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2017 Year-End Tax Planning

Introductions

Presenters

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Moderator

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COMMERCIAL TAXATION

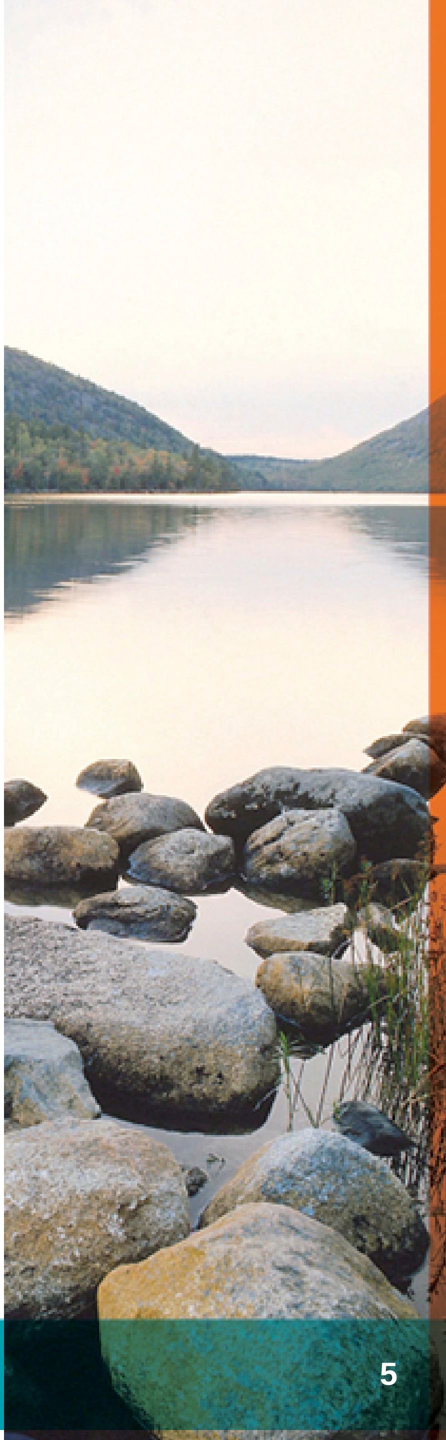
Richard Weiner, CPA, MST

Administrative Matters

- Due date changes
  - Federal due date for C corporations was moved from March 15 to April 15. All states are now in full conformity, with MA being the last state to ratify the change.
  - FBAR date moved from June 30 to April 15, with a six month extension period to October 15. The six month extension is now automatic.
- Changes to partnership (LLC) audit rules
  - Audit adjustments will be assessed directly to the partnership rather each individual partner.
  - Partnerships with less than 100 owners may elect out.
  - Applies for 2018; more information to come.

Protecting Americans from Tax Hikes (PATH) Act of 2015 – Tax Extender Legislation

- Extended or made permanent many provisions that had previously been renewed annually
- Permanent extensions
  - "Section 179" property expensing of $500,000, if acquisitions are under $2,000,000
  - Research Tax Credit, with payroll tax offset for startup companies
  - 100% gain exclusion for sales of Qualified Small Business Stock
  - 15-Year depreciable life for certain qualifying leasehold improvements
  - Reduced recognition period for Built-in Gains Tax (C corporation converting to S corporation), now 5 years



PATH Act (Cont.)

- Extended through 2019
  - Bonus depreciation (50% in 2016-17, 40% in 2018, 30% in 2019)
  - Work Opportunity Tax Credit
  - New Markets Tax Credit

Tangible Property Regulations & Depreciation

- Background
  - Regulations issued in 2013 & 2014; rules applicable to all taxpayers starting in 2014
  - Bright line test established for capitalization vs deductibility of repairs and improvements
- Changes effective in 2016
  - New safe harbor allowing 75% deduction for “remodel” and “refresh” of retail and restaurant space. Applies to entities whose financial statements are audited. Rule does not apply to some industries, including vehicle dealers.
  - The maximum De Minimis deduction for taxpayers whose statements are not audited increases to $2,500 from $500 per-item.
- Items capitalized under these regulations may still be eligible for immediate expensing (Section 179) or bonus depreciation
- Recordkeeping and asset tracking for GAAP vs tax treatment of repairs and additions can be burdensome

Tax Reform Considerations

Legislative Process

- House tax writing committee → House Ways & Means → House Vote
- Process scheduled to be completed prior to Thanksgiving, if not sooner.
- Senate concurrently drafting their own draft of the legislation, the details of which will be released after the House vote. After their own deliberations, a vote will occur.
- House and Senate members form a conference committee to develop a final bill based on areas of agreement, and compromise where needed.
- After both the House and Senate vote on the compromise legislation, the bill moves to the President’s desk for signature.
- Congress’ desire is to complete their process prior to the Christmas holiday

Tax Reform Considerations

Legislative themes (Individual taxation)

- Four individual tax rates: 12%, 25%, 35%, 39.6%
- Elimination or caps on many itemized deductions
- Elimination of Alternative Minimum Tax
- Elimination of itemized deduction phase-out (“Pease Limitation”)
- Elimination of exemptions but doubling of standard deduction
- Phase-out and eventual elimination of Estate Tax

Tax Reform Considerations

- Legislative themes (Businesses and Investors)
  - 20% tax rate on C corporations
  - One time preferential tax rate on repatriation of foreign income, contingent on if and how funds are reinvested in the US
  - No change to 20% tax rate on dividends and capital gains
  - 25% rate on income from flow through entities, with significant differences for Active vs Passive investors, including imposition of Self-Employment Tax on a portion of S corporation income
  - Immediate expensing of all fixed asset purchases
  - Elimination of a portion of deduction for interest expense
  - Elimination of most tax credits, with notable exceptions being the Research Credit and Low Income Housing Credit

Overall, the proposals look to broaden the tax base by reducing tax rates in exchange for the elimination of a number of deductions and credits.

