TAX ALERT

2018 TAX PLANNING GUIDELINES FOR INDIVIDUALS AND BUSINESSES

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In 2018, tax planning was significantly impacted by the Tax Cuts and Jobs Act (TCJA), which contains arguably the most sweeping changes in US tax law since the enactment of the Tax Reform Act of 1986. The TCJA has affected many areas of taxation including international tax, individual and business income tax, estate and gift tax, state and local tax, compensation and benefits, and not-for-profit tax.

Among other changes, it has:

- Introduced new concepts such as repatriation tax, Global Intangible Low-Taxed Income (GILTI) and Base Erosion and Anti-Abuse Tax (BEAT);
- Drastically changed the corporate tax rate;
- Reduced the individual income tax rates;
- Significantly increased estate and gift tax exemptions;
- Greatly altered the impact of alternative minimum tax;
- Created an uproar in certain states due to the much-reduced benefit of the deduction for state and local income taxes and real estate taxes;
- Created a brand new deduction for "pass-through entities" (the so-called 20% pass-through deduction);
- Altered the expensing rules with respect to capital assets in an effort to spur the economy; and
- Created tax benefits associated with investments in Qualified Opportunity Zones as an inducement to invest in economically distressed areas.

As a result of the TCJA, proposed regulations, Notices and other pronouncements were issued during the course of 2018 that provided guidance with respect to the implementation of TCJA provisions, although many questions are still unanswered. Other far reaching developments, such as the Supreme Court's decision in Wayfair, also occurred in 2018. Wayfair changed the ability of states to collect sales tax and overturned Quill with respect to the physical presence test.

We cover the TCJA, its related guidance and other interesting developments throughout this year's Tax Planning Guidelines for Individuals and Businesses. As you read this and consider how to apply the TCJA and other developments to your particular situation, you should also consider how the recent mid-term elections could affect enactment of future legislation and/or possible repeal of certain provisions of the TCJA. Democrats now control the House, while Republicans retained control of the Senate, and members of the tax writing committees will be changing.

Will the hotly contested cap on state and local tax deductions be repealed or modified? Will the increase in the estate and gift tax exemptions be rolled back to their 2009 levels as part of a compromise? Will any part of Tax Reform 2.0 become law? Will a divided legislative branch create a stalemate with respect to the passage of tax legislation? These questions and others may be answered in 2019, so stay tuned for another potentially interesting year.

Mazars USA's Tax Thought Leadership Team has issued over 25 newsletters and Tax Alerts explaining various aspects of the TCJA, and we have presented several webinars concerning its impact. We have kept you up to date on other significant developments through Tax Alerts, webinars and presentations throughout the course of the year. We have also had individual conferences and meetings to apply the TCJA provisions to clients' specific situations and plan accordingly.

We thank you for continuing to rely on us as your trusted advisor. Please enjoy our annual publication at your leisure and use it as a summary of the current tax landscape. Enjoy the holiday season and best wishes for a Happy and Healthy New Year.

Richard Bloom

Richard Bloom
Partner, Tax Thought Leadership Committee Chairman

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Individual Income Tax Planning

Individual & Fiduciary Income Tax Rates

The TCJA lowered the top individual income tax rate to 37% from 39.6%. The new income tax brackets and rates for 2018 and 2019 are detailed below.

2018 Federal Individual and Fiduciary Income Tax Rates and Brackets

Rate	Single	Married Filing Jointly	Married Filing Separately	Head of Household	Trusts and Estates
10%	$0 to $9,525	$0 to $19,050	$0 to $9,525	$0 to $13,600	$0 to $2,550
12%	$9,526 to $38,700	$19,051 to $77,400	$9,525 to $38,700	$13,601 to $51,800	N/A
22%	$38,701 to $82,500	$77,401 to $165,000	$38,701 to $82,500	$51,801 to $82,500	N/A
24%	$82,501 to $157,500	$165,001 to $315,000	$82,501 to $157,500	$82,501 to $157,500	$2,551 to $9,150
32%	$157,501 to $200,000	$315,001 to $400,000	$157,501 to $200,000	$157,501 to $200,000	N/A
35%	$200,001 to $500,000	$400,001 to $600,000	$200,001 to $300,000	$200,001 to $500,000	$9,151 to $12,500
37%	$500,001 or more	$600,001 or more	$300,001 or more	$500,001 or more	Over $12,500

2019 Federal Individual and Fiduciary Income Tax Rates and Brackets

Rate	Single	Married Filing Jointly	Married Filing Separately	Head of Household	Trusts and Estates
10%	$0 to $9,700	$0 to $19,400	$0 to $9,700	$0 to $13,850	$0 to $2,600
12%	$9,701 to $39,475	$19,401 to $78,950	$9,701 to $39,475	$13,851 to $52,850	N/A
22%	$39,476 to $84,200	$78,951 to $168,400	$39,476 to $84,200	$52,851 to $84,200	N/A
24%	$84,201 to $160,725	$168,401 to $321,450	$84,201 to $160,725	$84,201 to $160,700	$2,601 to $9,300
32%	$160,726 to $204,100	$321,451 to $408,200	$160,726 to $204,100	$160,701 to $204,100	N/A
35%	$204,101 to $510,300	$408,201 to $612,350	$204,101 to $306,175	$204,101 to $510,300	$9,301 to $12,750
37%	$510,301 or more	$612,351 or more	$306,176 or more	$510,301 or more	Over $12,750

Capital Gains Tax Rates

Short-term capital gains are taxed at ordinary income tax rates (see Individual & Fiduciary Income Tax Rates section above).

Long-term capital gains are taxed at 0%, 15% or 20% depending on your taxable income and filing status.

2018 Long-Term Capital Gains Tax Rates and Brackets

Rate	Single	Married Filing Jointly	Married Filing Separately	Head of Household	Trusts and Estates
0%	$0 to $38,600	$0 to $77,200	$0 to $38,600	$0 to $51,700	$0 to $2,600
15%	$38,601 to $425,800	$77,201 to $479,000	$38,601 to $239,500	$51,701 to $452,400	$2,601 to $12,700
20%	$425,801 or more	$479,901 to more	$239,501 or more	$452,401 or more	$12,701 or more

Capital gains are also subject to net investment income tax.

Net Investment Income Tax

Like 2017, taxpayers with qualifying income are liable for the 3.8% net investment income ("NII") tax on certain items of unearned income. The tax is levied on the lesser of NII or the amount by which modified AGI exceeds certain threshold amounts.

Net Investment Income Tax Thresholds

Filing Status	Threshold Amount
Married Filing Jointly	$250,000
Married Filing Separately	$125,000
Single	$200,000
Head of Household (with qualifying person)	$200,000
Qualifying Widow(er) with Dependent Child	$250,000

Investment income for NII purposes is (1) gross income from interest, dividends, annuities, royalties, and rents (other than from a trade or business); (2) other gross income from a passive activity or a trade or business of trading in financial instruments; and (3) net gain attributable to the disposition of property other than property attributable to an active trade or business. Some items not included in net investment income include: distributions from certain qualified retirement plans and individual retirement accounts; amounts subject to self-employment tax; and municipal bond interest.

2018 Standard vs. Itemized Deduction

A taxpayer may claim a standard deduction or choose to itemize deductions

2018 Standard Deductions

Filing Status	Threshold Amount
Single	$12,000
Married Filing Jointly or Qualifying Widow(er)	$24,000
Married Filing Separately	$12,000
Head of Household	$18,000

Note that there is an additional standard deduction for elderly and blind taxpayers, which is $1,300 for tax year 2018. This amount increases to $1,600 if the taxpayer is also unmarried.

