

ONE YEAR IN

Tax Reform Impact and Planning Strategies

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THE FMS FORUM
2019

OBJECTIVES

Share information that provides a deeper working knowledge of the impact of the Tax Cuts & Jobs Act (TCJA)



Discuss opportunities to save on taxes and what to focus on when planning your tax strategy



AGENDA



Opportunity Knocks: Tax Credits for New Markets, Low-Income Housing, Opportunity Zones, and Paid FMLA



Mergers and Acquisitions and BOLI Transfers, Oh My!



Anyone Have a Key? Turning the Lock on Savings, Planning Strategies, and Other TCJA Topics



Some Day, This Will All Be Yours: What's Ahead on the State Tax Horizon

OPPORTUNITY KNOCKS

Tax Credits for New Markets, Low-Income Housing, Opportunity Zones, and Paid Family and Medical Leave



REHABILITATION CREDITS

- **Historic Preservation Tax Incentive** programs
- **Encourages private investment** in rehab and re-use of old and historic buildings

BEFORE TCJA

Two-tiered federal credit for buildings subject to tax depreciation:

20% for the certified rehabilitation of certified historic structures

or

10% for rehab of non-historic, non-residential structures built before 1936

AFTER TCJA

- **Continues at 20%**
- **Allowed evenly over a five-year period**
- **Uncertified structures aren't eligible**

NEW MARKETS TAX CREDIT

WHAT

Credits **39% of invested dollars** against federal income tax

WHEN

Claimed over 7 years through CY19 (5% in years 1-3, 6% in years 4+) with carryover of unallocated credits through 2024

NOTES

- *General business credit (each dollar lowers the investment basis, formerly limited by alternative minimum tax, and tax cannot be brought to \$0)*
- *Not for low-income housing, so accounting doesn't typically follow ASU 2014-1*
- *Unallocated credit investment opportunities still available*
- *Reduction rate may impact this and other pricing*

LOW-INCOME HOUSING CREDIT

WHAT

Dollar-for-dollar reduction in federal tax

WHEN

Claimed over 10 years

NOTES

- *General business credit (each dollar lowers the investment basis, formerly limited by alternative minimum tax, and tax cannot be brought to \$0)*
- *Investors must invest in a limited partnership*
- *Must be a qualifying project for 15 years—if not, credit is subject to recapture (determined by rent/income tests and/or the sale of the building/partner's interest)*
- *Generally unaffected by TCJA (IRC §163(j) - interest expense deduction limitations)*

DIRECT PAY BONDS

WHAT

No new issuances

Mostly known as **tax-credit bonds**, holder receives credit in lieu of interest

Still applies to formerly issued bonds, thus **more valuable under TCJA**

NOTES

Examples:

- *Build American Bonds (BABs)*
- *Clean Renewable Energy Bonds (CREBs)*
- *Quality Zone Academy Bonds (QSCBs)*
- *Qualified School Construction Bonds (QSCBs)*

QUALIFIED OPPORTUNITY ZONES

WHAT

Gross income of gains reinvested in a Qualified Opportunity Zone

NOTES

State governors can designate up to **25% of low-income communities**, but must designate 25+ zones in total

Requirements:

- *Must be a fund investment made within 180 days of gain transaction*
- *No other election(s) are allowed for the respective gain transaction*
- *Some assets qualify for reinvestment (stock, partnership, business)*
- *90% of the investment fund's assets must qualify*

PAID FAMILY AND MEDICAL LEAVE

WHAT

12.5% - 25% for each hour of leave
(equal to percentage of wages paid)

WHEN

Tax years 1/1/18 to 12/31/19

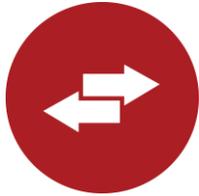
NOTES

- *General business credit*
- *Depends on amount of regular earnings replaced (12.5% covered if workers receive half of their regular earnings; increases at intervals to 25% if workers receive the full amount of regular earnings)*
- *Only applies to employees with 1+ years of seniority who were paid no more than \$72,000 for 2017 (ceiling will be adjusted for inflation moving forward)*
- *Must have a written policy that provides full- and part-time workers at least 2 weeks of paid leave and compensates 50% or more of their regular earnings*
- *Must offer paid leave to full- and part-time employees, and allow part-time employees to take a commensurate amount of pro-rated paid leave*

Mergers and Acquisitions and BOLI Transfers, Oh My!