Tax Reform – What To Do Now

- Recognize that proposals appearing in the news are just…proposals.
- Focus on proposed effective dates, most to occur in 2018
- Potential for high earners to accelerate deductions into 2017 (assuming no Alternative Minimum Tax impact)
- Watch for changes in tax brackets (not just rates)
- Depending on when law is enacted, some last minute adjustments to previously completed tax planning may be advisable.

- Call your AAFCPAs Tax Advisor with questions.

MULTISTATE TAXATION

Bella Amigud, CPA, MST

Nexus: Background

- Nexus = Connection or presence in a state sufficient to subject to state taxes
- States prefer to tax out-of-state businesses as opposed to in-state businesses (“tax exporting”)
- U.S. Constitution restricts a state’s right to impose taxes – Due Process Clause Test and Commerce Clause Test
- Nexus Standards – Physical presence, Agency Nexus, Affiliate Nexus, Economic Nexus
- Nexus standards depend on the types of taxes – Sales Tax, Income Tax, Other taxes
- Physical presence required for Sales/Use Tax Nexus

Economic Nexus

- Purposefully directing business activity to a state regardless of the physical presence in the state

- There are different levels of economic nexus standards
  - Factor Presence Economic Nexus Standard – Bright Line Test
  - General Economic Nexus Standard – No Minimum Activity
  - Potential Economic Nexus – No Formal Codification

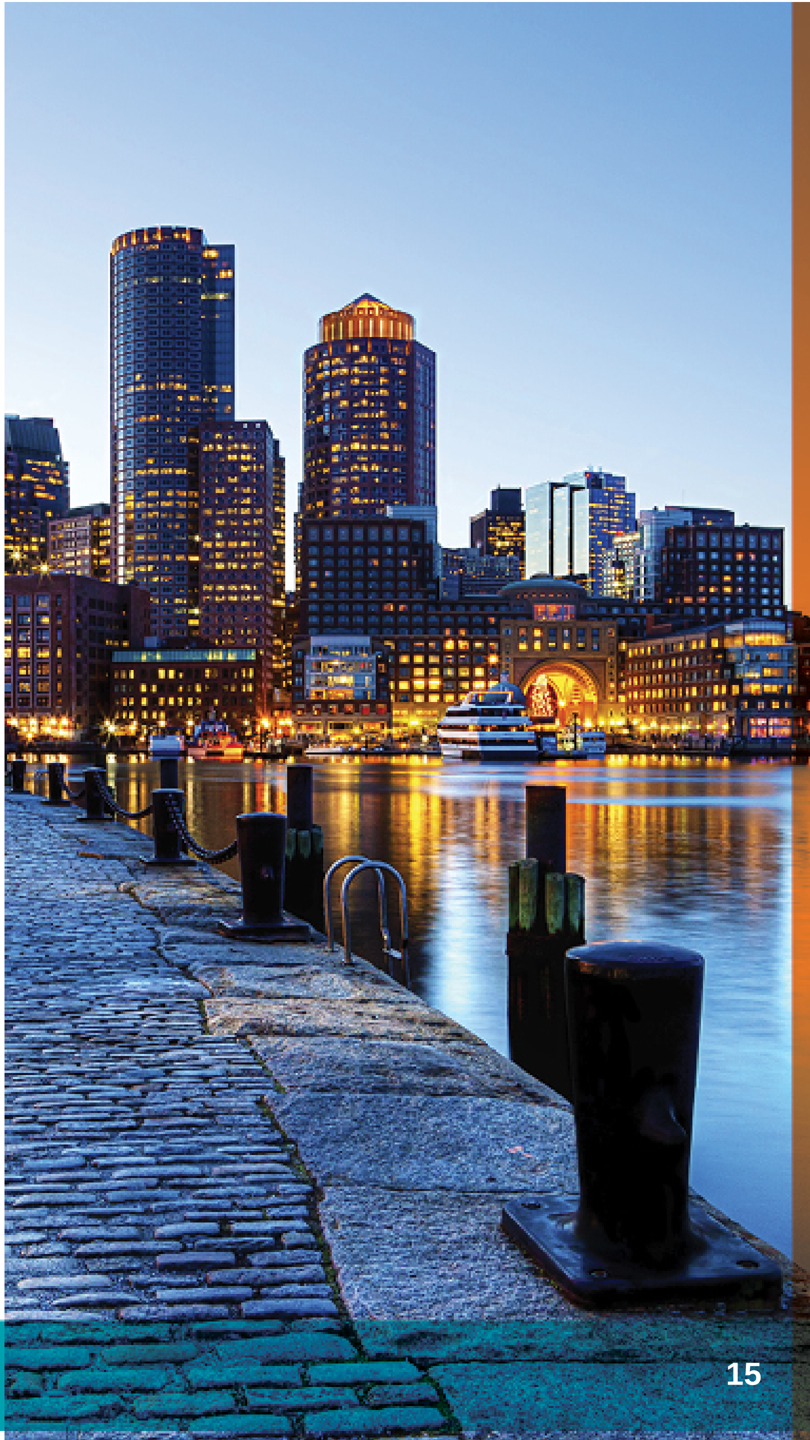
- The different standards provide varying levels of potential nexus risk by state