The TCJA modified the deductibility of many itemized deductions. For this reason, it is anticipated that many taxpayers will now claim the standard deduction instead of itemizing. Some of the changes include:

1. Medical expenses are deductible to the extent they exceed 7.5% of adjusted gross income for the 2018 tax year. After 2018, they are deductible to the extent they exceed 10% of adjusted gross income.
2. Charitable contributions made in cash to certain charitable organizations are now deductible up to 60% (previously 50%) of adjusted gross income.
3. Mortgage interest on new home acquisition debt up to $750,000 (previously $1 million) is now deductible. Loans entered into prior to December 15, 2017 are still subject to the $1 million limitation and there are transition rules with respect to binding contracts entered into prior to December 15, 2017. Interest on home equity indebtedness is no longer deductible. Despite the disallowance of interest on home equity indebtedness, taxpayers can still deduct interest on a loan that is labelled a home equity loan or a home equity line of credit provided the loan proceeds are used to buy, build, or substantially improve the taxpayer's home that secures the loan to the extent the loan doesn't exceed the home acquisition debt limit.
4. The aggregate amount of nonbusiness state and local real property taxes, personal property taxes and state and local income taxes that may be deducted is capped at $10,000 ($5,000 for a married taxpayer filing a separate return). This change is the most impactful of all the changes to itemized deductions. Some states have implemented workarounds to help offset the deduction cap, including allowing municipalities to set up charitable funds and offering state tax credits for contributions made

to these funds. The IRS has released guidance aimed at stopping these workarounds, but this may not be enough to stop state efforts to avoid tax increases on residents.

5. Miscellaneous itemized deductions such as tax preparation fees, investment advisory fees, unreimbursed employee business expenses, repayment of social security benefits, trustee fees for an IRA if billed separately, and repayments of income under a claim of right are no longer deductible.
6. The phaseout of itemized deductions has been eliminated.

Additional Provisions in The TCJA Affecting Individuals

1. Moving expenses: The moving expense deduction previously allowed in calculating adjusted gross income is disallowed beginning in 2018 (except for members of the armed forces for certain expenses).
2. Alimony payments: These are not deductible by the payor nor includible in income by the payee for any divorce or separation agreements executed after 2018. Payments made pursuant to pre-2019 agreements remain deductible/taxable in accordance with prior law.
3. Section 529 Plans: Distributions from Section 529 education plans for certain expenses associated with enrollment or attendance at an elementary or secondary public, private or religious school up to $10,000 are now considered qualified-distributions.
4. Child tax credit: The non-refundable credit is increased from $1,000 to $2,000 per qualifying child. The refundable portion of the credit is also increased from $1,100 to $1,400. Additionally, there is a new $500 family credit for qualifying dependents other than qualifying children.
5. Personal Exemptions: The personal exemption was repealed beginning in 2018.
6. Alternative minimum tax (AMT): Increases have been made to the exemption amounts used in calculating this tax. The thresholds at which these exemptions amounts become subject to phase-outs are also significantly increased. (Exemption phase-out $500,000 single and $1,000,000 MFJ; previously, these amounts were $120,700 single and $160,900 MFJ). Additionally, due to the cap on the state and local tax deduction allowable and the elimination of the miscellaneous itemized deductions, it will take significantly more tax preference items to generate the AMT.
7. Qualified Business Income Deduction: Relief is provided to owners of businesses which operate as sole proprietors (including single member limited liability companies), partnerships, and S-corporations – commonly referred to as "flow-through or pass-through entities." New section 199A of the Internal Revenue Code allows owners of pass-through entities to deduct 20% of the entities' qualified business income (QBI).
   a. For owners with taxable income under $315,000 for joint filers and $157,500 for other filers, the 20% deduction applies to all qualified trade or business income.
   b. For owners with taxable income over $415,000 for joint filers and $207,500 for other filers, the 20% deduction is limited to the greater of (a) 50% of W-2 wages or (b) 25% of W-2 wages and 2.5% of the unadjusted basis of investment assets (UBIA) used in the business. In addition, certain "specified service trades or businesses" do not qualify for the 20% deduction.
   c. For owners with taxable income between the amounts above, a complex set of phase-out rules apply, so that a portion of specified service trade or business income qualifies for the deduction and the W-2 or W-2/UBIA limits apply in part.
8. The kiddie tax applies to unearned income for children under the age of 19 and college students under the age of 24. Unearned income is income from sources other than wages and salary, like dividends and interest. For 2018, the kiddie tax threshold, meaning the amount of unearned net income that a child can take home without paying any federal income tax, remains at $1,050. Previously, all unearned income in excess of $2,100 was taxed at the parent's tax rate. Under the new TCJA, all unearned income in excess of $2,100 will now be taxed at trust tax rates.

Planning for Capital Gains and Losses

1. Netting of capital gains and losses: Taxpayers are allowed to deduct up to $3,000 of net capital losses against ordinary income. Excess capital losses are carried over to future tax years. Review your capital loss carryovers to determine if any appreciated positions could be sold without incurring additional income tax.
2. Harvest tax losses: If you have overall net capital gains, consider selling loss positions. Securities sold at a loss could be repurchased subject to the wash sale rule. This rule prohibits you from recognizing losses if you purchase substantially

identical securities within 30 days before or after the sale. Consider purchasing Exchange Traded Funds tied to the original securities industry or sector to avoid waiting the 30 days.

3. Qualified small business stock ("QSBS"): QSBS is defined as stock of a C-corporation of an active business with assets of less than $50 million at all times since August 10, 1993 or initial issuance of the shares. The active business cannot involve personal services and the stock must be acquired in exchange for money, property or as pay for services. Those who acquire the stock from another person generally do not qualify for the preferred tax treatment. Taxpayers who acquire stock that is qualified small business stock, and hold the stock for 5 years, may exclude up to 100% of the gain from income upon the sale of the stock. The exclusion is generally 50% but was increased to 75% for QSBS acquired after February 17, 2009, and before September 28, 2010, and to 100% for QSBS acquired after September 27, 2010. QSBS gain is generally treated as a preference item for AMT purposes, except QSBS gain that qualifies for the 100% exclusion, which is not treated as an AMT preference item.

Retirement Planning

There has been very little change in the realm of retirement planning from the prior year. There are, however, minor changes to contribution limits and phase-out amounts coming into effect in 2019 that should be planned for prior to year-end.

PLAN TYPES	2018 LIMITS	2019 LIMITS
SEP IRAs and Solo 401(k)s Contribution Limit	$55,000	$56,000
Defined Benefit Plan Annual Benefit Limit	$220,000	$225,000
401(k)s, 403(b)s and 457 plans Contribution Limits Under Age 50 Age 50 and Older	 $18,500 $24,500	 $19,000 $25,000
SIMPLE Plans Contribution Limits Under Age 50 Age 50 and Older	 $12,500 $15,500	 $13,000 $16,000
IRA, Traditional and Roth Contribution Limits Under Age 50 Age 50 and Older	 $5,500 $1,000	 $6,000 $1,000
OTHER THRESHOLDS	2018 LIMITS	2019 LIMITS
SEP Annual Compensation Limit	$275,000	$280,000
Key Employee in a Top-Heavy Plan	$175,000	$180,000
Highly Compensated Employee	$120,000	$125,000

1. Establishment of Retirement Plan: Qualified retirement plans need to be established by December 31, 2018, although they can be funded in 2019. IRAs can be established and funded by April 15, 2019. Many people wait until the last minute to fund IRAs, usually around April 15th of the following year when tax returns are filed. Consider funding IRAs in January of each year so that the earnings grow tax deferred as soon as possible and will gain an extra 15 months or so of tax deferred earnings.
2. Required minimum distributions: A taxpayer must take their required minimum distribution by April 1st of the year after they turn age 70 ½. The taxpayer could take the first distribution in the year they turn age 70 ½ to avoid having to take two distributions in the same year.
3. AGI Limitations for Deductible IRA and Roth IRA Contributions: Contributions to an IRA are deductible provided the taxpayer's adjusted gross income is below a certain amount. For single and head of household taxpayers who are active participants in a workplace retirement plan, the contribution is fully deductible if the adjusted gross income is $63,000 or less ($64,000 in 2019). It then begins to be phased out and is not deductible at all once the taxpayer's adjusted gross income is $73,000 or

more ($74,000 in 2019). For married filing jointly taxpayers, the range is $101,000-$121,000 ($103,000-$123,000 in 2019). For taxpayers who are not active participants in a workplace retirement plan, but their spouse is, the phase-out range is $189,000-$199,000 ($193,000-$203,000 in 2019). Taxpayers whose adjusted gross income exceeds these ranges can still make a contribution to a non-deductible IRA. The phase-out range for single and head of household taxpayers to be eligible to make a Roth IRA contribution is $120,000-$135,000 ($122,000-$137,000 in 2019) and for married filing jointly taxpayers the range is $189,000-$199,000 ($193,000-$203,000 in 2019).

