Tax Reform One Year Later: Maximize Benefits and Minimize Burdens

WEDNESDAY, DECEMBER 12, 2018, 1:00-2:50 pm Eastern

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Tax Reform One Year Later: Maximize Benefits and Minimize Burdens

WEDNESDAY, DECEMBER 12, 2018

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Tax Reform One Year Later: Determining the Winners and Losers

Income Tax Changes Having Significant Impact on Individual Taxpayers

Stanley A. Barsky
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Outline

• Tax Rates
• Standard Deduction
• Mortgage Interest Deduction
• State and Local Tax Deduction
• Alimony
• Itemized Deductions
• Section 529
Outline (continued)

• Charitable Contribution Deduction
• Certain Suspensions
  – HELOC
  – Casualty
  – Moving Expenses
  – Tax Preparation Expenses
• Entertainment Expenses
• Section 199A
• International Provisions – Sections 965 and 951A
Tax Rates

• Individual ordinary income tax rates are reduced for the years 2018 through 2025. For example, MFJ rates are:
  – Section 1(j)(2)(A)

Not over $19,050 10% of taxable income.
Over $19,050 but not over $77,400
Over $77,400 but not over $165,000
Over $165,000 but not over $315,000
Over $315,000 but not over $400,000
Over $400,000 but not over $600,000
Over $600,000

$1,905, plus 12% of the excess over $19,050.
$8,907, plus 22% of the excess over $77,400.
$28,179, plus 24% of the excess over $165,000.
$64,179, plus 32% of the excess over $315,000.
$91,379, plus 35% of the excess over $400,000.
$161,379, plus 37% of the excess over $600,000.
Standard Deduction

• For the years 2018 through 2025, the standard deduction is increased.
  – For single taxpayers, from $6,500 to $13,000.
  – For heads of household, from $9,550 to $18,000.
  – For married filing jointly, from $13,000 to $24,000.
  – Section 63(c).
Mortgage Interest Deduction

• The mortgage interest deduction applies to mortgage amounts of up to $750,000 (for mortgages incurred in years 2018 through 2025).
  – The prior limit was $1 million.
  – Section 163(h)(3)(F).
  – See also HELOC discussion below.
State and Local Tax Deduction

• State and local tax deduction is limited to $10,000 for tax years 2018 through 2025. Income, property and sales taxes are aggregated.
  – Section 164(b)(6).
  – Certain states have considered, and some have enacted, potential “work-arounds,” including providing tax credits for certain charitable contributions made to the state.
  – The IRS issued proposed regulations that would shut down the charitable run-around, for contributions made after August 27, 2018. REG-112176-18. The proposed regs were issued on August 23, 2018. IR-2018-172.
Alimony

• For divorce decrees and separation agreements entered into after 2018, alimony payments are not deductible by payor, and are not includable in income of payee.
  – In pre-2019 years, alimony payments may be deducted by payor and included in income of payee, permitting for certain tax rate arbitrage.
  – Sections 61(a)(8), 62(a)(10), 71, 215.
Itemized Deductions

• For years 2018 through 2025, the overall limitation on itemized deductions is repealed.
  – Section 68.
Section 529

• Section 529 has been expanded to apply to elementary and secondary school tuition.
  – Up to $10,000 per student per year.
  – Tax benefits generally include tax-free returns on investment and tax-free withdrawals.
  – Ability to roll over into ABLE account before 2026.
Charitable Contribution Deduction

• For years 2018 through 2025, charitable contribution deduction limit for cash contributions is increased from 50 percent of adjusted gross income, to 60 percent.
  – Section 170(b)(1)(G).
Certain Suspensions

• HELOC
  – Deduction for interest paid on a home equity line of credit is suspended for years 2018 through 2025, unless proceeds are used to buy, build, or substantially improve the home that secures the loan. IR-2018-32, Feb. 21, 2018.

