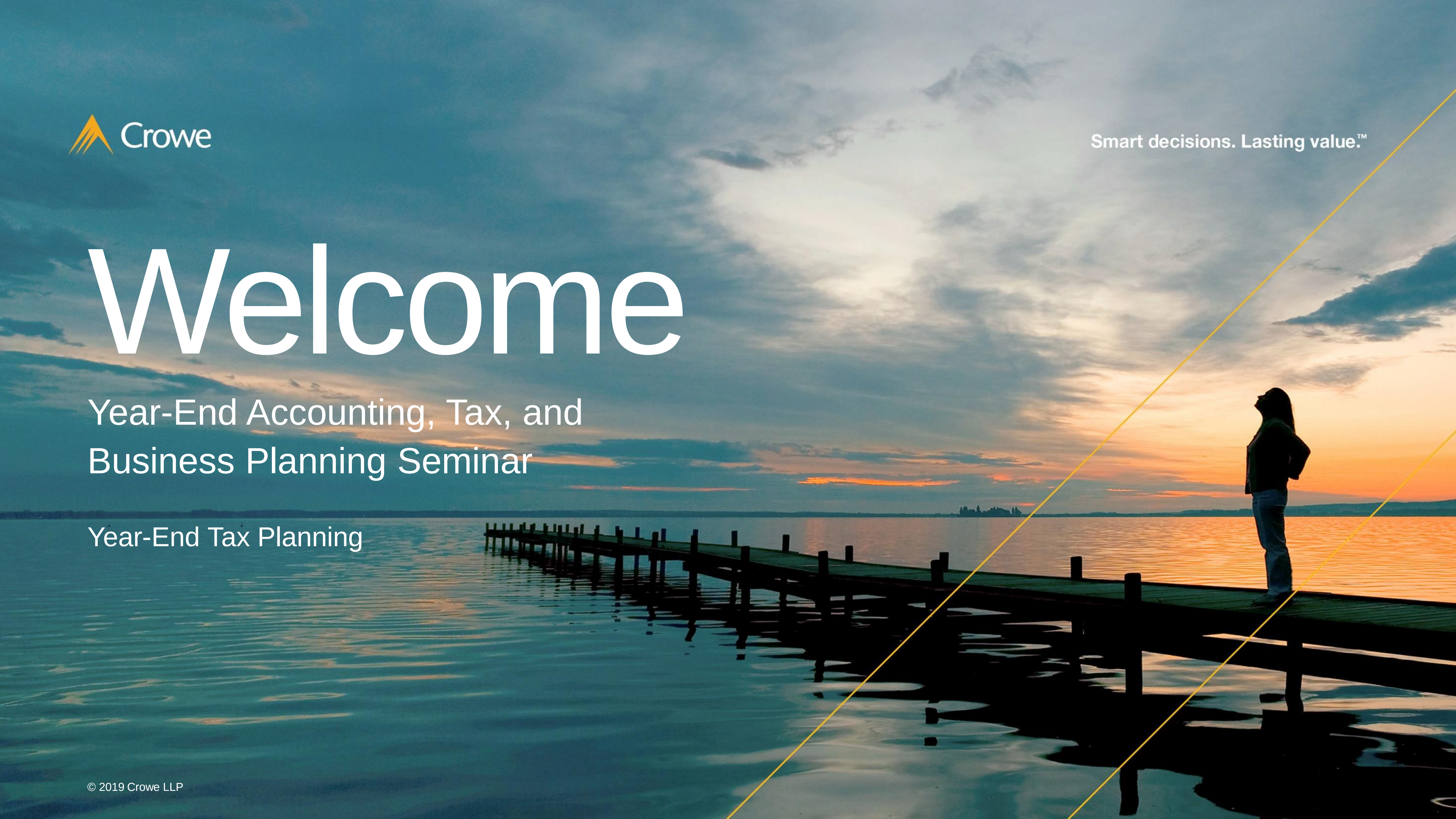

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Welcome

Year-End Accounting, Tax, and Business Planning Seminar

Year-End Tax Planning

Agenda

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Washington outlook

Washington outlook

"It is easy to be skeptical of Congress' ability to complete their work on schedule, and it would not be surprising if they kick the can into 2020 for much of their to-do list. But, as the tax writing committees are still negotiating an end-of-year package, it's crucial to keep in mind the policy and political pressures that will influence any potential final deal. The political pressures are easily seen in the headlines of the day, but tax-writing lawmakers are trying to keep focused on the substance as best they can.**

The various legislative puzzle pieces will have to be assembled in the proper sequence and proportion to attract the greatest number of votes in both chambers. Since Congress is split between the two parties, it will take a precise balance of tax benefits to various constituencies versus potentially lost revenue to survive the legislative process."

Peter F. Judge,
Government Relations Manager
Crowe LLP

2019 Tax Legislative Update

- Congress is working toward a year-end tax package.
  - Likely to be several different policy areas cobbled together.
- Reports are conversations continue to be positive and fruitful, but slow in progress.

TCJA Technical Corrections

- A technical corrections bill would fix errors in the 2017 tax law. Lawmakers have introduced bills to fix some high-profile errors, but there isn't yet a comprehensive package.
  - H.R. 1869, S. 803, The bill would correct the "retail glitch," which prevents restaurants and retailers from immediately writing off the cost of interior improvements.
  - H.R. 1223 House Majority Whip James E. Clyburn (D-S.C.) and Ways and Means member Tom Suozzi (D-N.Y.) introduced a bill to repeal a 21% tax rate on nonprofits' fringe benefits, such as free parking and mass transit.

