



NAW Large Company CFO Roundtable

*U.S. Tax Reform: Opportunities and
Challenges*

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Introduction...



David Sites

Partner, Technical Leader
International Tax
Washington National Tax Office
+1 202.861.4104
David.Sites@us.gt.com

Bio

David Sites, International Technical Leader of Grant Thornton's Washington National Tax Office, has more than 17 years of experience working with U.S.-based multinationals, foreign-owned inbound U.S. corporations, closely held businesses and high net worth individuals. His primary focus is income tax planning and consulting for multinational enterprises. Sites has served a wide array of companies in various industries, including manufacturing, technology and retail. He is primarily engaged on issues involving federal and international taxation of business enterprises, including multinational corporate groups and pass-through entities.

Sites has participated in numerous consulting projects for his clients, including cross-border planning and structuring, repatriation planning, foreign tax credit planning, and industry-specific research on a wide variety of issues involving federal and international tax. In addition to his consulting responsibilities, he has a wide range of experience in compliance matters, including transactional reporting issues. He has also participated in numerous assurance engagements mainly focusing on the application of FAASC 740 to worldwide consolidated financial statements.

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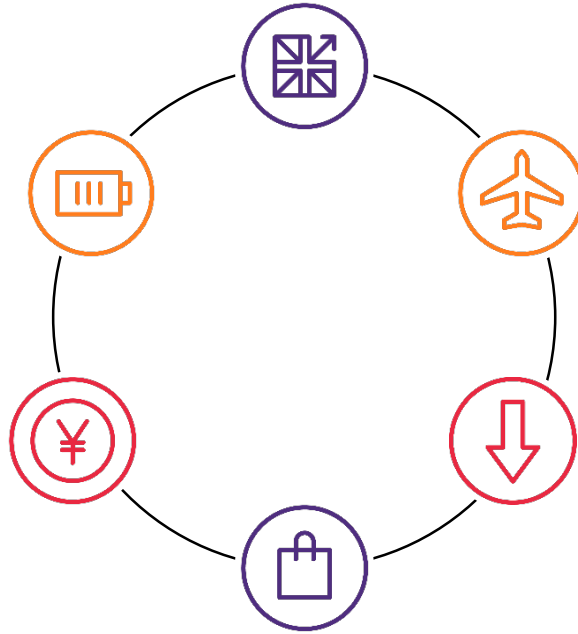




Overview:

A brief rundown of the major provisions

Business taxes



Tax reform overview

- Flat 21% corporate rate
 - Effective on Jan. 1, 2018
- Significant expensing and cost recovery provisions
- General interest limitations based on taxable income
- Corporate AMT repealed, but with net operating loss limitations
- Pass-through taxation
- Significant international provisions, including:
 - Territorial system and one-time tax on unrepatriated earnings
 - Global minimum tax on certain foreign income

Corporate rate cut

- Flat 21% rate:
 - Effective for tax years *beginning after* Dec. 31, 2017
 - Fiscal year taxpayers use blended rate based on ratio of days in calendar years 2017 and 2018 pursuant to Section 15:
 - Take % of year prior to, and after, Jan. 1, 2018, and apply to total income for the year to get your blended rate. (Treas. Reg. Sec. 1.15-1)
 - 52/53 week filers: If year-end within the last week of 2017, then treated as Calendar Year filer. If not, then must apply Section 15 analysis.
 - Important: If FY filer, then deductions, other non-rate provisions are governed by effective date of provision as enacted in new law. Must check!
- Personal service corps get 21% rate

Expensing and cost recovery

- Bonus depreciation doubled for five years:
 - 100% for property placed in service after Sep. 27, 2017 and Jan. 1, 2023
 - Used property added (if new to taxpayer)
- Enhances Section 179 expensing for five years
- Repeals Section 174 expensing and requires 5-year amortization for costs incurred after Dec. 31, 2021. Software development included.

Interest deduction

New law uses the OECD concept of limiting interest to 30% of income

- 30% of taxable income roughly equivalent to EBITDA pre-2022; and EBIT post-2022
- Exceptions: Public utilities, electing real estate, and businesses with <\$25 million in gross receipts
- Unlimited carryforward

Alternative minimum tax

- Corporate AMT repealed effective for tax years beginning after Dec. 31, 2017
 - Existing AMT credits monetized as refundable tax credits over the next four years
 - Sequester will take ~ 7% off the top of any refundable payment amount

Net operating losses

- Can offset only 80% of taxable income in any year
- NOL carrybacks eliminated but carryforwards are indefinite
 - Property and casualty businesses retain current-law 2-year carryback and 20-year carryforward.
- Income limit applies to NOLs in tax years beginning after Dec. 31, 2017, while new carryback rules apply to NOLs in tax years ending after Dec. 31, 2017

