded from the QBI deduction. The way the law is currently written this could include just about every consultant in every field where his or her business rests on his or her reputation. Therefore, if you are a service business (other than an architect or engineer which were specifically excluded from this service business classification) and your taxable income is above the upper range of the phase-out, you most likely will lose the 20% QBI deduction entirely.

However, there is good news for companies not in these excluded service industries. As long as they are a pass-through business to their individual owners and have taxable income from the particular business, the 20% deduction is subject to another limitation. Generally speaking, in addition to the 20% limitation of the business owner’s (Form 1040) taxable income mentioned above, the 20% QBI deduction is also limited to the greater of the following criteria:

- ▶ Half of the W-2 wages paid with respect to the qualified trade or business (W-2 wage limit)
- ▶ The sum of 25% of wages paid plus 2.5% of the unadjusted basis of all depreciable assets

The W-2 wages include both wages paid by the business and wages paid to the owners of the entity. This calculation includes depreciable assets such as property used in the business that is less than 10 years old or past the last full year of depreciation, whichever comes first. Rarely would we see a business be limited by the 2.5% of depreciable assets because the 50% of total W-2 wages will be the primary limit. This 2.5% of depreciable basis limitation will be used primarily by real estate investors. These investors typically have no wages and therefore their only limit will be the 2.5% of the real estate’s tax basis excluding land.

With regard to taxpayers with multiple businesses, the QBI deduction is calculated separately for each of the taxpayer’s trades or businesses then compounded into one aggregate QBI deduction. For taxpayers with no combined net business income, no QBI deduction will be allowed. Taxpayers with multiple businesses that have a mix of income and losses will need to calculate the “deduction reduction” amount. The “deduction reduction” amount is the amount of negative deduction that is generated from multiplying the business loss by the 20% deduction. This amount reduces any positive deduction from the taxpayer’s businesses with QBI. In the case of rental properties, it appears, based upon the guidance that is currently available, that owners of multiple rental properties will aggregate these properties and compute one QBI deduction on the total net income from the combination of all rental properties. Businesses that provide services and manufacture and sell goods to customers are called mixed service and non-service businesses. Determining how these entities are treated involves determining whether the business is subject to the taxable income phase-out amounts or not. The deduction is available to these types of business that are below this threshold. However, for a mixed service and non-service business that is over the taxable income phase-out amount threshold, there is little guidance available at this time to compute the deduction. One possibility would be that the deduction would not be available to these types of businesses unless the business meets a certain non-services business threshold, such as 80%. Another possibility is that there may be a requirement that the QBI would have to be computed separately for the service business and the non-services business and a separate accounting and allocation of expenses would need to be performed to derive these amounts to compute the deduction.

The bottom line is that a business owner with a successful company could have the potential of saving substantial federal tax dollars starting this year with this new QBI deduction. For example, a business with $8 million in profit would qualify for a $1.5 million deduction, as long as the W-2 wages of the business were at least $3 million. At a top tax rate of 37 % this translates into almost $600,000 in tax savings. Let’s assume that the total W-2 wages were only $2 million, which would mean that the deduction would be limited to 50% or $1 million.

Now with the 21% tax rate for C corporations many owners of businesses are comparing whether or not the effective 29.6% for their current pass-through business tax rate justifies not switching immediately to a C corporate form. Granted there is an 8.6% differential which is a clear advantage to a C corporate form, this conversion to a C still carries with it the double taxation of dividends when the C corporation distributes to its shareholders. This 20% extra tax in almost every case eliminates the tax differential above. A decision to convert a pass through to a C corporation should not be taken lightly. We recommend consulting with your CPA and attorney before making this move. In conclusion, this QBI deduction will be extremely valuable to almost all owners of pass-through businesses; however, there is still a great amount of guidance that is needed over the next year before the first tax returns are ready to be filed claiming this extremely valuable deduction.