- **House**: The Ways and Means Committee approved a bill (H.R. 3300) in June that included a repeal of the taxation of fringe benefits. Chairman Richard Neal (D-Mass.) has said that he wants to have more hearings before addressing other fixes.

- **Senate**: Republicans would need Democratic support to rectify the errors. Senate Democrats have said that any fixes will be subject to heavy negotiation.

- **House and Senate:** Fixing some errors, such as the "retail glitch," has bipartisan support.
  - Other fixes might happen if the Republicans agree to some Democratic priorities such as expanding the earned income tax credit or the child tax credit.

Tax Extenders

- H.R. 3301, S. 617
  - The measures would extend various tax breaks targeted to industries and individuals on a temporary basis. The expired tax breaks include perks for biodiesel, rail, and other industries.
- **House**: The Ways and Means Committee approved H.R. 3301 by a vote of 25-17 on June 20.
- **Senate**: The Finance Committee may hold a hearing or markup regarding extenders in the fall.

- Many extenders have bipartisan support and could be attached to funding legislation this fall. But several have also lapsed for close to two years without renewal, and major tax provisions packaged with them in the past have been made permanent, calling into question whether there is as much support to pass them.

SALT Deduction Reintroduction

- H.R. 1142, S. 437, H.R. 257, H.R. 188
  - The measures would repeal the 2017tax law's $10,000 state and local tax deduction cap. The cap has hit residents in high tax states such as New York and Connecticut.
- **House and Senate**: The bills have been referred to the House Ways and Means and Senate Finance committees.

- **Senate**: Many Republicans have criticized Democrats for pushing a policy that would largely benefit high earners in certain states.

- **Administration**: The White House has given no indication that it would be in favor of repealing the SALT cap and the Treasury Department recently issued regulations that invalidated some state workarounds to the cap.

Secure Act – Retirement Plan Reform

- H.R. 1994, H.R. 2481, S. 1370
  - The “Gold Star Fix” would end an inadvertent tax increase on military survivors’ benefits included in the comprehensive tax law enacted in 2017.
- **House**: The House passed H.R.1994, the Setting Every Community up for Retirement Enhancement (SECURE) Act, a broad retirement policy reform package that includes the fix on May 23 by a vote of 417-3.

- **Senate**: H.R. 1994 has stalled due to objections from some Republicans. If Majority Leader Mitch McConnell (R-KY.) can overcome those objections, he would likely bring it to the floor fora unanimous consent approval.

- **Administration**: No stated position, but the administration would likely support the fix.

Other Legislative Priorities

- Earned Income Tax Credit/Child Tax Credit Expansion
  - The bill could be negotiated as part of broader compromise making technical corrections to the 2017 tax law. But it isn't clear if there could be such an agreement. The Senate is unlikely to pass it as a standalone measure

- Electric Vehicle Tax Credit
  - The electric vehicle legislation could be attached to a larger tax extenders bill later this year.

Selected Expiring Provisions – 12/31/2019

- Work opportunity credit
- New markets tax credit (no new credits granted after December 31, 2019)

Tax Reform – Where are we now?

Tax Reform – Where are we now?

- Status of Key IRS Guidance:
  - Final bonus depreciation regulations do not have a Qualified Improvement Property fix
  - Still waiting on final regulations under Section 163(j) including:
    - Guidance on Cost of Goods Sold Depreciation
    - Treatment of carryforwards of disallowed interest expense in tiered partnerships
  - No guidance yet on interplay of Section 382/383 and refundable AMT credits
- Are pass through entities still the right choice or would a C corporation conversion be warranted?
- Status of SALT workarounds.

Uniform Capitalization of Costs (UNICAP) Opportunities

UNICAP – New Items From Final Regulations

- Final regulations issued on 11/29/2018 (TD 9843) and apply to tax years beginning on or after November 20, 2018 (e.g., calendar year 2019)

- Modified Simplified Production Method (MSPM) is a new simplified method for producers

- New treatment of “negative” adjustments
  - Unfavorable Book-Tax adjustments resulting in a reduction to Section 263A costs

- New Definition of Section 471 Costs (Alternative Method)
  - Cost capitalized for financial reporting purposes, but must include all direct costs.
  - *De minimis* rules and safe harbor
    - Direct Materials
    - Direct Labor
    - Variances

UNICAP – Section 471 Costs & Alternative Method

- General rule – Section 471 costs are the <u>types</u> of costs, other than interest, that a taxpayer capitalizes to property produced or property acquired for resale in its financial statement
    - Must take the tax amounts into account

- New alternative method – taxpayer may determine the amounts of Section 471 costs by using the <u>amounts</u> of such costs that are incurred in financial statements
    - Must include all direct costs of property produced or acquired for resale
        - New de minimis rules and safe harbor for uncapitalized direct costs (including variances and cash and trade discounts) as additional section 263A costs
    - Cannot include any financial statement write-downs, reserves or other financial statement valuation adjustments
    - Book/tax difference in Section 471 costs generally treated as additional Section 263A costs
    - Available to taxpayers that:
        - Have audited financial statements
        - Use MSPM, simplified resale method, or small taxpayer (< $50M Gross Receipts) using the simplified production method.

- New alternative method is consistent with what most taxpayers do in practice (i.e., referencing book cost types and amounts)
    - Section 471 costs are the types of costs capitalized for F/S purposes but using the book amounts of such costs incurred in the tax year.