4. Conversion of IRA to Roth IRA: Taxpayers can choose to convert an IRA to a Roth IRA. This is favorable in various situations such as when a taxpayer has NOLs that can absorb the income generated from the conversion. Previously, taxpayers could "unwind" the conversion within a certain period of time after the year in which the conversion occurred. In effect, it was a free second look to see if the conversion was beneficial. Effective for tax years beginning after 2017, the "unwinding" is no longer allowed.

Passive Activities

Taxpayers may take deductions for business and rental activities that they do not materially participate in, but nonetheless derive income from (i.e., passive activities). The passive activity rules stipulate that a taxpayer is allowed to deduct losses stemming from passive activities to the extent of one's passive income or if it is the final year of the investment. When passive losses exceed passive income, unused passive losses are carried forward to offset future passive income.

1. Review your passive activities to determine if some can be grouped together. You may meet the material participation test for a group of activities even though you may not meet the material participation test for each individual activity. Certain tax elections must be made in order to group activities.
2. Consider the real estate professional rules if you spend the majority of your time in real estate related activities. A real estate professional is not subject to the passive activity rules.
3. Converting a passive activity to a non-passive activity, i.e., one in which you materially participate, would reduce your net investment income tax.
4. Rental Income Exclusion. If you rent out all, or a portion, of your principal residence or second home for less than 15 days, the income is tax free, but expenses directly associated with the rental won't be deductible.

Miscellaneous Items

1. You can elect to amortize certain bond premiums, thus creating a current year tax deduction. If amortizing is elected, the premium is considered a basis adjustment that is factored into the gain or loss calculation on disposition.
2. Consider accelerating or deferring income, such as salaries or bonuses, to take advantage of income tax brackets.
3. You should review your income tax withholdings and estimated tax payments already made to determine if you already have paid enough to avoid the underpayment of estimated tax penalty. If not, request that your employer take out additional withholdings and/or make a fourth-quarter estimated tax payment. Income tax withholdings are considered withheld pro rata throughout the year, so if there is a shortfall during one of the previous quarters, additional withholdings at this time can help avoid or minimize the underpayment of estimated tax penalty. When determining your estimated tax liability for 2018, remember to include the additional .9% Medicare tax as well as the 3.8% net investment income tax.

Estate and Gift Tax Planning

The TCJA drastically increased the federal gift, estate and generation skipping transfer tax exemption. As a result, this is an opportune time for taxpayers to re-evaluate their estate plan and gifting techniques to help maximize tax savings and transfer more wealth tax-free.

Increased Exemption Under the TCJA

The lifetime exemption for both gift and estate tax increased from $5 million, indexed for inflation, to $10 million, indexed for inflation. The 2018 exemption was slated to be $5.6 million ($11.2 million for a married couple). As a result of the TCJA, the exemption is now $11.18 million ($22.36 million for a married couple) for tax year 2018 and will gradually increase, based on inflation, through 2025. The exemption amount for 2019 is scheduled to be $11.4 million. The increase in the gift, estate and generation skipping transfer tax exemption sunsets after December 31, 2025, at which point it reverts back to $5 million, indexed for inflation unless Congress renews the provision.

On November 23, 2018 the Treasury Department issued proposed regulations to address the effect of recent legislative changes to the basic exclusion amount used in computing Federal gift and estate taxes. The proposed regulations provide that individuals taking advantage of the increased gift and estate tax exclusion amounts in effect from 2018 through 2025 will not be adversely impacted after 2025, when the exclusion amount is scheduled to drop to pre-2018 amounts.

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Although the provision is set to sunset after December 31, 2025 please keep in mind that the law can change at any time, especially with the recent shift in control of the House of Representatives and the upcoming 2020 presidential election. Careful consideration should be given with respect to when to utilize one's lifetime exemption.

Increased Annual Exclusion

The annual gift exclusion increased from $14,000 in 2017 to $15,000 in 2018. The annual exclusion amount remains the same for 2019. This exclusion is the amount you can give away per year tax-free to an unlimited number of donees. In addition, married couples can elect to split gifts which allows married taxpayers to gift up to $30,000 (in 2018) to an individual without gift tax. The amount a spouse can give to his or her non-US citizen spouse each year will increase from $149,000 in 2017 to $152,000 in 2018 (this amount is scheduled to increase to $155,000 in 2019). To qualify for the "annual exclusion," the gift must be a present interest, meaning the donee must have an immediate right and access to the gifted property.

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Annual gifting is a simple way to reduce the value of a taxpayer's gross estate over time, without reducing one's lifetime exemption and thereby lowering the amount subject to estate tax upon death. Consideration should be given to making annual exclusion gifts early in the year to utilize the annual exclusion before the potential passing of a taxpayer. Failure to utilize the annual exclusion can be costly for a taxpayer who can potentially make gifts to multiple donees in a single year.

Trusts and Estates Tax Rates

The TCJA did not change the gift, estate, or GST tax rate, which remains at 40% top rate.

The maximum income tax rate for trusts and estates has been reduced to 37% at the top bracket of $12,500. The law indexes the new brackets for inflation. The various income tax rates and brackets are detailed in the Individual and Fiduciary Income Tax Rate section above.

Section 199A and Trusts

The new deduction under Section 199A, discussed in the Additional Provisions in the TCJA Affecting Individuals section above, also applies to fiduciary income tax returns.

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In order to maximize the Section 199A deduction, taxpayers should consider utilizing various non-grantor trusts to own pass-through entities. However, the proposed regulations under Section 199A prevent a taxpayer from establishing multiple trusts that have substantially the same grantors and primary beneficiaries for the principal purpose of avoiding income tax. Careful consideration of the Section 199A deduction should also be performed before making a Section 645 election to treat both a trust and estate as one entity for income tax purposes.

Portability

The "portability" of a deceased spouse's unused exemption (DSUE) remains available under the TCJA, allowing transfer of a deceased spouse's unused estate tax exemption (but not GST tax exemption) to a surviving spouse as long as an estate tax return has been filed for the deceased spouse's estate. Through use of portability, a married couple can take advantage of the full $20,000,000 exemption (indexed for inflation).

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Although many estates will not be subject to estate tax with the new increased exemption amount, it is important to consider filing for the portability election. The IRS has issued guidance on the ability to make a late portability election where no election was made due to the estate not having a filing requirement, other than to elect portability.

Basis Step-Up

Beneficiaries of an estate are allowed to increase the tax basis of an inherited asset to the fair market value as of the date of the decedent's death. This is commonly known as the basis step up rule and the TCJA did not change this.

> *Mazars Insight*
> *For estates that do not exceed the increased exemption amount of $11.18 million for single ($22.36 million for married couples) it is important to carefully compare the benefit of gifting assets and removing the future appreciation from the estate with the income tax savings that would arise from a "step-up" in basis if the assets remained in the estate at death.*

State Considerations

Multiple states have made changes to their transfer tax system recently.

New Jersey: Estate tax repeal took effect in 2018 so decedents dying on or after January 1, 2018 are no longer subject to New Jersey estate tax. The New Jersey inheritance tax remains in place so bequests to non-lineal beneficiaries will still be subject to a transfer tax.

New York: The estate tax exemption is currently $5.25 million and will increase on January 1, 2019 to catch up to the federal exemption under pre TCJA law ($5,740,000). Also, decedents with dates of death on or after January 1, 2019 will no longer be required to include the amounts of any gifts made during lifetime in the calculation of their New York gross estate.

Maryland: The 2018 estate tax exemption is now $4 million (an increase of $1 million) and will increase to $5 million beginning in 2019. In addition, Maryland will allow for spousal portability of any unused exemption beginning in 2019.

Connecticut: During the 2018 legislative session, the Connecticut General Assembly passed two bills amending the estate and gift tax thresholds and enacting two different schedules of rates for 2020 and thereafter. The first increased the gift and estate tax threshold beginning in 2020, annually through 2023 until it matches the federal threshold. The second enacted a different schedule, which set the threshold at $5.49 million for tax years beginning January 1, 2020 and thereafter. Connecticut has yet to clarify which law will hold.

> *Mazars Insight*
> *The disparity between the federal estate tax exemption amount and a particular state's amount may cause a decedent's estate to be liable for a state estate tax even though no federal estate tax is due. Careful consideration needs to be given to state estate taxes when one's taxable estate is below the federal exemption amount, but above the state estate tax exemption amount.*

Recent Developments

The Department of the Treasury issued Notice 2018-61 to announce their intention to issue regulations clarifying that trusts and estates will be able to deduct certain expenses (such as estate administration expenses or expenses of a trust that would not be incurred but for the property being held in trust) despite miscellaneous itemized deductions being eliminated for individuals.