Brad Hall
Brad is the Managing Director of Hall & Company. He is involved in all aspects of taxation and business planning. He has over 35 years of experience in public accounting with core strengths in tax planning for high net worth individuals, closely held corporations, partnerships, LLC’s and trusts.For more information, you can contact Brad at 949-910-4255 or bh@hallcpas.com.

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Tax Changes Likely to Fuel More M&A

M&A multiples are at an all-time high thanks to the low-interest rate environment that we have been enjoying. As long as banks continue to lend, deals will continue to happen. Wall Street and most of Main Street have embraced the tax changes as favorable. Individuals living in high tax states are dreading the $10,000 limit on state, and local tax deductions and many are considering a move. States are pushing back and trying to create incentives for their residents not to move. The most creative approach was set forth by California to try and make the state income tax payment a charitable deduction. The IRS is likely to frown upon such legislation and find ways to disallow the deduction.

The heart of the tax cuts was centered on dropping the maximum federal corporate income tax rate from 35 to a flat 21 percent. In addition, many pass-through businesses which are not professional service businesses will now enjoy a 29.6 percent maximum federal income tax rate. Those in a professional service business earning high income are stuck with a 37 percent maximum federal income tax rate and are limited on their state and local tax deductions.

Businesses that acquired new or used tangible assets after September 27, 2017, will enjoy 100 percent bonus depreciation benefits in the year of purchase. This change will impact future purchase price negotiations between buyers and sellers and will impact buyer side gross-up payments.

To pay for these tax incentives, U.S. taxpayers who own more than 10 percent of a foreign corporation are required to pay a federal tax on offshore earnings as of December 31, 2017. This tax is payable over eight years and is at a reduced rate of 15.5 percent on accumulated earnings and profits held in cash equivalents and 8 percent on remaining foreign earnings and profits. This should incentivize U.S. owners to repatriate cash into the U.S. and fuel more U.S. investment. Other changes in the international tax arena include a minimum tax on low taxed foreign profits. Additionally, in situations where partnerships that operate a U.S. business have foreign owners, there is now a mandatory withholding on the foreign partner's gain in a sale transaction.

As of the date of this article, California has not adopted any of these tax changes, and it is likely that most of the changes will not be adopted. These changes coupled with the favorable tax rules afforded to qualified small businesses under IRC Section 1202 are a big incentive for business owners to re-evaluate their entity structures to make sure they are taking advantage of available tax benefits.

No, Mr. Trump, we will not be able to fit the tax information for most of our clients on a postcard.

Andy Torosyan, Tax Partner
Andy has over 20 years of experience providing strategic tax advice to clients on transactional and tax compliance services across numerous industry sectors including manufacturing, distribution, online-retail, commerce and software, real estate, and investment funds. As the leader of HCVT's Mergers & Acquisitions Tax practice, Andy addresses the tax structuring and reporting issues associated with complex transactions. He focuses on the analysis of the tax efficiencies of proposed deal structures and conducts comprehensive tax due diligence. Andy's M & A experience includes both buy-side and sell-side strategic advisory services. Contact Andy at 626-243-5125 or andyt@hcvt.com. Learn more about HCVT at *www.hcvt.com*.

Tax Cuts and Jobs Act

Significant Changes to Estate & Gift Taxes

President Donald Trump signed the Tax Cuts and Jobs Act (TCJA) into law in late December 2017 bringing many changes in both the income tax and estate/gift tax areas.

Estate/Gift Tax

The TCJA increased the lifetime estate, gift and generation skipping transfer tax exemption to estimated to be $11,180,000 for 2018 per person (an increase from the originally announced amount of $5,600,000 under prior law). The exemption will be adjusted for inflation through 2025 and will return to the inflation-adjusted amount under prior law effective January 1, 2026, without further legislation.

This increase provides an opportunity for additional planning over the next eight years to effectively transfer your wealth to the beneficiaries of your choice. Here are a few planning ideas that could be considered:

- ▶ Outright gifts to children and/or grandchildren directly or via trusts.
- ▶ Sales to defective grantor trusts.
- ▶ Use of grantor retained annuity trusts (GRATs).