UNICAP – Negative Adjustments

Large taxpayers (> $50M Gross Receipts) currently using the simplified production method are generally prohibited from classifying negative adjustments as additional Section 263A costs

Negative adjustments are only permitted as additional Section 263A costs for:

- Taxpayers using the Modified Simplified Production Method
- Taxpayers using the Simplified Resale Method
- Small Taxpayers (< $50M Gross Receipts) using the Simplified Production Method

Examples of common negative adjustments:

- Section 174 costs and certain distribution costs
- Unfavorable book/tax difference related to production expenses capitalized for book purposes, such as plant related depreciation and employee expenses

Tangible Property Regulation Opportunities

Tangible Property Regulations – Repairs Redetermination

- Most taxpayers filed accounting method changes (Form 3115) with their 2014 federal income tax returns to comply with the final tangible property regulations for the 2014 tax year.

- The final regulations presented opportunities to immediately deduct previously capitalized repairs and maintenance expenditures.
  - Example: Taxpayer previously capitalized roof repairs and recovered costs through depreciation over 39 years. A change in method of accounting was made to comply with final regulations and immediately expense these costs as repairs and maintenance.
- Many taxpayers decided to forego accelerated tax deductions when complying with the final regulations and continue following their book capitalization criteria.

Tangible Property Regulations – Repairs Redetermination

- Taxpayers are generally unable to change a method of accounting under the automatic change procedures if they filed a change for the same item within the last 5 tax years.

- With the 5-year period expiring for 2014 method changes, taxpayers can revisit their existing methods for repairs and maintenance expenditures.

- Method change can produce the following benefits:

  - Accelerated tax deductions – immediate cash tax benefits.

  - Audit protection for prior tax years.

Opportunity zones

Opportunity Zones

The *Tax Cuts and Jobs Act of 2017* created the Qualified Opportunity Zone, a new tax incentive codified in IRC Sections 1400Z-1 and 1400Z-2 that is designed to reward investors for making long-term reinvestments in economically underdeveloped zones.

If a taxpayer elects to defer gain and reinvest in a Qualified Opportunity Fund (QOF), the benefits include tax deferral and, if holding periods are met, the exclusion of a significant portion of the gain. Following are examples of the benefits taxpayers can experience from reinvesting in a QOF:

- If a taxpayer sells an investment and reinvests an amount equal to the gain in a QOF, the gain on the old investment is deferred. The deferral is available until the earlier of the sale date of the QOF or Dec. 31, 2026.
- If an investment in a QOF is held until at least December 31, 2026, the deferred gain is recognized. The deferred gain recognized is the lesser of the following, less the basis in the QOF investment:
  - The original deferred gain
  - The fair market value of the QOF
- The initial basis of the QOF investment is zero.

Opportunity Zones (con't)

- If a QOF investment is held for at least five years, a portion of the deferred gain converts to basis in the QOF. Ten percent of the deferred gain is added to basis after five years, and an additional 5 percent is added to basis in the seventh year, for a 15 percent total basis increase in the deferred gain. Because this is an increase to the basis of the QOF investment, it has the effect of lowering the gain recognized in 2026.
- Any deferred gain recognized in 2026 (or earlier upon sale of the QOF) adds to the basis of the QOF investment.
- If an investment in the QOF is held for 10 years, all gain from the QOF attributable to the 10-year period is excluded from income. The exclusion is accomplished by increasing the basis in the QOF to its fair market value at the date of QOF sale.
- Effectively, the maximum gain exclusion equates to 100 percent of the QOF gain and 15 percent of the original deferred gain. This assumes an original investment gain that is deferred in 2018 or 2019 combined with a QOF investment held at least 10 years.

Opportunity Zones (con't)

Example One

A taxpayer owns an asset with a fair value of $25 million with a basis of $5 million that would result in $20 million of capital gain if sold. If the taxpayer sells the asset in 2018 and reinvests at least $20 million of proceeds in a QOF, the taxpayer can defer recognition of the $20 million gain. The taxpayer would recognize the following portion of the deferred gain based on when the QOF is sold:

- $20 million (full deferred gain as the five-year basis increase is not reached)
- $18 million (10 percent basis increase in year 5)
- $17 million (15 percent basis increase in year 7)

If the taxpayer sells the QOF in 2026 for $30 million, the initial zero basis in the QOF will increase to $20 million. Three million dollars (15 percent of the $20 million deferred gain) is excluded from income, and $17 million of the deferred gain is recognized. The gain on the sale of the QOF will be $10 million. The total gain recognized is $27 million: $17 million of the original $20 million of deferred gain plus $10 million of gain on the QOF. This provides for a net gain exclusion of $3 million.

Opportunity Zones (con’t)

Example Two

Assume the same facts as in example one, but the taxpayer sells the QOF for $40 million in 2029, more than 10 years after the QOF investment.

On Dec. 31, 2026, the taxpayer recognizes $17 million of the $20 million deferred gain. The basis in the QOF is increased to $20 million, 15 percent of the $20 million deferred gain and the $17 million gain recognized.

Upon the sale in 2029, the basis in the QOF is stepped up to its fair market value of $40 million. When the taxpayer sells the QOF in 2029, no additional gain is recognized. This provides for $23 million of net gain exclusion.