In the Estate of Sower v. Commissioner the courts ruled that the IRS acted within its legal authority when it examined the return filed by the first deceased spouse and adjusted the DSUE available to the second estate. The IRS's authority to examine returns of a deceased spouse applies with respect to each transfer by the surviving spouse to which a DSUE amount is or has been applied. An adjustment of DSUE of a predeceased spouse, though it may affect the liability for a subsequent estate claiming the exclusion, is not an assessment of tax against the estate of the predeceased spouse.

In Mart D. Green v. U.S., a trust's charitable contribution deduction for real property was limited to the trust's basis in the property as opposed to the fair market of the property. The court concluded that the contribution had to be paid from the trust's gross income. Since the unrealized gain was never included in gross income, the contribution was limited to basis. The result could have been avoided if the trust was a grantor trust.

In a settlement in Estate of Richard Cahill v. Commissioner in August 2018, the estate conceded to the IRS's valuation of an intergenerational split dollar receivable of $9.6 million, instead of the estate's reported value of $183,700. Intergenerational split dollar life insurance agreements are a popular planning tool allowing a grantor to make large premium payments on life insurance policies benefiting his or her family without incurring excessive transfer taxes. This strategy usually involves an adult child purchasing life insurance on his/her life (through a life insurance trust) and paying the premiums with a loan (or split dollar advance) from the parent. Split dollar arrangements can be structured one of two ways; 1) as a loan evidenced by a note with appropriate interest (loan regime) or 2) as in the Cahill case, a split dollar advance evidenced by a split dollar agreement where the receivable is typically the greater of the premiums advanced (without interest) or the cash value (economic benefit regime). Since the advance/loan will not be paid back until the death of the child, potentially decades later, the grantor's receivable is discounted in the parent's estate, therefore reducing estate tax. Though many believe loan regime arrangements should warrant some level of discount, economic benefit arrangement outcomes are uncertain. A settlement is not precedent and several other cases are pending decision or trial. In the interim, care must be taken when establishing an intergenerational split dollar life insurance arrangement depending on the anticipated results.

Other Gift, Estate and GST Planning Considerations

- Review of current estate planning documents: One should review their current Last Will and Testament in light of the significant increase in the estate tax exemption. If the current Last Will and Testament contains formulas clauses for determining how much is bequeathed to certain beneficiaries and/or trusts, the increased exemption amount may cause too much to be transferred to certain beneficiaries, such as children, and not enough to be transferred to other beneficiaries, such as one's spouse.
- Swapping assets with a grantor trust: A grantor can swap high basis assets held individually for low basis ones held by one's grantor trust. The benefit of this is that the low basis asset would get stepped up to fair market value when the grantor passes away, thus minimizing income taxes.
- Front Loading Section 529 Plans: A section 529 plan is a plan established to put aside funds for college. A transfer to a section 529 plan is considered a gift and qualifies for the annual exclusion discussed above. Five years' worth of gifts can be made at one time, thereby allowing a married couple to gift up to $150,000 to a 529 plan in 2018. This gift would not generate a tax or use one's lifetime gift tax exemption. Instead, the gift is treated as having been made over 5 years. For instance, if you gave $75,000 to a section 529 plan before the end of 2018, you would be deemed to have given a $15,000 annual exclusion gift that year and for the following 4 years. Consideration should be given to the taxpayer's state income tax rules when analyzing this strategy.
- Grantor Retained Annuity Trusts (GRATs): GRATs can be used to transfer future appreciation of an asset to beneficiaries. These trusts generally work best with assets that are likely to appreciate quickly and during a time (such as now) when interest rates are low.

Domestic Business Planning

The TCJA, will affect nearly every business from 2018 into the future. One of the most significant changes is the decrease in the corporate tax rate, which dramatically reduces the effects of double taxation on C-corporations. The TCJA also allows for more generous tax provisions for businesses making capital investments. The new law increases the tax benefits available to businesses under Section 179, providing a significant cash flow benefit for any company putting qualified capital equipment to work. It also expands the types of property and capital equipment that are eligible for first-year expensing or bonus depreciation. Additionally, the law allows for simplified tax accounting methods.

However, the TCJA does have some drawbacks for businesses such as the interest expense deduction limitation, net operating loss limitations, and changes further limiting meals and entertainment deductions.

Strategies that made sense in the past may not anymore, while new tax-saving opportunities may be available. Taxpayers need to understand and analyze the new law to see if changes enacted by the TCJA will apply to their specific tax situation. Action may be required before year-end to fully take advantage of benefits or minimize unexpected consequences.

Corporate Tax Rate Cuts

For tax years starting in 2018 or later, the graduated tax rates applicable to C corporations with a top rate of 35% is replaced with a flat 21% corporate rate and this rate also applies to Personal Service Corporations. For fiscal years taxpayers, the rate is bifurcated applying the old rate structure to income earned prior to December 31, 2017 and the flat 21% rate on taxable income thereafter.

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The tax rate decrease means that many C-corporations may pay significantly less tax, and many companies will see a significant impact on the value of deferred tax assets and liabilities.

The reduction of the corporate tax rate also brings into question whether it is more advantageous for an entity to be taxed as a C-corporation or as a pass-through entity. However, taxpayers should keep in mind the effect of double taxation applicable to C-corporations and their owners. While the corporate tax rates were reduced, taxes on dividend distributions remain. Furthermore, the TCJA also created the §199A deduction for income earned from eligible businesses treated as pass-through entities (see discussion under Additional Provisions in TCJA Affecting Individuals *section). The change to both the corporate rate and the §199A deduction available for pass-through entities may provide tax benefits to entities and their owners. However, further analysis regarding future business environments and other factors should be considered to determine the best entity choice. The type of business and its income level will also be factors in choosing the most appropriate entity form.*

Corporate AMT Repealed
Prior to the TCJA, the corporate alternative minimum tax ("AMT") was imposed at a 20% rate on alternative minimum taxable income. For tax years starting in 2018 or later, the corporate AMT is repealed. For corporations that paid the corporate AMT in earlier years, an AMT credit was allowed. The new law allows corporations to fully use their AMT credit carryovers in their 2018–2021 tax years.

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This provision can provide additional funds to C-corporations in the form of reduced tax liabilities and refundable credits through 2021. In addition, C-corporations will no longer be required to track the many AMT-related adjustments required in determining alternative taxable income.

Dividends Received Deduction
Prior to the TCJA, C-corporations that received dividends from less than 20% owned corporations were entitled to deduct 70% of those dividends. For corporations owning greater than 20% but less than 80%, an 80% deduction applied. For tax years starting in 2018 and later, the TCJA reduces the 70% deduction to 50% and the 80% deduction to 65%. For C-corporations owning greater than 80% of another C-corporation, the100% deduction remains unchanged.

Accounting Method Changes
The TCJA allows small business taxpayers with average annual gross receipts of $25 million or less in the prior three-year period the option to use certain simplified tax accounting methods.
The simplified tax accounting methods allow eligible taxpayers to:

- Use the overall cash basis method accounting
- Be exempt from certain accounting rules for inventories
- Be exempt from capitalizing costs related to real and personal property
- Be exempt from long-term contract reporting

In addition, the TCJA modified Section 451 of the Internal Revenue Code so that a business recognizes revenue for tax purposes no later than when it is recognized for financial reporting purposes. Under Section 451(b), taxpayers that use the accrual method of accounting will meet the "all events test" no later than the taxable year in which the item is considered revenue in a taxpayer's "applicable financial statement. Taxpayers wishing to change their current method of tax accounting for the above will be required to file Form 3115 to conform to the new rules.

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While some of the business provisions in the new law created additional complexity and uncertainty, the tax accounting method changes for eligible small businesses along with Revenue Procedure 2018-40 expand eligibility for the use of cash basis accounting methods as well as simplify the tax compliance burdens on small businesses in making a method change. In addition, one or more of these method changes can provide planning opportunities for acceleration of expenses or income deferral.

For example, where a business has more receivables than payables, adopting the cash method may result in tax savings in year one because the amount of revenue that will be deferred will exceed the amount of deductions that would have been taken.

Conversely, where a business has more payables than receivables, adopting the cash method in year one may not be advantageous because the amount of income that would get deferred would be less than the amount of deductions that would not be accelerated.