- Public Law 86-272 protects a seller of tangible property from being subjected to income tax regardless of economic nexus

Factor Presence
Economic Nexus States

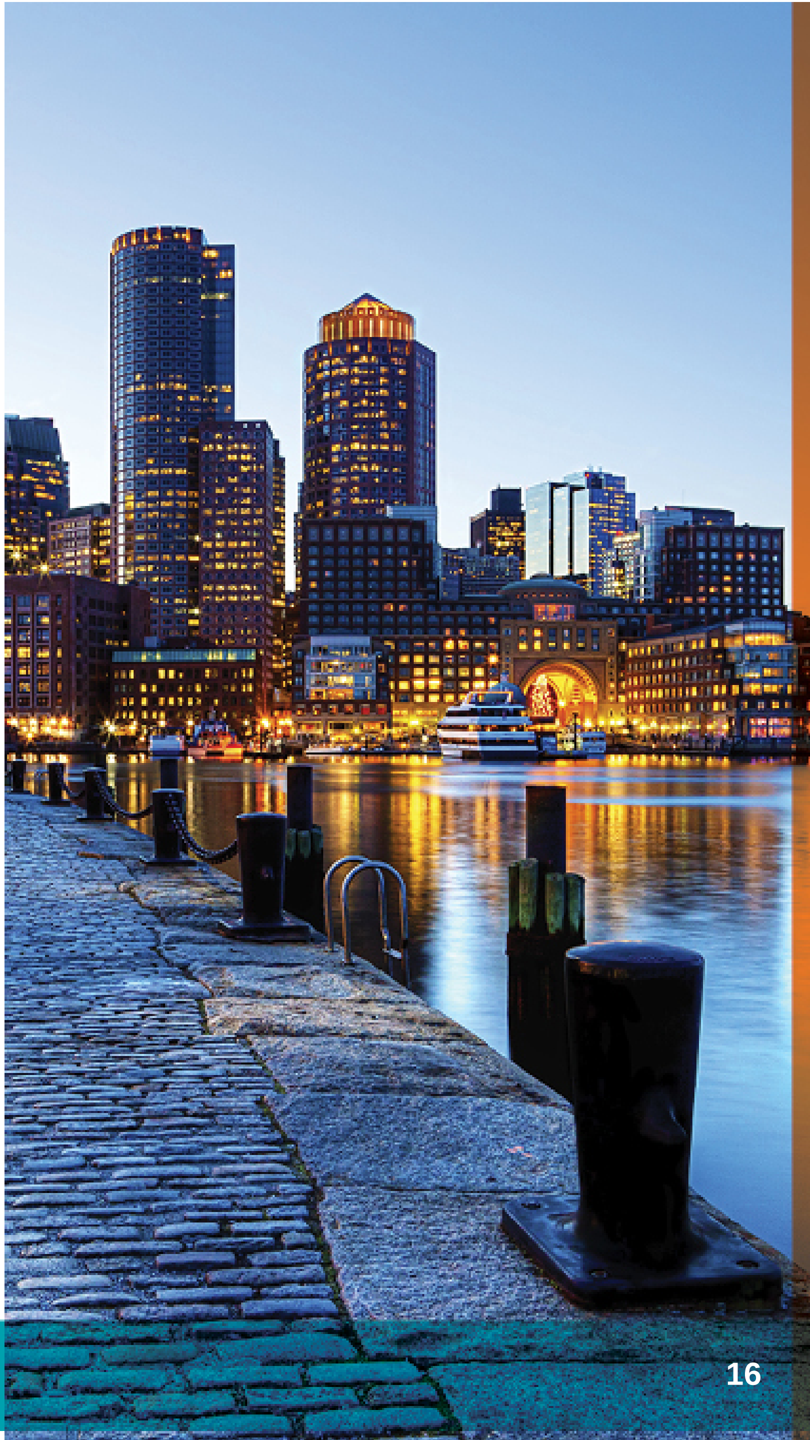
- AL ($500K sales or $50K property/payroll)
- CA ($530K sales or $53K property/payroll)
- CO ($500K sales or $50K property/payroll)
- CT ($500K sales)
- MI ($350K sales)
- NY ($1M sales)
- OH ($500K sales or $50K property/payroll)
- TN ($500K sales or $50K property/payroll)
- VA (any positive factor)
- WA B&O Tax ($267K sales or $53K property/payroll)

For states with three factor thresholds, 25% of any factor would create nexus as well.