Section 1202 Qualified Small Business Stock Opportunities

Qualified Small Business Stock - Requirements

- Under Section 1202, gain from the sale of qualified small business stock (QSBS) is eligible for an exclusion from income.
- Changes made by the Tax Cuts and Jobs Act (TCJA) have caused businesses to reevaluate their choice of entity structure.
  - The reduction of the corporate tax rate from 35 percent maximum to a flat 21 percent have caused some to consider whether a C corporation structure versus a flow-through structure (e.g. S corporation or partnership) may be preferred.
  - When it applies, Section 1202, coupled with the reduction in the corporate tax rate may result in significant tax savings.

Qualified Small Business Stock - Requirements

Requirements for QSBS

1. On the date of issuance, the issuing corporation must be a domestic C corporation, and the stock must be issued after Aug. 9, 1993.

2. At all times from Aug. 9, 1993, through the date stock is issued, the aggregate gross assets of the corporation (or any predecessor) must not have exceeded $50 million.

Qualified Small Business Stock - Requirements

3. Stock must be acquired directly from the issuing corporation in exchange for money or other property (not including stock) or as compensation for services provided to the corporation (other than services performed as an underwriter).

4. During substantially all of the shareholder’s holding period, at least 80 percent of the corporation’s assets must have been used in the active conduct of a qualified trade or business.

5. For substantially all of the shareholder's holding period, at least 80% of the assets of the corporation must be used in the active conduct of one or more qualified trades or businesses.

QSB Stock – Gain Exclusion

- For QSBS acquired on or after September 27, 2010, 100% of the gain is eligible for the exclusion, not to exceed the greater of :

1. $10 million (reduced by eligible gain taken into account during prior years) and
2. 10 times the taxpayer's aggregate adjusted basis of the QSBS sold during the taxable year.

Partnership items

Partnership Basis Reporting

- IRS concerned that it does not have the appropriate tax basis information on partnerships that do not report capital accounts on a tax basis.

- Partnerships had the option of reporting a partner's capital account on their K-1 on a variety of methods through 2018

- In 2018 the IRS required disclosures of partnerships with deficit tax basis capital
- In 2019 the IRS mandated that all capital accounts be reported on the tax basis
- In 2019 also requires disclosure of each partner's share of unrecognized section 704(c) gain or (loss) at the beginning and the end of the year.

Partnership Basis Reporting

- In 2019 the IRS indicated it would assert penalties for failure to file accurate K-1s if the basis reporting was omitted
- Penalty is $210 per partner per month.
- Penalty relief was provided by the IRS in Notice 2019-20. Penalty relief available if:
  - The partner Schedules K-1 were timely filed, including extensions, and furnished to the partners containing all other required information.
  - The negative tax basis information must be provided to the IRS within 180 days of the extended due date of the partnership's return (March 15, 2020 for calendar year taxpayers).

New Partnership Audit Regime

- All partnerships are subject to rules of the Bipartisan Budget Act (BBA) for taxable years beginning on or after January 1, 2018
  - Certain small partnerships may elect out of BBA
  - Partnerships may elect into BBA for certain taxable years before 2018

- For tax years beginning before 2018 all partnerships filed an amended return to make changes.
- Beginning with the 2018 tax year:
  - Partnerships subject to BBA file an Administrative Adjustment Request (“AAR”)
  - Partnerships not subject to BBA still file amended partnership returns

Administrative Adjustment Request (AAR)

- An AAR is used to make adjustments to already-filed partnership returns after the due date
  - Filed by the partnership representative (PR)
  - Generally must be filed within 3 years of the date the partnership return is filed
  - May not be filed after receipt of a Notice of Administrative Proceeding (notice of an examination)
  - Partnerships required to electronically file (currently those having more than 100 partners) file an AAR by attaching a Form 8082 to a Form 1065; paper filers use Form 1065X
  - No corrected Schedules K-1

Administrative Adjustment Request (AAR)

- The PR must compute the imputed underpayment resulting from the adjustments and then decide whether to have the partnership pay the tax or push out the adjustments
  - The partnership <u>must</u> push out adjustments that do not result in an imputed underpayment (generally taxpayer favorable adjustments)
  - If the partner receiving a push out statement is a partnership or an S corporation (pass-thru partner), the pass-thru partner must determine the imputed underpayment and decide whether to push or pay
- If the partnership pays the IU, the cost is borne by “current year” partners
  - The IU is a non-deductible expense allocated to adjustment year partners (partners of the partnership for the year the AAR is filed)

Administrative Adjustment Request (AAR)

- If the partnership pushes out the adjustments, the cost is borne by review year partners but is reported for and paid in the "current year"
  - The partnership sends each reviewed year partner a statement with their allocable share of the adjustments
  - Each reviewed year partner takes the adjustments into account in the reviewed year (and intervening years), determines the additional or reduction to tax, and reports and pays this amount with the return for the reporting year (generally the partners year that includes the year the statement was received)

Revenue Recognition – Tax Issues

Entities adopting ASC 606 or IFRS 15 (New Standards)

Key Tax Considerations

- Transaction price may be different for applicable financial statement (AFS) and tax purposes (variable / contingent consideration included in AFS transaction price, such as discounts, rebates, price concessions, incentives, etc.)
- Satisfaction of performance obligation generally means the income is “earned” for tax purposes
- Section 451(b)(4) provides that if a contract contains multiple performance obligations, the allocation of the transaction price to each performance obligation shall be equal to the amount allocated to each in the taxpayer’s AFS

Proposed Regulation Under Section 451(b)

Overview

- New Section 451(b) requires recognition no later than when recognized as revenue in AFS – “AFS Inclusion Rule”
- Applies on a year-by-year basis
  - Must have AFS for entire taxable year for rule to apply
- Does not apply to income recognized under a “special method of accounting”
  - However, it does apply to “specified credit card fees”
- The AFS Inclusion Rule does not change the treatment of a transaction for Federal income tax purposes
- Regulations are generally effective beginning on or after the date the final regulations are published – however, taxpayers may rely on proposed regulations.