MERGERS, ACQUISITIONS, AND BOLI TRANSFERS



Applies to transfer of BOLI policies

- IRC §101(a)(3)
- Applies to M&A transactions
- Not new—TCJA seeks to apply rules to “reportable policy sales”



Reportable policy sales

- Transfers of equity interests in entities owning policies in tax-free M&A transactions (carryover tax basis)



Once transferred for value, BOLI policies lose their tax-exempt status

- Death benefits taxed unless exempted

MERGERS, ACQUISITIONS, AND BOLI TRANSFERS



Doesn't apply to substantial business, financial, or family relationships

- Employee, director, and/or shareholder relationships appear to meet requirements



If exception isn't met...

- Target-owned policies become taxable investments and require information reporting
- Taxable income recognized on receipt of death benefit for amount exceeding the value paid for the policy plus premiums subsequently paid by the acquirer
- Deferred liability recognized at merger or acquisition closing and for subsequent increases to cash surrender value

MERGERS, ACQUISITIONS, AND BOLI TRANSERS



Information reporting requirements are suspended until new regulations are issued by the IRS (Notice 2018-41)



Proposal released on 3/22/19 shows favorable ruling for C corps

If the merger/acquisition target owns life insurance policies, there are no reporting requirements or additional income taxes if those policies are <50% of the acquired company's assets

ANYONE HAVE A KEY?

Turning the Lock on Savings, Planning Strategies, and Other TCJA Topics



ALTERNATIVE MINIMUM TAX

WHAT

Repealed—reduces complexity in federal tax law for C Corporations

WHEN

Tax years beginning 12/31/17

NOTES

- *Eliminates some of the complexity inherent in federal tax law*
- *Due to limit of 80% of taxable income on NOL utilization going forward, some level of “AMT” concept remains*
- *Can still use carryforward AMT credits to offset tax liability—all credits will be refunded by 2022*
- *For tax years beginning after 2017 and before 2021, can claim 50% of the excess minimum tax over allowable credits against typical tax liability*
- *Any remaining AMT credits will be refunded for tax years starting 2021*

NET OPERATING LOSSES

BEFORE TCJA

Used to zero out taxable income:

- **2 net operating loss (NOL) computations** (regular tax and AMT)
- AMT NOLs limited to **90% of AMTI**
- If taxable income exceeded \$550,000, **there still may have been an AMT payment**

Must maintain computations for NOLs generated before TCJA (not subject to new limitations)

AFTER TCJA

Limited to **80% of taxable income**

NOLs can't be carried back to a prior year, **but there is an indefinite carryover period**

Capital impact—no longer a two-year look-back

An example: assuming taxable income = \$100K, maximum NOL deduction = \$80,000

- Tax is still paid even if total NOLs exceed \$100,000
- No AMT? No AMT NOL computations necessary

DIVIDENDS RECEIVED DEDUCTION

WHAT

In effect, **no change in tax on dividend income**

WHEN

46-day holding period for common stock, 91-day for preferred stock

NOTES

Based on percentage ownership and holding period:

OWNERSHIP	DEDUCTION
Less than 20%	70% in pre-2018 50% in post-2017
20% to less than 80%	80% in pre-2018 65% in post-2017
80% or more	100% in pre-2018 100% in post-2017

CAPITAL INVESTMENT EXPENSES

WHAT

Section 179—**expense limit raised to \$1M** from \$510K for post-2017 tax years

NOTES

- *Under Section 179, can deduct/expense qualifying property costs rather than recover via depreciation*
- *Reduces \$1M amount (not below zero) by amount by which the cost of qualifying property placed in service during the tax year exceeds \$2.5M*
- *Removes references to qualified leasehold improvement, qualified retail improvement, and qualified restaurant property—replaces with “qualified improvement property”*
- *Can elect to include improvements to non-residential real property made after the property’s first-placed-in-service date, including:*
 - ✓ *Roofs*
 - ✓ *Heating, venting, and air conditioning property*
 - ✓ *Fire protection/alarm systems and security systems*