General Economic Nexus States

ME	OK
MA	OR
MN	RI
NH	UT
NJ	WI

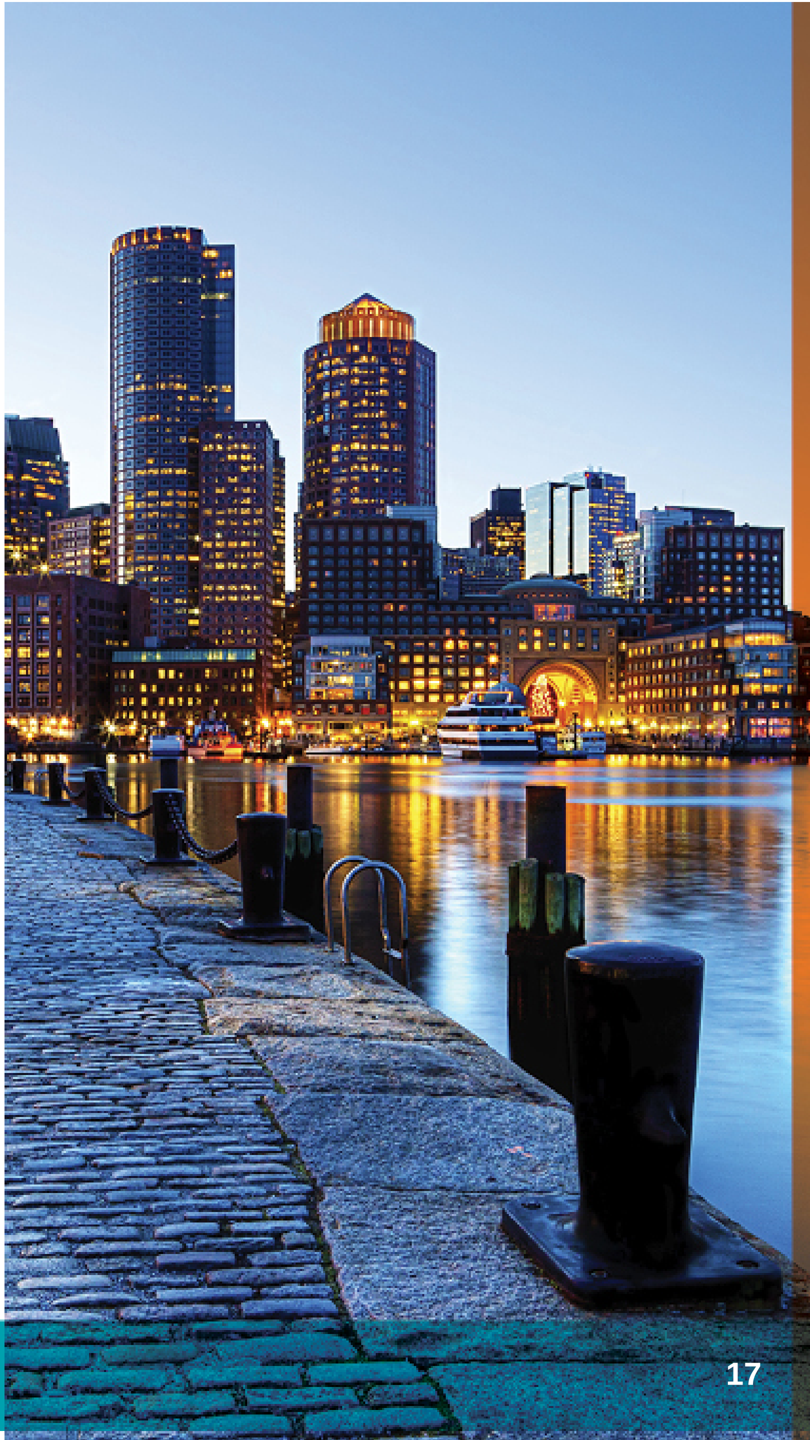


Potential Economic Nexus States

AZ
AR
FL
GA
HI
ID
IL
IN
IA
KS
KY
LA

MD
MS
MO
MT
NE
NM
NC
ND
SC
VT
WV

In general, these states "impose a tax on every corporation doing business in the state."