Proposed Regulation Under Section 451(b)

Special Methods of Accounting

- Defined as a method of accounting permitted or required for tax purposes under which an item of income is taken into account in a taxable year other than the taxable year in which the all events test is met

  - Percentage of completion (Section 460)
  - Hedging transactions (Treas. Reg. Section 1.446-4)
  - Certain rental payments under Section 467
  - Mark-to-market method (Section 475)
  - Certain transactions under Treas. Reg. Sections 1.988-5 / 6
  - Certain original issue discount (OID), including de minimis OID (Sections 811(b)(3) and 1272 and Treas. Reg. Section 1.1273-1(d))
  - Accrued market discount, including de minimis market discount (Sections 1276, 1278(b), and 1278(a)(2)(C))
  - Methods provided in Sections 1502 and 1503

Advance Payments Under Section 451(c)

Advance Payments – General Rule

- Taxpayer using an accrual method and receives any advance payment during the taxable year, shall –
  - Include such advance payment in gross income for such taxable year (Full Inclusion Method), or
  - Include the advance payment (or any portion thereof) in gross income in the taxable year of receipt to the extent included in revenue in its AFS, and include the remaining amount in gross income in the next taxable year (Deferral Method)
- New Section 451(c) generally follows the provisions of Rev. Proc. 2004-34
- *By codifying these rules, the two-year deferral for inventoriable goods under Treas. Reg. Section 1.451-5 had to be eliminated*

Revenue Procedures 2018-29, 2018-49, and 2019-37

Method Change to Adopt ASC 606 or IFRS 15 (New Standards) for Tax Purposes

- Automatic method change for income recognition to a method under the New Standards for (i) identifying performance obligations, (ii) allocating transaction price to performance obligations, and/or (iii) considering performance obligations satisfied
- Proposed method must otherwise comply with Section 451
- Must be made in the year of adoption of New Standards in AFS
- Change can be made on a cut-off basis or with a Section 481(a) adjustment
- If taxpayer is under exam, audit protection is still granted (although special two-year adjustment period would still apply for an unfavorable Section 481(a) adjustment)

Revenue Procedures 2018-60 and 2019-37

- Method Changes for Income Recognition under Section 451(b) or Proposed Section 451(b), and Changes Relating to Advance Payments under Proposed Section 451(c) Regulations

- Automatic method change for a taxpayer:
  - With an AFS that wants to change their method for determining when the all events test is met (including application of new Section 451(b));
  - With an AFS that is not adopting the New Standards for the year of change, and wants to allocate transaction price to performance obligations under Section 451(b)(4);
  - With an AFS that wants to change to a method of accounting that complies with the proposed Section 451(b) regulations (including a change for a specified credit card fee); or
  - With or without an AFS that wants to change to a method of accounting that complies with the proposed Section 451(c) regulations

Revenue Procedures 2018-60 and 2019-37

- Certain changes can be made on a cut-off basis or with a Section 481(a) adjustment

- If taxpayer is under exam, audit protection is still granted (although special two-year adjustment period would still apply for an unfavorable Section 481(a) adjustment)

- Section 481(a) adjustment period for a change in income from a specified credit card fee is 6 years

- Streamlined method change procedure – no 3115 required – if either;

  (1) a small taxpayer ($25 million gross receipts test), or (2) the Section 481(a) adjustment would be zero.

Proposed Section 382 NUBIG/NUBIL Regulations

Section 382

- Section 382 places limits on the use of net operating losses, built in losses and credits when a company has an ownership change.

- Applies if more than 50% ownership change of a loss corporation over a three year period

- Annual limitation equals:
  - Value of stock multiplied by long term tax exempt rate PLUS
  - Recognized built in gains

Section 382 – Proposed NUBIG/NUBIL Regulations

- Notice 2003-65 allowed two methods:
  - Section1374 Method
  - Section 338 Method

The Section 338 method was favorable for loss companies with built in gains as it resulted in a higher Section 382 limitation.

New Prop. Reg. Sec. 1.382-1 would mandate the use of a modified Section 1374 method and eliminate the Section 338 method.

Section 382 – Proposed NUBIG/NUBIL Regulations

Item	Notice 2003-65	Proposed Regulations
Contingent Liabilities	Impacted NUBIL/NUBIG but not treated as RBIL.	RBIL up to amount of estimated liability considered in NUBIL/NUBIG calculation.
Deferred Deductions	Generally do not impact NUBIG/NUBIL.	RBIL and impact NUBIL/NUBIG.
Bad Debt Deductions	Only bad debt deductions in first 12 months are RBIL.	All bad debt deductions during the recognition period are RBIL.
Cost Recovery Deductions	Assume new asset placed in service on date of ownership change to compute cost recovery for RBIL/RBIG.	Hypothetical cost recovery calculated using the same depreciation schedule used by the corporation to the fair market value of the asset.

Section 1446(f) trap on sales of partnership interests

Section 1446(f) - Trap on Sales of Partnership Interests

- Section1446(f) imposes a withholding requirement intended to capture US tax on sales of partnership interests by foreign sellers.
- Withholding rate is 10%
- All sales of partnership interests are presumed to be subject to withholding unless the purchaser provides a certification indicating they are subject to US taxation.