It is important to project business income over a few years and convert results to the cash basis. Business owners must be mindful of cash management and requirements to pay taxes as well as possibly losing eligibility to use any of the above methods and switching back.

Careful consideration and planning is required before adopting an overall change to cash basis tax reporting. Furthermore, taxpayers that previously made a mandatory change from cash to accrual must consider the transition rules outlined in Revenue Procedure 2018-40. The automatic Form 3115 must be attached to the timely filed (including extensions) federal income tax return for the year of change.

Net Operation Losses (“NOLs”)

For NOLs that arise in tax years starting after December 31, 2017, the maximum amount of taxable income that can be offset with NOL deductions is generally reduced from 100% to 80%. In addition, NOLs incurred in tax years ending after December 31, 2017, generally can’t be carried back to an earlier tax year but can be carried forward indefinitely. Losses incurred for years ending on or before December 31, 2017 have a 20-year carryforward period limitation. The rule eliminating the two-year carryback and 20-year carryforward limitations are applicable to NOLs generated for fiscal years ending in 2018. Special attention is required by fiscal year taxpayers as the statutory language regarding the carryback of NOLs is inconsistent with the legislative intent.

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Tracking NOLs going forward will be extremely important, as completely different rules apply depending on what year the NOL was generated. For companies that have NOL carryovers from tax years after 2017, planning ahead will be necessary, as a company that normally would be able to offset their entire taxable income with a NOL carryforward (old rules) will now be subject to an 80% limitation on post-2017 NOLs, and could be left with taxable income and a resulting tax liability. Presumably, the 80% limitation was put in place to offset the repeal of the corporate AMT.

In addition, the ability to use an NOL carryforward may be limited where a loss corporation has experienced a change of stock ownership, for example, as a result of a merger or acquisition, the issuance of new stock, or the acquisition of outstanding stock by one or more 5% shareholders. Therefore, appropriate planning is needed to preserve and maximize the use of NOLs.

Under the new rule where only post 2017 NOLs are utilized up to the 80% limit, the tax rate will be 4.2% on taxable income after NOL utilization. NOLs will be utilized on a first in, first out basis, according to the years they were generated.

Bonus Depreciation

The TCJA temporarily allows 100% expensing for business property acquired and placed in service after September 27, 2017 and before Jan. 1, 2023. Qualified assets include both new and used tangible property with a recovery period of 20 years or less (such as office furniture and equipment), off-the-shelf computer software, water utility property and, depending on when it is placed in service, qualified improvement property.

The 100% allowance generally decreases by 20% per year in taxable years beginning after December 31, 2022 and expires Jan. 1, 2027:

- 80% for 2023
- 60% for 2024
- 40% for 2025
- 20% for 2026.

The law now allows bonus depreciation for certain film, television, and live theatrical productions, and used qualified property with certain restrictions. For certain property with longer production periods, these reductions are delayed by one year. For example, 80% bonus depreciation will apply to long-production-period property placed in service in 2024.

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Under the TCJA, in some cases a business may not be eligible for bonus depreciation starting in 2018. Examples include real estate businesses that elect to deduct 100% of their business interest, and dealerships with floor-plan financing, if they have average annual gross receipts of more than $25 million for the three previous tax years.

Managing the timing of purchasing eligible property will assure maximum use of this annual asset expense election and bonus depreciation as the 100% bonus depreciation deduction begins to phase out after December 31, 2022. A taxpayer-favorable development is that bonus depreciation is now permitted for both new and used property acquired by purchase, provided the property was not used by the taxpayer before the taxpayer acquired it.

Taxpayers should be mindful of the de minimis safe harbor expensing rule that allows for immediate expensing of up to $2,500 or $5,000 where an audited financial statement is prepared. While de minimis expensing vs. bonus depreciation may produce the same result at the federal level, it may reduce state level income taxes as most states follow the de minimis provisions but disallow bonus depreciation.

Taxpayers purchasing a sport utility vehicle should consider purchasing one which is rated 6,000 pounds or more. This will allow the business to take bonus depreciation up to 100% of the cost of the vehicle. Vehicles rated at 6,000 pounds or less don't satisfy the SUV definition and thus are subject to the passenger vehicle limits. For passenger vehicles placed in service in 2018, the first-year depreciation limit is $18,000 ($10,000 plus $8,000 bonus depreciation).

Section 179 Election

A taxpayer may elect to expense the cost of any section 179 property and deduct it in the year the property is placed in service. The new law increased the maximum section 179 deduction from $500,000 to $1 million. It also increased the phase-out threshold from $2 million to $2.5 million. For later tax years, these amounts will be indexed for inflation. You can claim the election only to offset net income, not to reduce it below zero to create a net operating loss.

The other significant change to Section 179 is the modification of the type of assets that qualify for the deduction. The significant change includes qualified improvement property and certain other improvements to nonresidential real property, such as:

- Roofs
- Fire alarm and security systems
- HVAC systems

Mazars Insight
If the taxpayer has purchased or is purchasing real estate by year's end to rent out or use in business, consider a cost segregation study so they can capture the bonus depreciation on land improvements and contents of the building. Typical assets that qualify include decorative fixtures, security equipment, parking lots, landscaping and architectural fees allocated to qualifying property. A cost segregation study will identify personal property and determine optimum depreciable lives for both current and prior acquisitions and construction.

In many cases, assets that have been classified as 39-year assets, which are not eligible for bonus depreciation, can be carved out from the overall cost of the building and would be eligible for bonus depreciation or depreciable over a shorter life. Generally, taxpayers can file an amended tax return for the property's placed-in-service year to claim the bonus depreciation and adjust the depreciation allowable on the qualified property, provided that the amended tax return is filed before the taxpayer files its tax return for the first taxable year succeeding the placed-in-service year. However, if the first taxable year succeeding the placed-in-service year is already filed before the cost segregation study is performed and the qualified property is identified, the taxpayer has adopted an impermissible method of accounting and must change from an impermissible method to a permissible method by filing a Form 3115.

Qualified Improvement Property ("QIP")

The TCJA eliminated the qualified leasehold improvement property ("QLHI"), qualified restaurant property ("QRP") and qualified retail improvement property ("QRIP") classifications and moved them under the QIP classification. This modification to the rules is effective for property placed in service after Dec. 31, 2017. The new law was intended to amend Section 168 of the Internal Revenue Code to provide a 15-year depreciation life to QIP, which would also make QIP eligible for 100% Bonus Depreciation. However, due to a drafting error, the TCJA does not assign a 15-year life to QIP. Unless a technical correction to the tax bill is passed by Congress, QIP acquired after September 27, 2017, and placed in service after December 31, 2017, will be subject to a 39-year recovery period and will not be eligible for bonus depreciation. QIP placed in service between September 28, 2017 through December 31, 2017 is eligible for 100% bonus depreciation.

Qualified Opportunity Zones

The TCJA created a new tax incentive program designed to spur economic development and job creation in distressed communities by providing a tax benefit to those that invest in specified areas known as Qualified Opportunity Zones. Funds established to invest in these zones are Qualified Opportunity Funds.

If a taxpayer realizes gains from the sale or exchange of property and invests some or all of the realized gain into a Qualified Opportunity Fund (QOF) within 180 days, the QOF investment allows a taxpayer to:

1. Defer those gains from taxable income until the earlier of (a) selling the investment or (b) December 31, 2026.
2. Permanently exclude 10% of the originally-invested gain from taxable income if the investment is held for at least 5 years (5-year period must be met prior to December 31, 2026).
3. Permanently exclude an additional 5% for a total exclusion of 15% of the originally invested gain from taxable income if the investment is held for at least 7 years (7-year period must be met prior to December 31, 2026).
4. Permanently exclude post acquisition appreciation in the investment if the taxpayer holds the investment for a minimum of 10 years.

Initially the taxpayer's basis in the fund is zero. The exclusion described in items two and three above is accomplished through an increase to the basis of the investment. If the investment is held for at least 5 years, the taxpayer's basis is increased by 10% of the deferred gain. If the investment is held for at least 7 years, the taxpayer's basis is increased by another 5% of the deferred gain, totaling 15%.

> *Mazars Insight*
> *An investment in a Qualified Opportunity Fund could provide significant benefit. Proposed regulations containing rules related to Qualified Opportunity Zones and Qualified Opportunity Funds were issued on October 19, 2018. Although these rules provide much needed guidance, many questions still remain unanswered. Taxpayers who have recognized capital gain should consider making an investment in a QOF to obtain significant savings.*

Section 199 Domestic Production Activity Deduction

Domestic production activities deduction ("DPAD") is eliminated for tax years beginning after Dec. 31, 2017.