• Casualty
  – Deduction for personal casualty losses is suspended for years 2018 through 2025, unless attributable to a disaster declared by the President under the Disaster Relief and Emergency Assistance Act.
  – Section 165(h)(5).
  – Compare Rev. Rul. 2009-9
• Moving Expenses
  – For years 2018 through 2025, the deduction for moving expenses is suspended, except for members of the Armed Forces.
  – Section 217.

• Tax Return Preparation Expenses
  – For years 2018 through 2025, the deduction for tax return preparation (and certain other miscellaneous itemized deductions) is suspended.
  – Section 67(g).
Entertainment Expenses

• Entertainment expenses are no longer deductible, even if “directly related” to the conduct of a trade or business.
  – Section 274(a)(1)(A).
  – Meals are generally still deductible up to 50 percent. Section 274(n)(1).
  – Notice 2018-76.
Section 199A

- Non-corporate taxpayers generally can deduct 20 percent of their business income.
- Expires after 2025.
- Impacts individuals who have business income from (i) sole proprietorships, (ii) partnerships, and (iii) S corporations.
- Discussed in greater detail later in this presentation.
Certain International Provisions

• Section 965
  – Generally, deemed repatriation of post-1986 accumulated earnings of controlled foreign corporations.
  – Section 965(h) provides for installment payments of the section 965 tax.

• Section 951A
  – Generally, current taxation of shareholders on business income of controlled foreign corporations.

• Discussed in greater detail later in this presentation.
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TAX REFORM ONE YEAR LATER: PARTNERSHIPS AND PASS-THOUGH ENTITIES
By: Brian T. Lovett, CPA, CGMA, JD
Partnership & Pass-Through Issues

Section 199A deduction planning
- Specified Service Trades or Businesses
- The *de minimis* rules
- Commonly controlled entities
- Aggregation of Activities
Pass-through Change: 20% Qualified Business Deduction

- The bill provides a deduction of 20% of “qualified business income,” capped at the greater of:
  - 50% of the individual’s allocable share of the W-2 wages deducted by the business.
  - 25% of the individual’s allocable share of the W-2 wages deducted by the business PLUS the individual’s share of 2.5% of the unadjusted basis of property used in business.

- Effective top rate on pass-throughs becomes 29.6%

- Limitations/Exceptions:
  - The wage limit doesn’t apply if the taxpayer earns less than $157,500 (if single, $315,000 if married).
  - The deduction is not available to owners of certain service businesses unless income is less than $157,500 (if single, $315,000 if married).
Specified Service Trade or Business Rules

[label:partnerships-pass-throughs]

Deduction is available to any trade or business except:

- A specified service trade or business ("SSTB"), or
- The trade or business of performing services as an employee

Why?

- Income received in exchange for services performed should be taxed at ordinary rates with no preference
Specified Service Trades or Businesses

An SSTB is: “Any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees or owners.”
Specified Service Trades or Businesses

The determination of whether a business is an SSTB is made at the business level. Reg. S1.199A-6(b)(3): an RPE must separately identify and report on the Schedule K-1 issued to its owners whether any business engaged in directly by the RPE is an SSTB.

This is very important. Consider the following example:
SSTB Example

Taxpayer A is a CPA. A works for an engineering firm S corporation, but performs all accounting functions, which IS an SSTB. The determination of the nature of the business is done at the S corporation level. Because engineering is not an SSTB, on the K-1 the S corporation provides A, it will not designate the business as an SSTB. Thus, A should not be prohibited from claiming the S199A deduction.
**SSTBs and the *de minimis* rule**

- What about entities with both SSTB income and non-SSTB income?
- A business will not be an SSTB if:
  - Gross receipts are less than $25M for the year,
  - Less than 10% of the gross receipts are attributable to the performance of services in one of the disqualified fields.

- *Ex. S Co., an S corporation, earns $20M in 2018 from the sales of computer software. It also earns $1.8M from separately-billed consulting revenue from helping the clients implement the software. While the consulting work is an SSTB (it was separately charged for), because the revenue from the work is less than 10% of the total revenue, it is ignored and none of the business is from an SSTB.*
SSTBs and the *de minimis* rule (Cont’d)

- A business will not be an SSTB if:
  - Gross receipts are greater than $25M for the year,
  - Less than 5% of the gross receipts are attributable to the performance of services in one of the disqualified fields.