Passthrough tax deduction: §199A

- Deduction of 20% of qualified income, BUT:
 - Excludes certain businesses (if over income thresholds)
 - Limited to greater of (if over income thresholds):
 - 50% of W-2 wages (including owner wages), or
 - 25% of W-2 wages plus 2.5% of the unadjusted basis of qualified property
- The 20% deduction creates effective rate of 29.6% against 37% top individual rate if allowed in full

Passthrough tax deduction: §199A

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

Passthrough tax deduction: §199A

- Qualified business income does not include:
 - S corp owner's reasonable compensation
 - Partner's guaranteed payments for services and (to extent provided in future regs) payments for acting other than in the capacity as a partner
- Specified service business not included (if over income threshold):
 - Health
 - Law
 - Consulting
 - Accounting
 - Any business where the principal asset is the reputation or skill of one or more employees or owners
 - Actuarial science
 - Performing arts and athletics
 - Financial and brokerage services, investing and investment management, and trading

New §199A – Income threshold test

- W-2 wage and wage plus asset tests and specified business exclusions do NOT apply if income below certain thresholds:
 - \$315,000 of taxable income if married filing jointly
 - \$157,000 of taxable income if filing single
- Phase out over next \$100,000 (mfj) or \$50,000 (single) of taxable income

New §199A – Special considerations

- Section 199A reduces taxable income, but not gross income or AGI
 - Will not affect AGI based phase-ins and phase-outs
 - Not expected to be deductible for state tax in states basing their income tax on Federal measures of AGI
- Section 199A does not itself modify any employment tax rules
- No distinction between passive and active owners

Entity choice

Federal rate comparison by entity	
Type of business income	2018 Top rate
• Pass-through: Active	29.6%
• Pass-through: Passive	33.4%
• C corporation: Distribute all earnings	39.8%
• C corporation: Distribute ½ of earnings	30.4%
• C corporation: Retain all earnings	21%
Includes 3.8% NII tax on investment income, but not FICA or SE tax on earned income Assumes 20% deduction not otherwise limited	

- *Grant Thornton insight: Rate comparison just one piece of puzzle. Also consider exit plans, accounting methods, costs of conversion itself, estate planning, state taxes, and more*

Other key business provisions

	H.R. 1, commonly referred to as the “Tax Cuts and Jobs Act” (the “Act”)
Section 199	REPEALED after 2017
Like kind exchanges	Limited to real property
Employer-provided child care credit	REPEALED
Work Opportunity Tax Credit	RETAINED
New Markets Tax Credit	RETAINED
Rehabilitation credit	REPEALED

Other key business provisions, cont'd.

	H.R.1, the Act
Insurance reforms	\$40 billion in revenue raising changes
Private activity bonds	RETAINED
Deduction for remaining 50% of meals and entertainment	Reduced to 50% in 2018, repealed in 2026
Enhanced oil recovery credit	RETAINED
Credit for producing oil and gas from marginal wells	RETAINED
Alternative energy provisions	No change to Section 45 or 48 credits

International overview

- Move to a territorial system with 100% dividends received deduction
- One-time tax on previously unrepatriated earnings as transition and pay-for
- Several very significant anti-base erosion provisions included:
 - Minimum tax on certain foreign intangible income (GILTI)
 - Base erosion anti-abuse tax (BEAT)
 - Anti-Hybrid Measures

One-time tax on unrepatriated earnings of CFCs

- Rate of tax:
 - 15.5% on cash and cash equivalents
 - 8% on non-cash assets
- Foreign tax credits allowed after a haircut
- Election available for tax to be payable in escalating installments over eight years
- Deficits taken into account (may offset earnings and deficits within the same affiliated groups)
- Election available to preserve NOLs

The Measurement Date

Greater of E&P balance on:



Global Intangible Low Taxed Income (GILTI)

- The new law imposes current U.S. tax on excess of foreign intangible income (broadly defined) earned by a controlled foreign corporation exceeding a routine return
 - Routine return is 10% rate of return on depreciable assets (reduced by certain interest expense)
- Calculation done entity by entity and then aggregated, loss entities included
- U.S. effectively connected income, Subpart F and certain other income excluded
- Limited credit provided for foreign tax but only current year foreign tax with no carryover or carryback for unused taxes

Base erosion anti-abuse tax (BEAT)

The new law includes a significant inbound base erosion provision

- Minimum tax on modified taxable income (computed without base erosion payments, and certain related NOLs) of domestic members of multinationals engaged in excessive base erosion
- The tax is phased in at a rate of 5% for tax years beginning in 2018, 10% for tax years beginning from 2018 through 2025, and 12.5% for tax years beginning after Dec. 31, 2025
 - These rates are increased by 1% for certain banks and securities dealers
- Applies to groups with \$500 million in average annual global gross receipts over 3 years that engage in excess base erosion
- Exceptions for payments subject to withholding, services with no mark-up and certain derivative payments
- Cost of goods sold generally not included (exception for certain inverted corporations)