No Formal Codification or Indirect Reference to Economic Nexus

AK

DE

DC

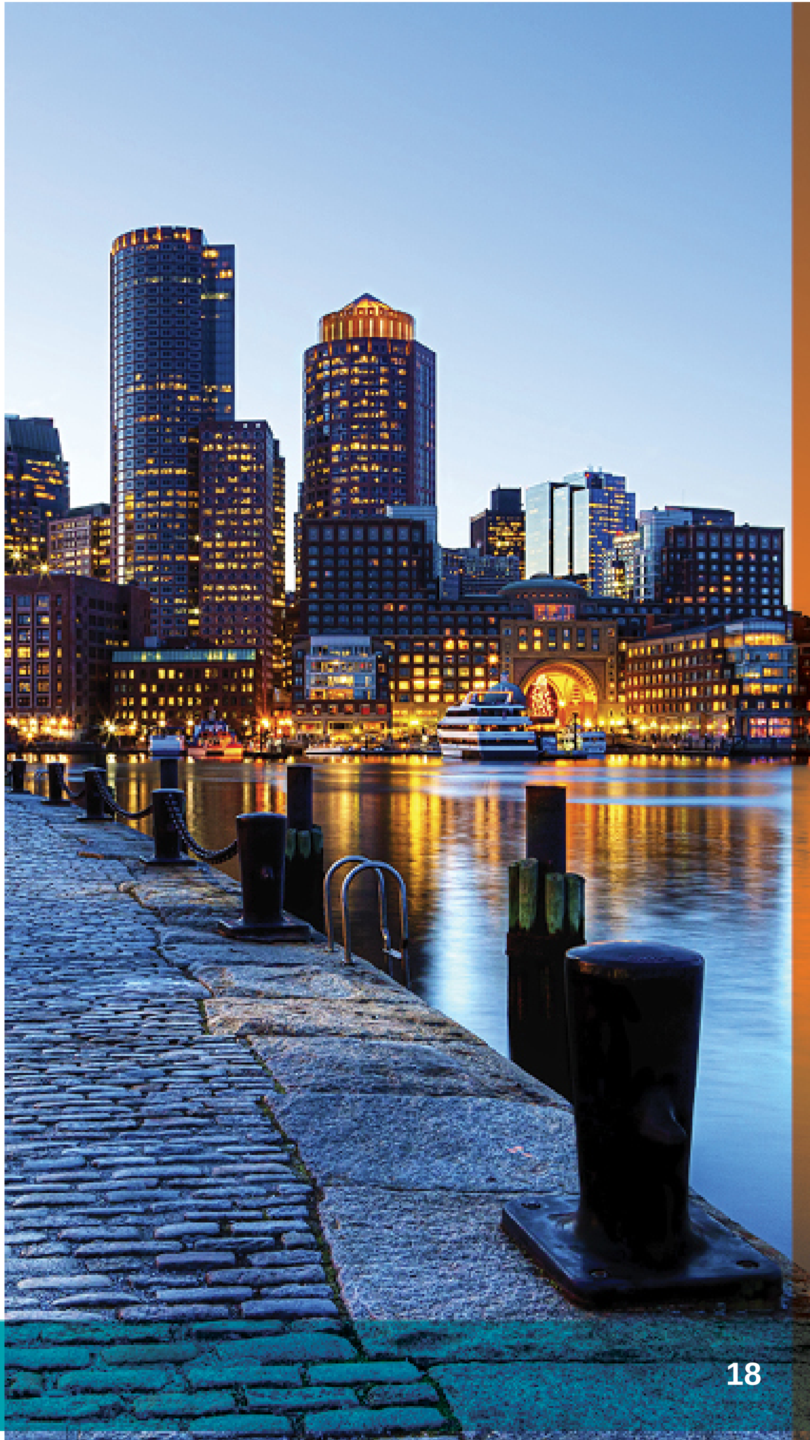
NV – Not Applicable

PA

SD – Not Applicable

TX

WY – Not Applicable



Benefits and Potential Pitfalls of Nexus

- Must have Nexus in 2 or more states in order to have the right to apportion income

- Benefits of Nexus
  - Apportionment can result in less than 100% of income being taxed
  - If apportionment allowed, have ability to shift income to lower tax rate jurisdictions

- Potential Pitfalls of Nexus
  - Apportionment could result in more than 100% of income being taxed
  - If shipping goods from a state that has throwback rule, must have Nexus in destination state to avoid throwback of sales

Apportionment Overview

Generally, three factors – **Payroll, Property** and **Sales**

- **Payroll** and **Property** are typically straightforward
  - Payroll – where the employee is located or services performed
  - Property – State in which property is located

- **Sales** depends on how the receipts are generated (sale of Tangible Personal Property (TPP) vs. non-TPP)
  - TPP – General rule is destination
  - Non-TPP – Typically one of four methods
    - Cost of Performance – Majority of Costs
    - Cost of Performance – Allocation of Costs
    - Time – Allocation of Costs
    - Market-Based Sourcing

Sales Factor Sourcing: Services

- In order to tax more out-of-state businesses, more states are adopting a single-sales or weighted sales factor apportionment (currently 35 states) with market-based sourcing apportionment methodologies (currently 23 states).

- Based on current sourcing methodologies, apportionment can result in more or less than 100% of income being taxed.

- Example: work performed in MA for an OR company:
    - MA would classify receipts as OR based on market-based sourcing
    - OR would classify receipts as MA based on COP
    - Since OR is an economic nexus state, these would be “nowhere sales”
- Reverse example: work performed in OR for a MA company:
    - MA would say the revenue should be sourced to MA
    - OR would say the revenue should be sourced to OR
    - Result: double allocation of revenue