- Ex. S Co., an *S* corporation, earns $50M in 2018 from the sales of computer software. It also earns $2M from separately-billed consulting revenue from helping the clients implement the software. While the consulting work is an SSTB, because the revenue from the work is less than 5% of the total revenue, it is ignored and none of the business is from an SSTB.
SSTBs and the *de minimis* rule (Cont’d)

Do we read the *de minimis* exception in the opposite? If a business has more than a *de minimis* amount of SSTB revenue, does:

- The ENTIRE business become treated as an SSTB, or
- Is that SSTB revenue significant enough that the business may qualify as its own trade or business for purposes of S199A? The -2 and -3 regulations state that an RPE can have more than one trade or business for S199A purposes.

There is support that it should be treated as two separate trades or businesses in the example at Reg. S1.199A-5(c)(3), where a dermatologist also sold skin care products out of the same LLC. They were treated as separate trades or businesses in that example, even though the skin care line was less than 5% of the dermatology revenue.
SSTBs and the *de minimis* rule (Cont’d)

In an informal statement, an IRS official explained that the *de minimis* rule IS intended to have a cliff effect; in other words, if SSTB revenue is not *de minimis*, the entire business is tainted.

Ex: *AB LLC generates $10M in revenue from the sales of software in 2018, and $5M from consulting related to that software. Because the prohibited consulting services comprise 33% of the total revenue, the *de minimis* exception is exceeded. None of the $15M in revenue is eligible for the S199A deduction.*
Commonly Controlled Entities

- An SSTB includes any business that provides 80% or more of its services or property to a commonly controlled business.
- Common control: the same owners own 50% or more of both businesses, using the relationship rules of Sections 267(b) and 707(b).
- Ex. LLC provides legal services. To maximize S199A benefits, the owners form P2 to own the office building that will be rented entirely to LLC, and P3, which will provide administrative services to LLC. Because P2 rents all of its property to LLC, and because P3 provides all of its services to LLC, and because LLC, P2 and P3 are commonly controlled, ALL THREE BUSINESSES ARE TREATED AS SSTBs.
Commonly Controlled Entities

If a business provides less than 80% or more of its services or property to a commonly controlled business, only the income from that property or those services is treated as SSTB income.

Ex. A, a dentist, owns a dental practice and also an office building. The building is rented 30% to the dental practice and 70% to unrelated parties. Because the businesses are commonly controlled, A must treat 30% of the rental income as earned in an SSTB. The 70% earned from the unrelated party is not SSTB income, because less than 80% of the rental is to the commonly controlled business.
The end of “cracking”?

The point of these rules is to kill of the “cracking” idea. And there is one more way the regulations do that:

- If a non-SSTB is commonly controlled with a SSTB, shares expenses with the SSTB, and has gross receipts of 5% or less of the total combined gross receipts, it is treated as an SSTB, even if it otherwise would not have been.

Ex. A, a dermatologist, earns $600,000 in 2018 from seeing patients. A also owns a business that sells skin care, and that shares employees and office space with the dermatology clinic. Total revenue from the skin care line is $20,000. The skin care line is treated as an SSTB, because the businesses are commonly controlled, share expenses, and the revenue of the skin care line is less than 5% of the total combined receipts of $31,000.
Aggregation for S 199A purposes

✦ General rule: the S199A deduction is determined separately for each T/B, using separate W-2 wages and UBIA.

✦ Prop. Reg. S1.199A-4, however, provides for an aggregation regime, whereby a taxpayer can elect (but is not required to elect) to aggregate certain businesses.

✦ If aggregation is elected, the taxpayer determines the S199A deduction for the aggregated businesses by using the combined QBI, wages and UBIA.
Aggregation for S 199A purposes

- Before a business can be considered for aggregation, it must rise to the level of a T/B. See Prop. Reg. S1.199A-1(b)(13), (an activity that rents or provides services to a commonly controlled T/B is treated as a T/B for these purposes, and may be aggregated.