> *Mazars Insight*
> *The Section 199 deduction can be claimed for any open tax year beginning before January 1, 2018. Therefore, taxpayers with qualifying production activity income within the scope of Section 199 that have never taken this deduction should consider amending returns for open tax years prior to 2017.*

Compensation Deductions

Companies with publicly traded stock or registered debt may not be allowed to deduct compensation in excess of $1million paid to certain covered employees. Prior to 2018, there were two exceptions to the deduction limit – the exception for performance-based pay (including stock options) and the exception for commission-based pay. However, the TCJA repealed these exceptions, placing an effective cap on the amount a company can deduct for executive compensation at $1 million-dollars for a company's CEO, CFO, and the three other most highly paid executives.

> *Mazars Insight*
> *TCJA changes to Section 162(m) do not apply to compensation paid under a "written binding contract" in effect on November 2, 2017, provided the contract is not "materially modified" after such date.*

Interest Deductions

Under the TCJA, for tax years beginning after December 31, 2017, newly amended section 163(j) of the Internal Revenue Code imposes a limitation on deductions for business interest incurred by certain large businesses. Generally, for businesses with $25 million or more in average annual gross receipts, business interest expense is limited to business interest income plus 30% of the business's adjusted taxable income and floor-plan financing interest. The $25 million limit is subject to aggregation rules that may require combining different businesses for purposes of this limitation. There are some exceptions to the limit, and some businesses can elect out of this limit. Disallowed interest expense may be carried forward indefinitely, with special rules for partnerships. Taxpayers will use new Form 8990, to calculate any Limitation on Business Interest Expense Under Section 163(j), and to track any disallowed interest being carried forward.

This limit does not apply to taxpayers whose average annual gross receipts are $25 million or less for the three prior tax years. This amount will be adjusted annually for inflation starting in 2019.

Other exclusions from the limit are certain trades or businesses, including performing services as an employee, electing real property trades or businesses, electing farming businesses and certain regulated public utilities. Taxpayers must elect to exempt a real property trade or business or a farming business from this limit.

> *Mazars Insight*
> *The interest deduction is potentially more valuable than the slightly shorter life available for depreciation of real estate assets. In addition, entities that are required to use ADS, such as partnerships with tax-exempt partners, or REITs that use ADS in connection with earnings and profits calculations, should not suffer adverse tax consequences by making the election.*
>
> *Further, the taxpayer can elect out of the interest deductibility limitation in any tax year, bearing in mind that once made, the election is irrevocable. Thus, a taxpayer can decide not to elect out in 2018, allow the interest deduction to be suspended, and then elect out in 2019 when the freed-up deductions are available to offset other income. In addition, it may be possible to claim bonus depreciation in one year and elect out of the deduction limitation the next year without recapturing the bonus depreciation claimed.*

Meals and Entertainment
For amounts paid or incurred after Dec. 31, 2017, the TCJA generally eliminated the deduction for any expenses related to activities considered entertainment, amusement or recreation. However, under the new law, taxpayers can continue to deduct 50% of the cost of business meals if the taxpayer (or an employee of the taxpayer) is present and the food or beverages are not considered lavish or extravagant. The meals may be provided to a current or potential business customer, clients, consultants, or other business contacts. If provided during, or at, an entertainment activity, the food and beverages must be purchased separately from the entertainment, or the cost of the food or beverages must be stated separately from the cost of the entertainment on one or more bills, invoices, or receipts.

> *Mazars Insight*
> *For expenses incurred after December 31, 2017, de minimis employer-provided meals will be 50% tax deductible and 100% non-deductible for expenses incurred after December 31, 2025. Businesses have tended to co-mingle meals and entertainment expenses in their books and records, since the tax treatment was generally the same. However, they should consider revising their bookkeeping practices to better identify the new tax deductible amounts.*

Commuting Costs and Transportation Fringe Benefits
Employer deductions for the cost of providing commuting transportation to an employee (such as hiring a car service) are no longer allowed, unless the transportation is necessary for the employee's safety. Also eliminated are employer deductions for the cost of providing qualified employee transportation fringe benefits (for example, parking allowances, mass transit passes and van pooling). However, those benefits remain tax-free to recipient employees.

> *Mazars Insight*
> *Employers now have to choose to either include these amounts in employee taxable income and take a 100% tax deduction or exclude the amounts from employee income and take a lesser deduction.*

Like-Kind Exchanges
Starting in 2018, the deferral allowed under the like-kind exchange provisions applies only to exchanges of real property and not to exchanges of personal or intangible property.

> *Mazars Insight*
> *Real property must still be held for productive use in a trade or business or for investment to be eligible for like-kind exchange treatment. This applies to exchanges completed after December 31, 2017. Real property located in the U.S. is not considered like-kind to real property located outside the U.S.*

Tax Credits

Some tax credits had been proposed for repeal, but the final version of the TCJA preserved them. Below is a brief description of some available credits to consider:

- Research Credit ("R&D Credit"). This credit was previously made permanent in the Protecting Americans Against Tax Hikes ("PATH") Act of 2015. Certain start-ups (in general, those with less than $5 million in gross receipts) that haven't yet incurred any income tax liability can use the R&D credit against their payroll tax.
- Work Opportunity Credit. This credit is designed to encourage hiring from certain disadvantaged groups, such as certain veterans, ex-felons, individuals who've been unemployed for 27 weeks or more and food stamp recipients. Despite its proposed elimination, the credit is still available for 2018.The size of the tax credit depends on the hired person's target group, the wages paid to that person and the number of hours that person worked during the first year of employment. The maximum tax credit that can be earned for each member of a target group is generally $2,400 per adult employee. But the credit can be higher for members of certain target groups, up to as much as $9,600 for certain veterans.
- New Markets Credit. This credit gives investors who make "qualified equity investments" in certain low-income communities a 39% tax credit over a 7-year period. Certified Community Development Entities ("CDEs") determine which projects get funded — often construction or rehabilitation real estate projects in "distressed" communities, using data from the 2006–2010 American Community Survey. Flexible financing is provided to the developers and business owners. The credit is scheduled to expire December 31, 2019.
- Retirement Plan Credit. Small employers (generally those with 100 or fewer employees) that create a retirement plan may be eligible for a $500 credit per year for 3 years. The credit is limited to 50% of qualified startup costs.
- Small-Business Health Care Credit. The maximum credit is 50% of group health coverage premiums paid by the employer, provided it contributes at least 50% of the total premium or of a benchmark premium. For 2018, the full credit is available for employers with 10 or fewer full-time equivalent employees (FTEs) and average annual wages of less than $26,600 per employee. To qualify for the credit, online enrollment in the Small Business Health Options Program (SHOP) generally is required. In addition, the credit can be taken for only 2 years, and they must be consecutive.
- Family Medical Leave Credit. The credit applies to wages paid in taxable years beginning after December 31, 2017, and before January 1, 2020. The credit is a percentage of wages (as determined for Federal Unemployment Tax Act (FUTA) purposes and without regard to the $7,000 FUTA wage limitation) paid to a qualifying employee while on family and medical leave for up to 12 weeks per taxable year. The percentage can range from 12.5% to 25%, depending on the percentage of wages paid during the leave

International Tax Planning

The passage of the TCJA left us with many more questions than answers. 2018 was a busy year for Notices, Memoranda, and Proposed Regulations aimed at filling some of the gaps created by the new law. This trend will certainly continue into 2019 as the lay of the international tax landscape continues to settle. What follows below is a summary of some of the salient US international tax changes.

Section 965 Transition Tax

One of the hot button issues in the tax reform discussions was the repatriation tax. Section 965 moves the US international tax system from a global regime to a territorial regime, requiring taxpayers to include their foreign corporate untaxed income in their subpart F income calculation for their latest tax year beginning on, or before, December 31, 2017. The result was a tax holiday where previously untaxed foreign income was repatriated but taxed at relatively low rates. Basically, the 2017 tax year was used to give all foreign businesses a clean slate from which to begin operating under the new territorial system.

Throughout 2018, the Treasury provided guidance in the form of memoranda and notices, and as late as August, the Treasury released proposed section 965 regulations.