Deduction for foreign-derived intangible income

- New incentive for domestic corporations that earn "foreign derived-intangible income" (FDII)
- Generally provides a deduction of 37.5% of the sum of its FDII plus 50% of its GILTI
 - Subject to a taxable income limitation, determined without regard to the deduction
- Results in a 13.125% effective tax rate on excess returns on certain foreign derived income
- Deduction for FDII is reduced from 21.875% for taxable years beginning after Dec. 31, 2025
- Effective date – Taxable years beginning after Dec. 31, 2017



Industry Issues:

Key law changes impacting the wholesale distribution industry

LIFO preservation

- The preservation of the Last-in First-out ("LIFO") method of accounting for inventory critical to the wholesale distribution industry
 - Businesses cannot deduct the cost of inventory until product is sold
 - LIFO protects against the impact of rising costs due to inflation
 - Taxpayers would have taken a one-time hit on the write-off of the reserve

NAW was instrumental in this effort!!!

Impact of tax reform on wholesalers and distributors (cont.)

- The reduction of the corporate tax rate to 21% will help to level the playing field between wholesalers and those in other industries
 - Historically, wholesalers and distributors have had effective tax rates close to 35% while other industries have benefited from provisions resulting in more beneficial rates
- The Section 199A deduction should help the 65% of NAW members who operate pass-through businesses, however, incongruity still exists.
 - Conversion to C Corporation should be modeled and considered

Impact of tax reform on wholesalers and distributors (cont.)

- Heavily leveraged entities need to be cognizant of the revised interest limitation under Sec. 163(j)
 - Real estate businesses may make an irrevocable election out of the limitation, which may provide a planning opportunity.
- Due to the relationship-driven nature of the wholesaling industry, taxpayers should be aware of the elimination of the 50% deduction for entertainment costs
 - Consider review of how these expenses are tracked and if they can be easily separated from business meals

Should you convert to a C corp?

- Significant reduction in corporate tax, coupled with modest reduction in effective rate for pass-through income begs the question: Should your business convert?
 - Cash/Accrual basis conversion - Section 481 adjustments from S to C now 6 years v. 4 years
 - New tax-free distribution from accumulated adjustment account (AAA) according to ratio of AAA to accumulated E&P

Pass-through considerations – S Corporations

- Consider whether revocation of S election creates immediate or near-term tax exposure
 - Changes in methods of accounting
 - Potential gain or other issues on corresponding termination of QSUB
 - Pre-revocation transactions or elections
 - Triggering of one-time tax
- Consider long term effects such as the loss of the value of an amortizable step-up in basis when exiting the business

State and Local Tax Considerations

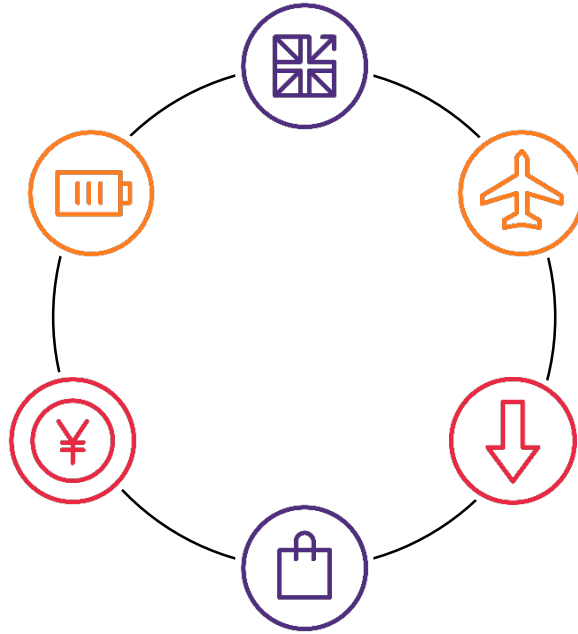
- ✓ State conformity provisions
 - ✓ A wide range of state tax implications will arise based on which states conform to the federal Internal Revenue Code provisions
 - ✓ Static conformity states have the ability to maintain conformity with the Code as it existed prior to federal tax reform
 - ✓ Rolling conformity states will automatically adopt the post-tax reform Code, though these states may already decouple from some of the adopted Code provisions based on the application of existing law, or decide to decouple from some of these provisions via state legislative action
- ✓ State reactions
 - ✓ Once conformity with the post-tax reform Code is achieved, we would expect states to react to some of the substantive provisions in the Code including decoupling from certain provisions like full expensing, and NOLs.



Summary and closing:

Final thoughts

Planning considerations



Planning considerations short-term?

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

Planning considerations short-term?

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

Planning considerations long-term?

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

Questions?



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