We also recommend that current estate planning documents be reviewed as there may be unintended consequences as a result of the new legislation and increased exemption amounts due to formula clauses.

While not part of the TCJA legislation, another important item to note is the increase in the annual gift exclusion amount to $15,000 per recipient for 2018. This allows for gifts of present interests up to $15,000 before gift tax applies. Payments for medical and educational expenses that are paid directly to the medical provider for services or educational institution for tuition are not subject to gift tax and is unlimited.

Income Tax

The TCJA did bring some good news with the drop in the tax rates that apply to fiduciary income tax returns. The TCJA also brought changes to deductions for income tax purposes. Here are a few items that may have the biggest impact on your income taxes:

▶ State income and property taxes on property owned by the fiduciary can be deducted up to $10,000 (under previous law, deductions were unlimited).

▶ Qualified business deduction – 20% deduction for business income from pass-through entities, including S corporations, partnerships/LLCs (publicly traded partnerships are included), rental real estate and Schedule C activity. This deduction is subject to exclusions and phase-outs so additional analysis should be done with your tax preparer (previous law did not provide for this deduction).

▶ Certain other expenses such as investment management fees will be disallowed starting in 2018. Upon further clarification, additional expenses could also be disallowed.

▶ Depending on the trust document, the income taxable to the beneficiaries may be affected based on the changes to the allowable deductions under TCJA.

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"In a fundamental change from prior law, U.S. corporations will benefit from rules similar to so-called participation exemptions used in a number of countries. U.S. C corporations that own 10 percent or more of a foreign corporation will be entitled to a 100 percent dividends-received deduction ("DRD") for the foreign-source portion of dividends received from foreign corporations."

Paul Burns
Director

How U.S. Tax Reform Affects International Tax Considerations

The new U.S. tax bill, enacted on Dec. 22, makes far-reaching changes to U.S. international tax law, affecting both inbound and outbound transactions for businesses and individuals.

This article provides brief descriptions of selected international tax provisions, and adds a few observations about the impact of those provisions.

International Provisions Background
Prior to enactment of the bill, U.S. individuals and businesses generally were taxed on their worldwide income, with important caveats. Active business income of foreign subsidiaries was generally not subject to U.S. tax until actually repatriated to its U.S. shareholders. Thus, some multinational businesses were able to combine foreign tax planning strategies with U.S. tax planning strategies to defer U.S. tax on those foreign earnings.

Estimates vary, but U.S. companies appear to have at least $2 trillion of foreign earnings held in cash, cash equivalents, and illiquid assets overseas that have not been subject to U.S. tax.

One-Time Repatriation Tax on Accumulated Foreign Earnings
The new law imposes a one-time tax on a 10-percent-or-more U.S. shareholder's share of previously untaxed post-1986 accumulated foreign earnings and profits of a controlled foreign corporation (CFC)—and other foreign corporations with 10-percent-or-more U.S. corporate shareholders—regardless of whether such profits are actually repatriated. Deemed repatriated earnings held in cash and cash equivalents will be taxed at 15.5 percent, while the remaining earnings will be taxed at 8 percent. C corporation shareholders are allowed a partial foreign tax credit. U.S. shareholders may elect to pay the tax in installments over eight years: 8 percent of the liability in each of the first five years, 15 percent in year six, 20 percent in year seven, and 25 percent in the last year. S corporation shareholders can elect to defer the tax until the S corporation sells substantially all of its assets, ceases to conduct business, or changes its tax status, or until the electing shareholder transfers its stock.

The tax is based on the greater of accumulated foreign earnings and profits at November 2, 2017 or December 31, 2017, so calculations of each U.S. shareholder's pro rata share of earnings and profits at both dates will be necessary to determine the amount due. Since the first tax installment generally is due April 17, 2018, U.S. shareholders have a very short time to determine the proper amount.