Taxpayers could include the transition tax in their 2017 returns or could elect to make payments in installments over the course of 8 tax years, beginning with the 2017 tax year.

Under the proposed regulations, installment payments will become immediately due if certain acceleration events occur. The three newest events, included in the proposed regulations, cover persons no longer being considered US persons, persons becoming part of a consolidated group, and cases where a consolidated group ceases to exist.

> *Mazars Insight*
> *Taxpayers with fiscal years ending in 2018 may not have filed yet and will need to calculate their tax under section 965. These taxpayers should model out their 965 burden and consider whether the 8-year installment option would provide a cash benefit.*

Base Erosion Anti-Abuse Tax (BEAT)

The Base Erosion Anti-Abuse Tax is a completely new tax regime that may impose additional tax on a new Modified Taxable Income (MTI) calculation. Taxpayers calculate their MTI by reversing certain credits and deductions attributable to payments made to foreign related parties. Modified taxable income is compared to taxable income and a tax is imposed based on the difference. BEAT is a tax conceptually similar to the alternative minimum tax, but is aimed at profit shifting strategies that include base eroding the US through interest, royalty, rent, or otherwise. These types of base erosion payments are typically the type dealt with by transfer pricing rules. BEAT applies to both inbound and outbound activities, so it affects everybody. Fortunately (or unfortunately), it only applies to corporations with more than a half billion dollars in gross revenue and sufficient base erosion percentage thresholds of 3% (or 2% in the case of financial services companies).

For tax years beginning in 2018, BEAT is calculated by subtracting actual tax paid from modified taxable income (or 5% of taxable income plus addbacks of base erosion payments). For tax years beginning after 2018, actual tax paid is subtracted from 10% of modified taxable income to determine BEAT. So, the threshold going forward will be double what it was for 2018. Then, beginning in 2026, the rate increases again from 10% to 12.5%.

In the future, BEAT may have a pronounced effect on some credits that are only partially creditable against BEAT (it looks like Congress wanted everybody to pay at least some tax). Additionally, guidance may be necessary where treaty rates reduce the tax rate on payments added back under the BEAT rules. Recently, the IRS released a draft Form 8991 that is used to calculate BEAT.

> *Mazars Insight*
> *Since BEAT is based on payments to related parties, some taxpayers will benefit by making deductible expense payments directly to unrelated third-party vendors. Additionally, some taxpayers will benefit by restructuring to remain outside of BEAT's reach. Finally, there will be additional compliance for large companies required to file Form 8991.*

Foreign Tax Credits

Almost every change to the international tax law also modified the foreign tax credit available to taxpayers. The new law also directly altered the foreign tax credit rules, and some of these changes were significant.

Prior to the tax law changes, US corporations receiving distributions from foreign corporations could take a credit for a ratable portion of the "pooled" foreign tax paid by the foreign corporation. The entire code section (§902) containing this provision was repealed, so US corporations can no longer take a credit for foreign taxes paid by the foreign corporations. The practical effect is mitigated by a part of the new law that makes the distributions themselves deductible. However, there are significant changes to the calculation of the credit, and some distributions that previously benefitted from the credit allowance under section 902 are not deductible under the new rules.
The TCJA does include a mechanism for claiming foreign taxes deemed paid by a US corporation that are properly attributable to items of foreign income under subpart F, Global Intangible Low-Taxed Income (GILTI), and Section 956. The "properly attributable" standard is still not clear, so we should expect guidance on this issue.

The now-famous Passive and General category baskets also got a makeover, along with the addition of new GILTI and Foreign Branch baskets.

> *Mazars Insight*
> *Concurrent with the final draft of this writing, proposed regulations were issued addressing foreign tax credits in general, and specifically, expense allocation, which also affects GILTI calculations. Theoretically, the more baskets there are, the less tax will be creditable, since each foreign tax paid is creditable against only the basket of income with which it is associated. So, planning opportunities will continue to arise where transactions can be structured to classify income within particular baskets.*

Foreign-Derived Intangible Income

Congress describes FDII as intangible income that is derived from serving foreign markets. Like the IC-DISC rules that have the practical effect of reducing the effective tax rate to exporter shareholders, the FDII rules are aimed at incentivizing the sale of goods and services that are for foreign use. The current effective tax rate on FDII is 13.125%. One of the issues outstanding with FDII lies in how we determine if something is sold for foreign use. The current law does not provide a lot of guidance.

In addition, the TCJA places limits on what sales qualify as FDII when the sales are made to related parties. The law allows such sales to qualify, but bases the qualification on a determination of end use. Again, guidance will be needed to clarify this limiting language, especially where buyer and seller file a consolidated return or where there is a time lapse between initial sale and ultimate use. The effective tax rate on FDII increases to 16.406% for tax years beginning after 2025.

> *Mazars Insight*
> *Exporters should model their effective tax rate by applying the FDII rules and compare that outcome with the benefits of a traditional IC-DISC structure. Because FDII only applies to C corporations, FDII may influence the choice in business entity for startups and existing companies looking to restructure. Finally, because of the rate increase after 2025, exporters should plan now to accelerate FDII prior to their 2026 tax year.*

Section 163(j) Limitation on Business Interest

The current version of section 163(j) under the new tax law creates a cap on the amount of business interest that a taxpayer can deduct in any tax year. The limitation applies to both domestic and foreign corporations, but only for those with gross receipts of $25 million or more. Fortunately for those corporations subject to section 163(j), any deduction rendered unusable by the limitation in the current year gets carried forward to future tax years indefinitely.

There are several questions remaining in regards to the limitation, especially in the context of international tax. In the calculations necessary to determine Subpart F income, FDII, GILTI, and BEAT, deductions play a key role. The regulations do tell us that the limitation does not affect E&P, but there is little additional guidance.

Section 163(j) also affects interest deductions when a treaty reduces the tax rate on interest income. In these situations, the interest is treated as taxed in proportion to the ratio of the treaty rate to the non-treaty rate. The remaining interest is treated as untaxed interest and may be disallowed as a deduction under section 163(j).

> *Mazars Insight*
> *Borrowers will need to examine their current debt/equity structure and may need to revise their financing plan. In addition, borrowers in treaty countries may change their position with respect to treaty elections because interest articles are less valuable under 163(j). Finally, on November 26, the Treasury released proposed regulations for section 163(j), which means that significant additional changes could be forthcoming.*

Global Intangible Low-Taxed Income (GILTI)

GILTI is a new type of Subpart F income created under the new tax law. The basic premise is that a tangible asset owned by a controlled foreign corporation should only produce a 10% return. Any return above 10% (the “excess return”) is thought to be the product of intangibles, rather than the tangible asset. This excess return is taxed to the US shareholder as subpart F income, subject to special rules that reduce the effective tax rate to the shareholder. So, GILTI is guilty of making some foreign source income taxable currently, where the tax would have previously been deferrable.

One of the main benefits of GILTI is that a 50% deduction is available to US shareholders that are C-corporations. This deduction brings the effective tax rate on GILTI down to 10.5% until 2026, when the deduction is reduced to 37.5%. Additionally, foreign tax credits are available to corporate shareholders, but not to individuals.

Late in 2018, the Treasury released proposed regulations addressing many of the outstanding issues, notably, regarding the effects of GILTI on domestic partnerships that are US shareholders and on adjustments to E&P and basis to account for losses determined under the GILTI regime. These provisions provide a starting point for the heavy lifting that will need to be done by US shareholders and their tax planners.

Mazars Insight
GILTI will be a significant consideration in entity choice for doing business because the GILTI deduction and foreign tax credits are only available to C-corporations. Because of the rate increase after 2025, taxpayers should plan now to accelerate GILTI prior to their 2026 tax year.

Equilibrium between Dividend Received Deduction and Section 956 Inclusion

The Treasury released proposed regulations in early November 2018 to tie out an inconsistency borne of the new tax law. Newly added section 245A grants a deduction for dividends received by a US corporation that is a 10% shareholder in a foreign corporation (including CFCs). The deduction is equal to 100% of the foreign source portion of the dividend.

Section 956, unchanged by the new law, requires a US shareholder of a CFC to include, in income, an amount equal to the CFC's investment in US property during the year.

The practical effect of these two rules, when taken together, is to benefit shareholders of CFCs that distribute earnings, because the dividend is fully deductible, while harming shareholders of CFCs that choose to invest in US property directly, because no deduction can be taken under section 245A against the amount invested in US property.