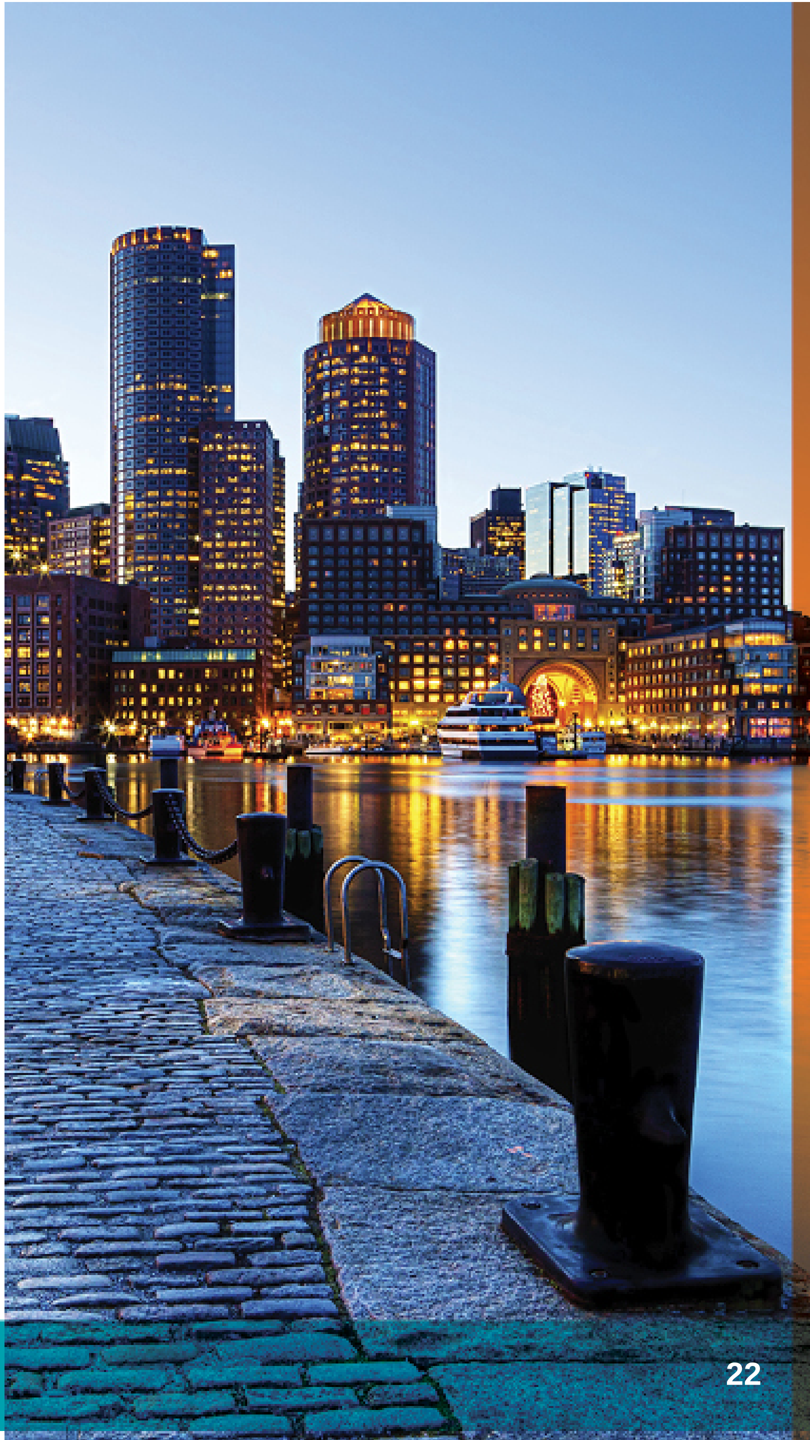
Market-Based Sourcing 2018 Adoptions

MT

NC*

OR

*NC bill introduced to Congress which would institute Market-Based sourcing – will likely apply to 2018 tax year



Sales Factor Sourcing: Tangible Personal Property

Throwback Rule

- The states attempt to close the state corporate tax loophole of "nowhere sales"
- If a corporation with facilities in the state has income that is not taxed by any state, then that income is "thrown back" and taxed in the state where the company has facilities or where the company is domiciled
- 27 states have adopted a throwback rule