Territorial System
In a fundamental change from prior law, U.S. corporations will benefit from rules similar to so-called participation exemptions used in a number of countries. U.S. C corporations that own 10 percent or more of a foreign corporation will be entitled to a 100 percent dividends-received deduction ("DRD") for the foreign-source portion of dividends received from foreign corporations. Similarly, the DRD will apply to the share of capital gain from a U.S. corporation's sale of stock in a foreign subsidiary that is treated as a dividend under Code Section 1248. All amounts eligible for the DRD will reduce the U.S. corporation's basis in its stock of the foreign corporation for purposes of determining any loss on the disposition of such stock. This DRD is only available to C corporations that are not regulated investment companies or real estate investment trusts.

Any foreign taxes attributable to the income that gives rise to the dividend will not be eligible for a credit or deduction. In addition, for a dividend to be eligible for the DRD, the foreign corporation's stock must be held for more than 365 days.

A U.S. corporation remains taxable on income from its foreign branches, the Subpart F income of its CFCs, and certain intangible low-taxed income as described below.

A U.S. individual, partnership or S corporation is *not* eligible for the DRD even if the 10 percent ownership threshold is met. For such persons, pre-reform planning for foreign income—such as use of a Interest Charge Domestic International Sales Corporation (IC-DISC)—may be useful.

Global Intangible Low-Taxed Income
Beginning in 2018, a new provision designed to reduce multinational businesses' incentive to shift profits to CFCs taxes the global intangible low-taxed income (GILTI) of a CFC currently to its U.S. shareholders, to the extent its aggregate net income exceeds a routine return.

GILTI is defined as the excess of the U.S. shareholder's "net CFC tested income" over the shareholder's "net deemed tangible income" These are complex defined terms that will require careful tax accounting.

U.S. C corporate shareholders of CFCs (but ***not*** individuals, partnerships or S corporations) can deduct 50 percent of GILTI income for tax years beginning in 2018 through 2025, and 37.5 percent of GILTI thereafter. U.S. C corporate shareholders of CFCs can also claim a foreign tax credit with respect to included GILTI amounts, but the credit is limited to 80 percent of the foreign tax paid, and unused foreign tax credits cannot be carried forward or back to other tax years.

Foreign-Derived Intangible Income
The new law also provides an incentive to keep intangible assets in the U.S., and encourages U.S. export activity, by allowing a U.S. C corporation (but *not* other U.S. persons) to deduct 37.5 percent of its foreign-derived intangible income (FDII) for taxable years beginning in 2018 through 2025, and 21.875 percent thereafter. FDII is generally income from (1) the sale of property to a non-U.S. person for foreign use or (2) services provided to any person or with respect to property located outside the U.S. that, to the extent considered U.S. income, would otherwise be fully taxable to the corporation.

FDII excludes several categories of income that should be carefully examined, including income from any foreign branch, thereby focusing the deduction on U.S.-generated income.

Anti-Base Erosion Provisions
The new law is also designed to prevent erosion of the domestic tax base by increasing the tax cost associated with shifting profits overseas to avoid or defer U.S. taxation.

First, the new base erosion anti-abuse tax (BEAT) is a minimum tax on corporations with gross receipts of at least $500 million that make payments to foreign related parties in excess of a threshold amount. These include payments deductible against U.S. taxable income such as interest, royalties, and service fees (but do not include cost of goods sold). The BEAT rate is 5 percent for tax years beginning in 2018, 10 percent for tax years 2019 through 2025, and 12.5 percent thereafter.

Second, an otherwise tax-deferred outbound transfer of goodwill, going concern value, or workforce in place to a foreign corporation will be subject to U.S. tax. In addition, the IRS is authorized to value intangible property transferred offshore on an aggregate basis (rather than asset-by-asset) to achieve a more reliable result.

The new law also denies deductions for interest and royalties paid to related parties involving so-called hybrid transactions or hybrid entities.

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