The proposed regulations mitigate this disparity by calculating the "tentative section 956 amount," a hypothetical distribution that would have taken place as if an investment in US property had not been made and instead the cash had been distributed by the CFC to the shareholder.

The proposed regulations can be applied by election to tax years beginning in 2018. In many instances, the inconsistency between sections 245A and 956 is rendered moot by the other changes made to the tax law. However, there are instances where both opportunities and pitfalls exist at the intersection of these two code sections, one old and one new.

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Where in the past a US parent was limited in the value of its lower tier CFCs that could be pledged as collateral, now the parent is able to borrow against the entire CFC structure.

Smith v. Commissioner

In this case, the Tax Court held that a taxpayer that had made a section 962 election and that received a distribution from a CFC organized in a nontreaty jurisdiction cannot benefit from the lower tax rates applicable to qualified dividends. Section 962 allows individual taxpayers, including trusts and estates, to elect to be taxed at corporate tax rates on Subpart F inclusions and to claim an indirect foreign tax credit for the taxes paid by the corporation. However, a later distribution of E&P for which a 962 election had been made is not treated as previously taxed income, but is included in gross income as a dividend. In Smith, the taxpayer argued that, by virtue of Section 962, a distribution from a CFC should be treated as if received from a domestic corporation and therefore subject to the lower tax rates applicable to qualified dividends. The Court rejected the taxpayer's position and held that Section 962 was designed to treat an individual taxpayer as a domestic corporation for the sole and limited purpose of claiming an indirect foreign tax credit and subjecting the Subpart F income inclusion to corporate rates. The Court therefore concluded that the dividend should be subject to ordinary tax rates because it was received from a corporation organized in a nontreaty jurisdiction. This decision limits the benefits of a Section 962 election for US shareholders of CFCs located in nontreaty jurisdictions.

Transfer Pricing Update

Country by Country Reporting

The ongoing implementation of the OECD Base Erosion and Profit Shifting (BEPS) Actions by member states around the world has been the driving force for changes in transfer pricing compliance. For many multinational enterprises (MNEs), 2018 marked a first year for compliance with Country by Country (CbC) reporting requirements, most of which came into effect for fiscal years ending in 2017 and early 2018. In the U.S., taxpayers that were the ultimate parent entity of a U.S. MNE group with annual revenue of $850 million or more in the previous period are required to file Form 8975 and Schedules A with their returns. As with all of BEPS, the CbC landscape can be complicated, as each country has developed its own forms, requirements, and deadlines. As of November 2018 there are over 1,900 bilateral CbC exchange relationships between jurisdictions, including between the 74 signatories to the CbC Multilateral Competent Authority Agreement, between EU Member States, and under Double Tax Conventions or Tax Information Exchange Agreements, including 40 bilateral agreements with the U.S.

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These are still very early days for the CbC reporting requirements, but the administrative burden on MNEs has already been notable. It remains to be seen whether tax authorities will truly have the capacity to leverage this additional information for enforcement purposes, and how this might impact mutual agreement procedure caseloads.

Master File and Local File Requirements

Two other aspects of BEPS implementation that seem to be causing some confusion among MNEs are the global Master File and Local File requirements. In simple terms, the Master File represents that part of a typical transfer pricing documentation report that has to do with the MNE group and its operations, including supply chain, allocation of income, and transfer pricing policies. The Local Files represent the economic analysis, prepared under the auspices of the OECD Guidelines and local transfer pricing regulations. So if the reports haven't changed substantially, why the fuss? Well, much like CbC reporting, Master File reporting requirements vary widely by jurisdiction, for example:

- Master File requirements have not been adopted in all jurisdictions (including the U.S.).
- Some countries require additional information beyond the OECD template (as in China).
- As with CbC, the thresholds for Master File preparation vary among jurisdictions, but may even differ from a country's CbC reporting threshold (as in the Netherlands, where consolidated group revenue of only €50 million triggers the Master File requirement).
- In some countries, the Master File must be submitted to tax authorities (as in Australia), but in others it must be prepared contemporaneously and held until requested.
- Some countries will accept a Master File written in English, but in others it must be translated to local language (as in Indonesia).
- Some countries have even instituted penalties for not meeting the Master File requirements (as in Belgium).

More importantly, the Master File and Local File requirements, especially in combination with CbC reporting, mark an unprecedented level of transparency and potential exposure to transfer pricing risk for MNEs worldwide. Even if a country does not itself require that a Master File be prepared, they may request one under audit if it exists.

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Consistency among the Master File and all Local Files, as well as an MNE's CbC reporting filings, is of critical importance. A well-prepared Master File and Local File package strategically reinforces data in the CbC reporting and supports the MNE's global business narrative and tax structure, while inconsistencies therein could serve as a road map for tax authorities ramping up enforcement.

Hard-to-Value Intangibles and Notable Court Cases

Another important development in transfer pricing was the first impact of 2017 revisions to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines). In particular, the revisions to Chapters I and VI, which are heavily colored by BEPS Actions 8-10. These changes are actually part and parcel of a broader global struggle to appropriately value intangibles, ascribe ownership thereto, and allocate income accordingly. Critical questions generally have to do with the development, enhancement, maintenance, protection, and exploitation (DEMPE) of the property in question. While the recent OECD efforts may be a step in the right direction, there appears to be little consensus on this issue among governments, MNEs, and service providers.
A good illustration of the challenges this presents can be seen in Medtronic, Inc. v. Commissioner, which is headed back to Tax Court after the Court of Appeals for the Eighth Circuit in August reversed an earlier decision in favor of the taxpayer. With the outcome still uncertain, many eyes are watching this one, which is expected to have serious implications for other large American taxpayers, including Facebook and Coca-Cola (which is still reeling from a 2015 Notice of Deficiency).

Also notable this summer was the July decision by the Court of Appeals for the Ninth Circuit which overturned the 2015 Tax Court decision in favor of the taxpayer in Altera Corp. v. Commissioner. This decision pertained to stock-based compensation in cost sharing agreements (CSAs).

Still under consideration in the Ninth Circuit is the IRS's appeal of the 2017 decision in Amazon.com, Inc. v. Commissioner, which also relates to a CSA. If recent circuit court decisions in the Medtronic and Altera cases are any indication, Amazon may have a rough road ahead.

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While the IRS has fared relatively poorly in transfer pricing cases in Tax Court, they have done far better in circuit court appeals of those decisions in recent years. It likely won't be long before some of these cases make their way to a conservative-leaning U.S. Supreme Court.

These cases offer a good reminder that the risks inherent to transfer pricing have gone well beyond adjustments and penalties. While transfer pricing has perennially topped the tax and controversy risks among surveyed CFOs, that risk should today be on the mind of every C-suite executive. The reputational risks associated with transfer pricing have ballooned as the subject has garnered increasing attention from political figures, media, and the general public. These risks can only be exacerbated by the uncertainties resulting from global transitions in the transfer pricing landscape.

Transfer Pricing Moving Forward

Many forward-looking predictions of transfer pricing trends cited big data and the corporate Internet of Things (IoT) as items to watch in 2018. However, the adoption and implementation of these ideas and technologies has yet to make a significant impact, beyond perhaps a renewed interest in strategic operational transfer pricing. Look for a greater impact after the dust has settled from the ongoing implementation of BEPS, and as MNEs learn more about their own operations and are better positioned to present such information to tax authorities in support and defense of their transfer pricing narratives.

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Even as big data and IoT become more prevalent in the business world, they are also expected to play a more significant role in government. Look for tax authorities to explore such ideas as they attempt to identify enforcement opportunities amid the wealth of new information flooding in from sources such as CbC reports and Master Files.

It is fair to say that while the use of profit-based methods to evaluate the transfer pricing of goods and services among related entities has become all but routine, the more complex questions of appropriately pricing intangible property (and the income therefrom), proper allocation of income from cost-sharing arrangements, and appropriate treatment for intercompany financing structures are far from settled. Expect these areas to garner even greater attention from tax authorities armed with an unprecedented amount of information about taxpayers' global business structures and activities.

Final Thoughts

Careful and well-executed planning requires special attention across a wide range of areas as discussed throughout this publication. Your planning should be analyzed in light of the current legislative environment and your individual goals.

To refine your approach, learn more about the strategies mentioned, or to discuss your individual circumstances, please contact your Mazars USA LLP tax professional for more information.

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