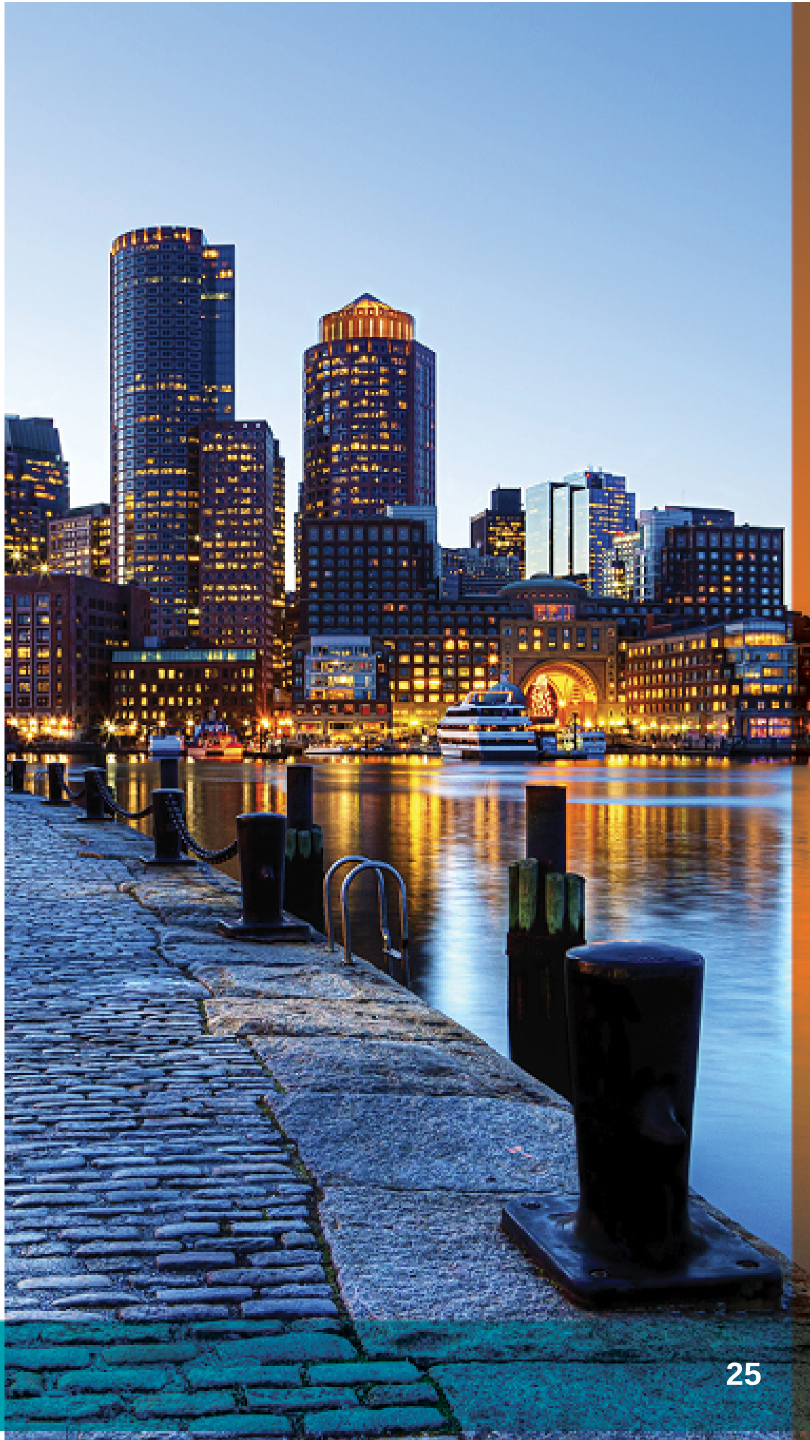
Sales Factor Sourcing: Services

Throw out Rule

- Another of the states' attempts to close the state corporate tax loopholes of "nowhere sales"
- Excludes from the numerator and denominator – or "throw out" – receipts attributable to a state or foreign country "in which the taxpayer is not subject to a tax on or measured by profits or income, or business presence or business activity"
- 7 states have adopted a throw out rule for service revenue

Planning Opportunities

- Selling through online retailers
- Expanding manufacturing or distribution operations to new states
- Adding salespeople or other employees in additional states
- Registering to do business in a new state
- Any change in operations in your current locations



What Happens If You Identify A Potential Exposure?

- Don’t ignore it!

- AAFCPAs can assist with determination of potential tax liability exposure and benefits for apportioning and filing in other states

- Potential resolutions could include:
  - Do nothing – You may want to live with risk (ASC740 issue)
  - File prospectively and risk the state contact for prior years (also ASC740 issue)
  - File returns back to the date exposure started (penalties and interest will likely be assessed)
  - Seek out an anonymous voluntary disclosure agreement (VDA) with AAF assistance that will limit the look-back period (usually 3-4 years), abatement of penalties and partial abatement of interest (some states)

State Amnesty Programs

- Amnesty is a governmental act of pardon
- States provide a time period when taxpayers can file late tax return and pay off any outstanding tax debts without penalty and a portion of interest
- Amnesties solve 3 types of tax problems:
  - Late tax returns
  - Taxes owed
  - Understated tax liabilities
- States will specify which types of taxes are included
- Upcoming amnesty programs in CT, OH, RI, SC, and TX
- OK is in process, expiring at the end of November

INDIVIDUAL & FAMILY TAXATION

Joshua England, JD, LLM

Importance of Tax Planning

- **Tax planning** is the art of arranging your affairs in ways that postpone or avoid **taxes.**

- You should not change your financial behavior solely to avoid **taxes.**

- Truly effective **tax planning** strategies are those that permit you to do what you want while reducing **tax** bills along the way.

- By knowing and understanding important tax laws and regulations you can avoid some potentially huge mistakes that could cost you significant amounts of money.

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GOP Tax Plan - Individuals

- Standard deduction increases to $12,000 for individuals
- Four tax brackets – 12%, 25%, 35% & 39.6%
- Increase child tax credit to $1,600
- Retains the Earned Income Tax Credit
- Non-refundable credit of $300 for non-child dependents
- Repeals the Alternative Minimum Tax
- Eliminates Most Itemized Deductions
  - Except personal property taxes up to $10,000
  - Except charitable deductions
  - Home Mortgage Interest for existing mortgages and new homes up to $500,000
- Eliminates Personal Exemptions
- Retains current 401(k) and IRA provisions
- Eliminates the death tax

GOP Tax Plan - Businesses

- Maximum tax rate of income from sole proprietorships, partnerships and S-Corps to 25%
- Reduces corporate tax rate to 20%
- Eliminates the Alternative Minimum Tax
- Allows business to write-off or “expense” new investments in depreciable assets
- Preserves R&D Credits and Low-Income Housing Credits
- Repatriated earnings taxed at a one-time 20% rate
- No longer taxes foreign profits of US companies

Year End Tax Planning

- Can Tax Reform be passed?