Section 1446(f) - Trap on Sales of Partnership Interests

- Proposed Regulations & Notice 2018-29 follow a the FIRPTA model and create a presumption that a sale of a partnership interest is subject to withholding unless the purchaser obtains a certification of nonforeign status from the seller on Form W-9.

- If a purchaser fails to meet the withholding requirement, Section 1446(f)(4) provides that the partnership is required to deduct and withhold an amount equal to the amount the transferee failed to withhold (10% of the amount realized on the transfer) plus interest from the transferee's future partnership distributions.

- The enforcement of partnership-level withholding from future distributions to the transferee is deferred until final regulations are issued.

Libor Replacement – Proposed Regulations

Libor Replacement – Proposed Regulations

- Proposed regulations issued providing guidance on the transition from interbank offered rates (IBORs), including LIBOR (London Interbank Offered Rate) to other reference rates.
- Provide guidance and safe harbors for avoiding Reg. Sec. 1.1001-3 debt modifications due to change in interest rate index on debt instruments.

- Change from LIBOR to new rate will not trigger a debt modification if all of the following conditions are met:

  - The new interest rate is a qualified rate
  - The currency requirement is satisfied
  - The fair market value (FMV) test is satisfied

- Similar relief available for hedges based on LIBOR

SALT update

South Dakota v. Wayfair, 138 S.Ct. 2080 (2018)

- The U.S. Supreme Court issued its decision in *Wayfair* on June 21, 2018 overturning *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992) and U.S. Supreme Court precedent set in *National Bellas Hess v. Department of Revenue of Illinois*, 87 S.Ct. 1389 (1967)
- The Court considered whether South Dakota's S.B. 106, which established nexus against remote sellers with $100,000 in annual gross revenue from sales delivered to the State or 200 separate transactions delivered to the State, violated *Quill* and the Commerce Clause.
- In its decision, the Court held:
  - *Quill* was "unsound and incorrect."
  - It established a new test that is more or less parallel to the Due Process Clause
  - New test for sales and use tax nexus is "**economic or virtual**" presence.

Wayfair - State Reactions

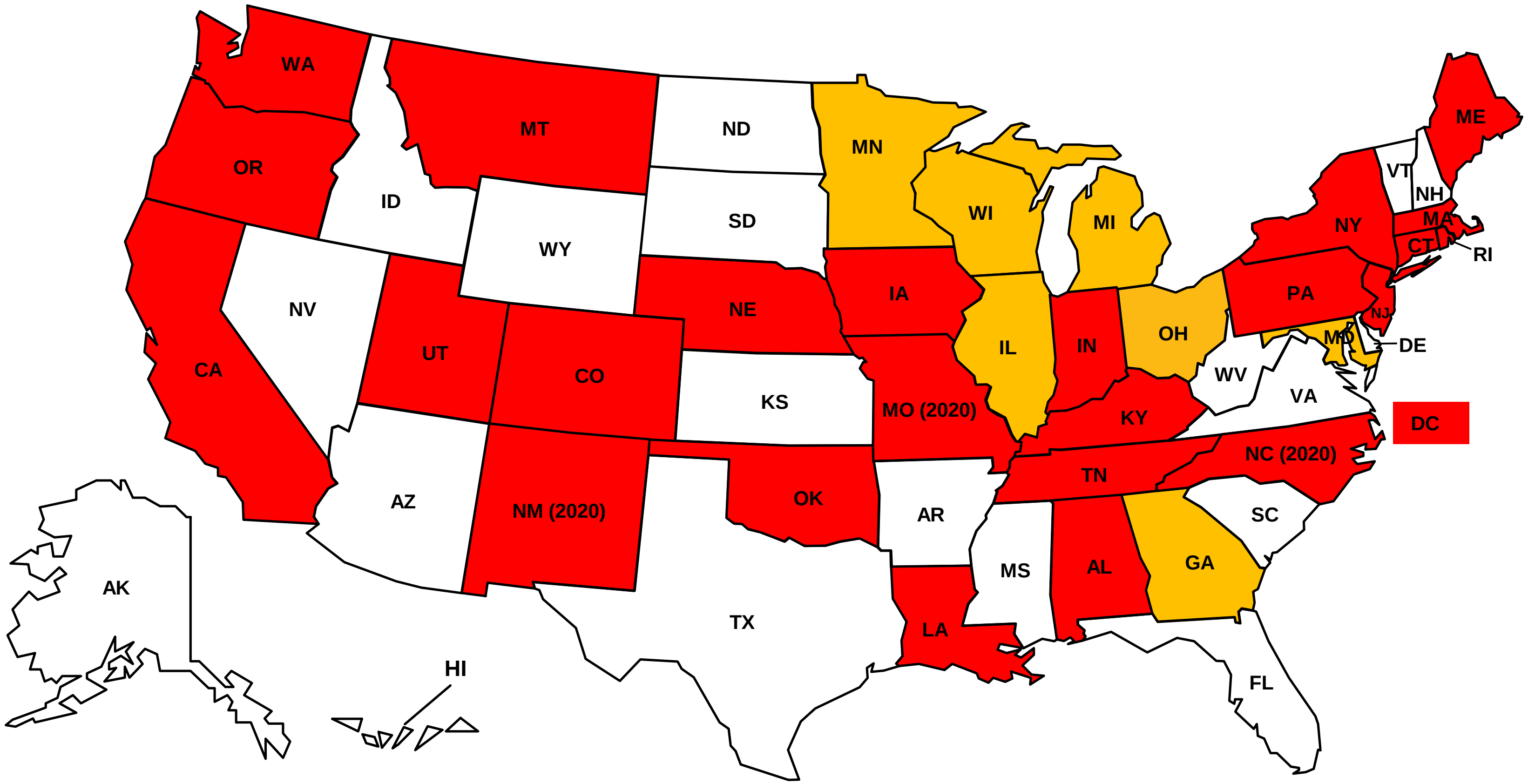
- Almost every state with a state-wide sales tax has adopted a threshold.
  - Florida proposal died in committee in May
- Most use $100,000 in sales or 200 transactions.
  - A few have adopted $250K or $500K
  - KS Department of Revenue issued guidance using $1 or 1 sale threshold, but Attorney General declared the guidance unlawful, leaving taxpayers uncertain.
  - Somewhat of a trend to drop the transaction count and look solely to sales volume.
- Most effective dates were 10/1/18 or later.
  - RI and MA use dates prior to decision.
  - A half a dozen or so states are effective shortly after decision.
- When to file after exceeding threshold varies.
  - Some states calendar year and begin Jan 1 of next year if exceeded.
  - Some apply a rolling 12 months with a set time period afterwards.

