Overview of Business Provisions of the Tax Cuts and Jobs Act

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Sunset Provisions

Most TCJA provisions sunset after December 31, 2025.

- Including the new tax rates, deductions and other limitations.
- 21% C corporation tax rate made permanent.
- Sunset provisions needed to pass the bill through budget reconciliation, requiring only 51 Senate votes as opposed to 60.
- Certain provision sunset earlier i.e., bonus depreciation.

Corporate Tax Rate Highlights

- Replaces the progressive C corporate tax rate structure with a maximum tax rate of 35% with a flat tax rate of 21%.
- Fiscal year C corporations can claim a blended rate for tax-years ending in 2018.
- Lowers the 80% DRD (from 20% or more owned corporations) to 65% and lowers the 70% DRD to 50% (from less than 20% owned corporations).
- Both ordinary income and capital gains are subject to the 21% tax rate.
- Eliminates the Corporate Alternative Minimum Tax (AMT).
- Provides for a deduction of up to 20% of QBI from sole-proprietorships, partnerships and LLC's and S corporations.

Corporate Tax Rates

2017

Taxable income:	Tax Rate:
$0-$50,000	15 percent
$50,001-$75,000	25 percent
$75,001-$10,000,000	34 percent
Over $10,000,000	35 percent

2018

21% flat rate
(Permanent)

Business Pass-Through Rate - Section 199A

- Deduction of up to 20% of domestic “qualified business income” (QBI) from a pass-through entity.
- Basically, provides an effective top marginal rate of 29.6%.
- Applies to trusts & estates.
- Applies to REIT dividends, qualified coop dividends, and qualified publicly traded partnership income, except for “qualified” dividends or capital gain dividends subject to LTCG tax rates.

Business Pass-Through Rate

- For those with taxable income in excess of $415,000 (MFJ) the deduction is limited to the greater of:
  - 50% of W-2 Wages
  - 25% of W-2 Wages <u>plus 2.5% of unadjusted basis</u>

- Unavailable to <u>Specified Service Business</u> owner's taxable income in excess of $415,000 (MFJ).

- Limitations phased-in from $315,000 - $415,000 (MFJ) of taxable income.

Business Pass-Through Rate

- <u>Specified Service Business</u> – defined in § 1202(e)(3)(A):

"any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees."

- The final version includes new statutory language to exclude architects and engineers from the § 199A Specified Service Business definition.

Business Pass-Through Rate

- The deduction also cannot exceed the lessor of
  - the Combined QBI Amount, or
  - 20% x (total taxable income – capital gain)

- Combined QBI amount = deduction for each qualified trade or business ***PLUS*** 20% of REIT dividends and PTP income.

Business Entity (Re)Classification

Marginal Rate Example –
Taxable Income of $315,000 (MFJ)

Pass-through

Business Income		$100.00
Special Business Deduction	20%	(20.00)
Taxable Income		$ 80.00
Income Tax	24%	$19.20
Business Income		$100.00
Less: Income Tax		(19.20)
Net to Business Owner		$ 80.80
Tax Rate		**19.2%**

C-Corp

Corporate Income		$100.00
Corporate Income tax	21%	(21.00)
Net to Corporation		$ 79.00
Dividend		$79.00
Shareholder Income Tax	18.8%	(14.85)
Net to Shareholder		**$ 64.15**
Tax Rate		**35.85%**

Business Entity (Re)Classification

Marginal Rate Example –
Taxable Income of $600,000 (MFJ) or Greater

Pass-through

Business Income		$100.00
Special Business Deduction	20%	(20.00)
Taxable Income		$ 80.00
Income Tax	37%	(29.60)
Business Income		$100.00
Less: Income Tax		(29.60)
Net to Business Owner		$ 70.40
Tax Rate		**29.6%**

**Assumes the W-2 Wage Limitation doesn't apply*

C-Corp

Corporate Income		$100.00
Corporate Income tax	21%	(21.00)
Net to Corporation		$ 79.00
Dividend		$79.00
Shareholder Income Tax	23.8%	(18.80)
Net to Shareholder		**$ 60.20**
Tax Rate		**39.8%**

Other Business Tax Changes

Increase in expensing of capital expenditures.

- Section 179
  - Increased from $500,000 to $1 million.
  - Phase-out for eligibility threshold increased from$2 million to $2.5 million.
  - Expanded to include certain assets used in residential and commercial rental real estate.
- Bonus Depreciation
  - 100% allowed, original use requirement repealed.
  - Applies to acquisitions after September 27, 2017, subject to a pre-existing signed contract limitation.
  - After 2022, the percentage allowed decreases by 20% per year until eliminated after 2026.
- Depreciation limits on luxury autos increased.

Other Business Tax Changes

- Business interest income limitation.
  - Limited to 30% of EBITDA.
  - Disallowed interest expenses will carryforward.

- Active business loss limitation (other than for C corporations).
  - Limits business losses to $500,000 (MFJ) to offset non-business income.
  - Excess losses treated as a net operating loss (NOL).

- Net operating loss
  - 2-year carryback generally disallowed.
  - Carryforward only up to 20 years.
  - Can only offset 80% of income in the carryforward year.

Other Business Tax Changes

- Like-kind exchanges limited to real property.
- Taxation of foreign subsidiary income.
  - New territorial system.
  - One-time tax on deemed repatriation of post-1986 deferred income.
- Entertainment expense deduction disallowed.
  - Business meals and certain meals provided to employees still 50% deductible.
  - Meals and entertainment related to company outings are 100% deductible.
- Domestic Production Activities Deduction (DPAD) is repealed.
- Research & Development costs paid or incurred after December 31, 2021 must be capitalized and amortized over a 5-year period.