- Senate rules require that any legislation that increases the deficit in the long term must be passed with 60 votes

- GOP Bill would likely increase the deficit by more than a trillion dollars over the next decade

Tax Rates

- Businesses may want to defer bonuses and income to 2018 if the maximum tax rate is 25%
- Taxpayers should look closely at maximizing IRA and similar contribution deductions in the 2017 return.
- Rare taxpayer who would incur the taxes to convert to a Roth IRA
- Everything turns on the taxpayer's particular circumstances and detailed calculations, projections

Capital Gain

- Those at top capital gains rates of 23.8% (including the 3.8% Medicare surtax) will still want to harvest losses and defer gains
- Those in the bottom tax brackets want to harvest capital gains at the 0% rate
- The 3.8% Medicare surtax is eliminated under the GOP Plan

Deductions

- Pay fourth quarter *state* estimated taxes by December 31st, instead of in early January by the deadline (though notably, this won't help anyone who is already subject to the AMT this year)
- Pay large medical expenses before the end of the year

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Retirement Savings

- Establish a 401(k)
  - Must establish before end of year but do not have to fund until return is due (including extensions)
  - For 2017, self-employed individuals may contribute the lesser of $56,000 or 100% of self-employment income
- Catch-Up Contributions
  - If age 50 or older, you may make an additional contribution of $6,000 to your 401(k) of up to $6,000 in 2017
- Establish a Spousal IRA
  - A spouse with little or no income and not active in an employer sponsored plan can still have an IRA
  - Can contribute up to $5,500 and have it deductible. Deduction begins to phase out at AGI of $183,000

Retirement Savings (cont.)

- Balance Tax Inefficient Assets
  - Consider allocating taxable bonds to IRAs and 401(k)s
  - Allocate low turnover long term capital assets to personal accounts
- Roth IRA Conversions
  - If in a lower bracket, convert IRA up to next bracket
  - If you have a Net Operating Loss about to expire, use it to convert to a Roth IRA
- Pay account management fees and broker’s commissions individually, instead of allowing the account to fund these amounts
- Consider the gift of an IRA or a Roth IRA contribution on behalf of a working child or grandchild

Charitable Donations

- Charitable Donations – Replace Donated Securities to Refresh Basis
  - Taxpayer has XYZ stock with a basis of $10 and FMV of $100
  - Donates $100 XYZ stock and buys $100 of XYZ stock gets a step-up in basis of $90

- Donate Total Annual Contributions to Donor Advised Fund
  - Only need one receipt for verification purposes
  - Then request DAF to make charitable contributions

- Maximize any planned charitable contributions before the end of the year

Charitable Donations (cont.)

- Consider a Charitable Remainder Trust to defer capital gains on sale of appreciated assets

- Consider Gifts of IRAs to Charity

  Can directly “rollover” up to $100,000 to a charity with no tax consequences

- Cannot deduct value of time but can deduct $0.14 per mile

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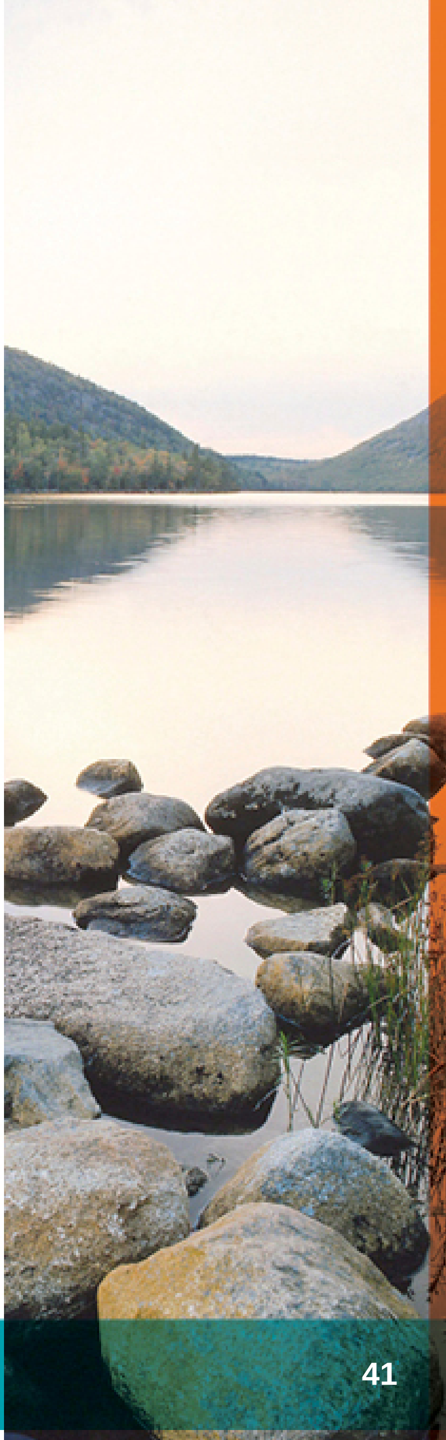
Estate & Gift Tax Planning

- Elimination of Estate Tax but not Gift Tax under GOP Plan
- Federal combined Estate & Gift Tax exemption of $5,490,000 for 2017
- Massachusetts exemption of $1,000,000
- Estate Tax Planning now requires income tax planning as well
- Consider step-up in basis by keeping assets in your estate
- Consider setting-up trusts in no tax jurisdiction to avoid the state income tax

Year Round Tax Planning

- Adopt a multiyear perspective in reviewing your tax situation
- Consider the effect of the Alternative Minimum Tax
- View Transactions with regard to both their economic and tax implications
- Stay engaged with tax changes being considered
- Review your tax situation with your AAFCPAs Tax Advisor on a regular basis



Questions & Comments

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