Wayfair for Income Tax?

A number of states have factor-based nexus standards based on sales:

- AL – after 1/1/15 - $538K
- CA – after 1/1/11 - $584K
- CO – after 4/30/10 - $500K
- CO – after 1/1/10 - $500K.
- **HI** – tax years after 12/31/19 - $100K or 200 transactions
- **IN** – “taxable to the fullest extent permitted by the Constitution of the United States”
- **MA** – effective 10/19/19 - $500K
- MI – after 1/1/12 for CIT - $350K with active solicitation
- NY– after 1/1/15 - $1,000K
- **PA** – 1/1/20 - $500K
- TN – after 1/1/16 - $500K.
- **TX** – tax years ending in 2019 - $500K

Adoption of Market Sourcing for Income Tax*



2009

2019

*Does not address industry-specific or optional formulas

TCJA Conformity

- IRC 951A – Global Intangible Low-taxed Income
  - Some states do not adopt (e.g., CA)
  - Some adopt, but treat as a dividend eligible for a state-level deduction
    - States excluding GILTI or providing a deduction for at least 95%

      CT, GA, HI, IL, IN, KY, MA, MI, MS, MO, NC, NM, OK, PA, SC, VA, and WI
    - States providing less than 95% deduction

      ID (85%), ME (50%), MT (80%), ND (70%), NJ (50%), NY (100%, but expense disallowance of up to 40%)

TCJA Conformity

- IRC 965 – Deemed Repatriation
  - Need to report actual distributions in states that did not adopt (CA, WI, et al)
  - Evaluate treatment of exchange gain or loss
- IRC 250 – Foreign Derived Intangible Income
  - Majority of states allow deduction
  - Need to compute a separately in most of these creates complexity

TCJA Conformity

- IRC 163(j)
  - Majority of states conform
  - Need to compute separate entity amounts for state purposes
  - CT, IN and VA provide modifications for disallowed amounts
  - Potential issue in determining interplay between IRC § 163(j) limitation and a state's related party interest expense disallowance
  - Beginning in 2022, Adjusted Taxable Income, includes deduction for depreciation, how will states that do not conform to bonus depreciation calculate Adjusted Taxable Income?
  - Application of IRC § 163(j) in a flow-through entity context is incredibly complex, and there are unique state tax consequences

International tax update

Section 385 Developments

- Regulations issued in 2016 final year of the Obama administration
- Aimed at making inversions more difficult but affected more innocent bystanders than bad actors
- Recharacterized related party debt as equity if vigorous documentation not undertaken or if certain transactions, e.g. dividends, occurred 3 years before or after the loan
- October 31 final regulations and advance notice of proposed rulemaking released
  - Final regulations repeal onerous documentation requirement
  - Advance notice of proposed rulemaking announces intent to soften the debt recasting rules including the 6-year coincidental forbidden transaction provision

BEAT Proposed Regulations

- Alternative minimum tax targeting earnings stripping payments to foreign related parties
- Two major wins for taxpayers
  - Only markup on services eligible for cost-based pricing are tainted payments
  - Pre-TCJA interest carryforwards are not tainted payments (reversing Notice 2018-28)
- Other take-aways
  - $500M gross receipts threshold determined by group at year-end & projected back 3 yrs
  - §988 deductions are excluded from numerator and denominator for 3% test (even if recognized in relation to transactions with unrelated parties)
  - Although testing or applicability is performed on an aggregate US basis, modified taxable income is calculated on a taxpayer-by-taxpayer basis
- Uncertainty for ultimate treatment of reinsurance payments remains and Treasury requested comments before final regulations