PERFORMANCE-BASED COMP. DEDUCTION

- **Can generally deduct reasonable compensation** for services that are ordinary and necessary business expenses
- **If publicly held corporation, deductible employee remuneration limited to \$1M per employee per tax year**

BEFORE TCJA

Performance-based comp. was exempt from \$1M limit

Various qualifiers for exemption, including:

- Tied to performance goals
- Overseen by a compensation committee
- Objective formula used to compute compensation

AFTER TCJA

- **No longer exempt from \$1M deduction limit**
- Adds performance-based compensation and commissions to the definition of “applicable employee remuneration”
- Must include when determining eligible employee compensation

ENTERTAINMENT EXPENSES

WHAT

100% of entertainment expenses are non-deductible, even if directly related to or associated with business

WHEN

Expenses paid or incurred after December 31, 2017

NOTES

- *Pre-TCJA deduction generally limited to 50%*
- *Significantly affects business deductions in proportion with the presence of a leisure element*
- *All forms of entertainment are expected to be non-deductible going forward, even if substantial and bona fide business discussions occurred, including:*
 - x *Golf outings and sporting events*
 - x *Fishing and sailing*
 - x *Theater and resort events*

ENTERTAINMENT EXPENSES (cont.)

WHAT

Event-related food and beverage expenses are still 50% deductible

Meals provided at employer-provided eating facilities no longer exempt from 50% disallowance

NOTES

50% deduction for food and beverage at event if:

- *An ordinary and necessary trade/business expense*
- *Not lavish or extravagant*
- *Taxpayer or employee present when food and beverage is provided*
- *Food and beverage is provided to a current/potential client, customer, consultant, or similar contact*
- *Must be purchased separately from entertainment and stated on a separate invoice or receipt*

PARKING

WHAT

No deduction for qualified transportation fringe benefits, including parking provided on or near business premises

NOTES

Depreciation expense is not a parking expense.

Includes direct and indirect expenses, such as:

- *Repairs and maintenance*
- *Utility costs*
- *Insurance, property taxes, and interest*
- *Snow, ice, and leaf removal*
- *Cleaning and landscaping*
- *Parking lot attendants*
- *Rent or lease expense (allocated portion of total rent expense if not separately stated)*

PARKING (cont.)

IRS Notice 2018-99 provides **two categories of qualified parking**:

THIRD-PARTY

- Employers that pay a third party for parking spots
- No deduction if provided to employees on a tax-free basis
- If amount of provided parking exceeds \$260/month:
 - ✓ Excess must be included in employee income
 - ✓ Allowed as wage expense if included in employee income

EMPLOYER-OWNED

- Employers that own or lease all or portion of parking facility
- Must use any reasonable method to calculate amount of disallowed deduction
- Use of the “value” of parking is not considered reasonable
- Calculated using a four-step approach to the Safe Harbor method

PARKING (cont.)

Safe Harbor method for calculating employer-owned costs:

1

Calculate cost of reserved employee spots

Percentage of spots reserved in relation to total spots available, multiplied by total parking costs

2

Determine primary use of remaining spots

During normal business hours on a typical business day. If 50% or more are used by the public, remaining costs are exempted from disallowance. If less than 50% are used by the public, move to Step 3.

3

Calculate cost of specifically reserved non-employee spots (e.g., customer-only parking)

Deductible amount is the % of reserved non-employee spots, multiplied by total parking costs

4

Reasonably allocate parking costs

Based on employees' use of the parking spots that remain after Steps 1-3

SOME DAY, THIS WILL ALL BE
YOURS

What's Ahead on the State Tax Horizon



STATE TAX HORIZON

WHAT

No longer need physical presence to collect tax from out-of-state sellers

WHEN

June 21, 2018, Supreme Court ruling on *South Dakota v. Wayfair*

NOTES

May result in lower nexus thresholds for financial institutions with multi-state customers

What should financial institutions do?

- ✓ ***Review out-of-state activities and state nexus requirements***
- ✓ ***Consider factor presence (sales, payroll, property, etc.)***
- ✓ ***Loans secured by out-of-state property could prompt nexus***
- ✓ ***Re-evaluate state income tax exposure under ASC 740-10 (“FIN 48”)***



QUESTIONS?

Thank you for your time!



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