Other Business Tax Changes

- The deduction for certain tax-free transportation fringe benefits is disallowed.
- Small business accounting.
  - Most businesses (including C corporations) with less than $25 million average revenues can be on the cash basis of accounting.
  - Inventory will be treated as non-incidental material and supplies.
  - Also are exempt from the 263A (UNICAP) rules.
- Gross income now includes contributions to capital by non-shareholders, such as a government entity or civic group.
- Gains on self-created patent, inventions, designs, secret formula or process no longer eligible for capital gain treatment.

International Tax Considerations

Territorial System

Prior Law

- U.S. corporations were taxed on worldwide income, including income of foreign subsidiaries.
- Undistributed foreign earnings were not taxed in the U.S.
- Repatriation of foreign earnings to the U.S. triggered taxation.

TCJA

- Most U.S. corporations no longer taxed on certain non-U.S income (under the Participation Exemption on Foreign Source Income).
- There is a one-time repatriation tax on deferred accumulated foreign earnings.

Participation Exemption on Foreign Source Dividends

- Most domestic C corporations are entitled to a 100% deduction for foreign-source dividends after December 31, 2017 in the form of a dividends received deduction (DRD).
- Exclusion only applies to shareholders that are domestic C corporations. It does not apply to shareholders that are U.S. individuals, partnerships or S corporations.
- Dividends must be from a 10% or greater owned-foreign corporation (SFC).
- Applies to any foreign corporation, except a PFIC (passive foreign investment company).
- Hybrid dividends are excluded. Hybrid dividends are payments from SFC's for which the SFC receives a (foreign) tax benefit.
- Foreign tax credit is not allowed on excluded foreign income.
- Section 1248 dividends are eligible for the exclusion.
- Holding period requirement. At least 366 days in the 731-day period beginning 365 days before and ending 365 days after, the ex-dividend date.

Mandatory Repatriation

- Transitional rule to the new territorial system that replaces the foreign earnings deferral taxing scheme (transition tax, IRC 965).
- Results in immediate U.S. taxation of deferred accumulated foreign earnings held by controlled foreign corporations since 1986.
- Tax rate is 15.5% on cash and cash equivalents, and 8% on non-cash holdings.
- Existing foreign tax credits can be used to offset the transition tax.
- Based on the greater of Foreign Accumulated E&P as measured on November 2, 2017 and December 31, 2017.
- Payment of the tax on the transition tax may be paid over 8 years at the taxpayer's election.
  - Years 1-5 – 8%, 6th year – 15, 7th year – 20% and 8th year – 25%, subject to triggering event acceleration.
- S corporations can elect to defer the transitional tax until a triggering event occurs.

Mandatory Repatriation

- Required transition tax is includible on 2017 tax returns.
- All IRC 965 elections are due by the due date of the 2017 tax returns (including extensions). If the 2017 return has already been filed, an amended return can be filed with the elections.
- If installment payments are elected, the first payment is due by the due date of the 2017 tax return (not including extensions), otherwise full payment is due by the same date.
- It is not clear whether the IRS will consider the lack of a timely payment an issue that would eliminate the option to make the election to pay on installments or if interest and penalties would apply to a late payment while still allowing the election.
- There is a required IRC 965 Transition Tax Statement, signed under penalties of perjury, that must be attached to 2017 tax returns, that includes all information necessary as to the amount of the tax and any applicable elections.
- Domestic partnerships. S corporations or other pass-through entities that are U.S. shareholders of foreign corporations must attach a statement to its Schedule K-1's that include the necessary information for the owners to determine their transition tax.

Mandatory Repatriation

- Taxpayers are to make two separate payments as follows: one payment reflecting tax owed without regard to the transition tax, and a second payment reflecting the tax owed from the transition tax (whether an installment payment or the full tax liability if not elections are made).
- If a taxpayer makes the election to pay in installment payments, and has an overpayment on its 2017 tax return, no refund or credit of the overpayment will be allowed. The 2017 overpayment will be credited to the amount of the subsequent year's transition tax installment.
- If an individual taxpayer has 2017 tax liability under $1 million, and makes a timely election to pay in installments, failure to pay the first installment, will not accelerate the remaining payments if the first and second installment payments are paid by the due date of the 2018 tax return without extensions (April 15, 2019).
- IRS Publication 5292 provides guidance on how to calculate section 965 amounts and the elections available to taxpayers.
- The IRS has issued a frequently asked question document (FAQ) on its website that answers many questions about reporting the transition tax on 2017 tax returns.
  - https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns

Howard Bakrins, Director of Tax

Howard Bakrins, CPA joined KRD in 2013. He brings over 29 years of experience providing middle market companies and their principals with expert tax guidance and planning opportunities.

Specifically, Howard specializes in tax and business planning for closely held businesses. His practice includes U.S., state and local, and international tax planning, and compliance, accounting for income taxes, tax credits and incentives, corporate merger and acquisition transactions, real estate, family wealth and succession planning. During his career, Howard has represented business in many industries, including manufacturing, distribution, service & technology companies, real estate businesses and not for profit organizations.

Howard also has extensive experience in entity structuring and tax strategies and methods that maximize the value of the businesses he represents.

Corporate executives and wealthy family groups value his experience with income tax planning, establishing charitable foundations, estate, gift and generating skipping tax planning, family limited partnerships and transactional planning and analysis. Howard is also knowledgeable in the tax laws pertaining to hedge fund transactions.

Howard earned his Bachelor of Science Degree (BS) from University of Illinois and is a member of the AICPA and the Illinois CPA Society.

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