Final GILTI Regulations

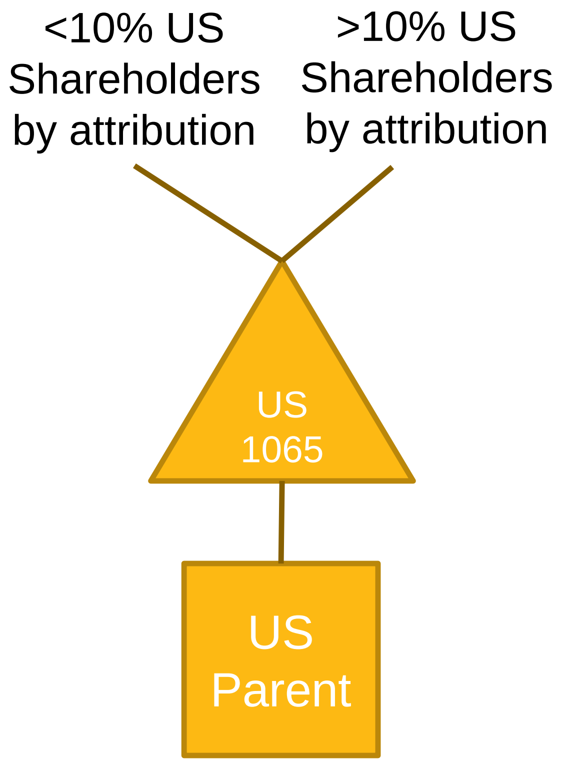
- Section 951A disincentive purportedly aimed at low-tax intangible income earned by CFCs - accelerates income
- Generally follow proposed regulations
- Notable changes, modifications & clarifications
  - Clarify how tested loss/QBAI etc. allocated among US shareholders
  - Intangible property to which Section 168(k) applies (computer software, qualified film or television rights, qualified theatrical productions) not tangible depreciable property.
  - Scrapped hybrid calculation for domestic partnerships - always treated as foreign partnership (aggregate theory) for GILTI purposes only
    - No distributive share GILTI Calculation
    - No US SH status for less than 10% SH after pro rata attribution
    - Applies to ownership through S-corps under Section 1373(a)
  - Downward basis adjustments can push stock basis below zero if E&P brings it to or above zero

Subpart F Proposed Regulations - Partnerships

- Proposed Reg would extend GILTI aggregate theory to Subpart F
- Accomplished by treating a domestic partnership as a foreign partnership
  - For purposes of Section 951 (Subpart F & Section 956) and Section 951A (GILTI) inclusions only
  - Includes provisions that reference or incorporate affected code sections
  - Makes partner/S-corporation shareholder direct or indirect owner
  - Determines 10% US shareholder at the partner/shareholder level rather than the entity
  - Does not apply for purposes of determining CFC or controlling shareholder status
  - Effective for years beginning after regulations are finalized
    - Controlling partner/SH can elect to apply final regulations to all years after 2017
    - All SH bound by election
    - Taxpayers can rely on proposed regulations until final regulations are passed

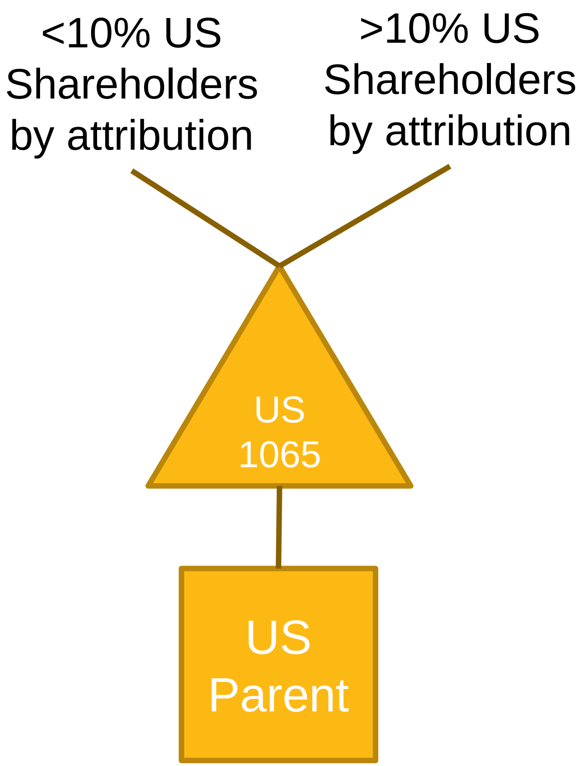
GILTI Final Regulations / Subpart F Proposed Regulations - Partnerships

Old Rules



100% of CFC income tested for GILTI and distributive share of Subpart F income

New Rules



Only 10% or greater US shareholders via attribution test income for GILTI and Subpart F

FDII/GILTI Deduction - Proposed Regulations

- FDII - Effective rate of 13.125% on export sales, services and licenses
- Computation
  - *Reference - alphabet soup formula: FDII = DII x foreign derived ratio*
    - *DII: deemed intangible income = DEI less 10% of QBAI*
    - *QBAI: qualified business asset investment = quarterly average of adjusted basis of tangible depreciable assets (using ADS depreciation)*
    - *Foreign derived ratio = FDDEI ÷ DEI*
    - *DEI: deduction eligible income = taxable income less certain items, e.g. branch & GILTI*
    - *FDDEI: foreign-derived DEI = DEI from licenses sales & services for foreign use*
  - Based on circular calculation: taxable income after interest limitations and NOLS that rely on Section 250 deduction - Preamble contains helpful guide based on “tentative Section 250 amount”

FDII/GILTI Deduction - Proposed Regulations

- FDII Computation (cont'd)
  - Domestic corporate partner generally takes partnership FDII elements into account in order to calculate its own FDII
  - FDEI includes transactions with US government for the benefit of a foreign government under *Arms Export Control Act of 1976*
  - Provides guidance on the determination of foreign use
- GILTI deduction - follows rules for FDII reduction but regulations confirm that it is available for individuals electing Section 962 treatment

Crowe

Thank You