- Businesses must be under “common control.” This is the case when the same person OR GROUP OF PERSONS own 50% or more of the:
  - Capital or profits interest in the case of a partnership, or
  - Outstanding stock in an S corporation.

- This control must exist for a “majority” of the tax year. What is a majority?

- The businesses must be on the same tax year.

- You CANNOT aggregate an SSTB.
Aggregation for S 199A purposes

In order to aggregate, all of the businesses to be aggregated must satisfy 2 of the following 3 factors:

- They must provide products and services that are the same or customarily offered together,
- They share facilities or share significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.
- They are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group (for example, supply chain dependencies).
Aggregation for S 199A purposes

Ex. A, B, C, and D each own 25% of two businesses, a restaurant and a catering business. The businesses share a kitchen, centralized purchasing to obtain volume discounts and a centralized accounting office that performs all of the bookkeeping, tracks and issues statements on all of the receivables, and prepares the payroll for each business.

Even though none of A, B, C or D own 50% directly, because the same group of taxpayers control 50% or more of both businesses, ANY OF A, B, C and D may aggregate the businesses if the other tests are met.

The two businesses satisfy two of the three factors:
- They both offer prepared food to customers, and
- They share facilities and centralized business elements.

As a result, any of A, B, C, or D can elect to aggregate some or all of the business together. They may all choose different groupings.
Aggregation for S 199A purposes

**Election Rules:**
- Once you choose to aggregate two or more businesses, you must report consistently in all subsequent tax years.
- You may add a newly acquired or formed business to an existing aggregation if all the requirements are met.
- All elections are made at the individual level, even with tiered businesses.
- In a subsequent year, if:
  - A business previously aggregated no longer is commonly controlled, or
  - The business no longer satisfies two of the three factors.
  - The businesses are no longer treated as aggregated.

**Disclosure Rules:**
- For EACH year, the owner must attach a statement to their return identifying each aggregated trade or business, including
  - The name, EIN, and description of each business,
  - Information identifying any newly formed, acquired, or disposed of business in the grouping.
Benefits of aggregation

Ex. *F, a single taxpayer, owns 100% of X, Y, and Z. None have UBIA, but each have QBI and wages as follows:*

- **Business X** - $1,000,000 in QBI and $500,000 in wages
- **Business Y** - $1,000,000 in QBI and no wages
- **Business Z** - $2,000 in QBI and $350,000 in wages

*F’s taxable income for the tax year after removing any capital gain is $2,850,000*
## Aggregation Example

<table>
<thead>
<tr>
<th></th>
<th>Business X</th>
<th>Business Y</th>
<th>Business Z</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>W-2 Wages</td>
<td>$500,000</td>
<td>$-</td>
<td>$350,000</td>
</tr>
<tr>
<td>UBIA</td>
<td>$-</td>
<td>$-</td>
<td>$-</td>
</tr>
<tr>
<td><strong>QBI Deduction</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tentative deduction</td>
<td>$200,000</td>
<td>$200,000</td>
<td>$400</td>
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<tr>
<td>50% of W-2 Wages</td>
<td>$250,000</td>
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<td>$175,000</td>
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<tr>
<td><strong>QBI Deduction</strong></td>
<td>$200,000</td>
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<td>$400</td>
</tr>
<tr>
<td>Taxable income</td>
<td>$2,850,000</td>
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<tr>
<td>Maximum QBI Deduction</td>
<td>$570,000</td>
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<tr>
<td>Actual QBI Deduction</td>
<td>$200,400</td>
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</tbody>
</table>
## Aggregation Example

<table>
<thead>
<tr>
<th></th>
<th>Business X</th>
<th>Business Y</th>
<th>Business Z</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$2,000</td>
<td>$2,002,000</td>
</tr>
<tr>
<td>W-2 Wages</td>
<td>$500,000</td>
<td>-</td>
<td>$350,000</td>
<td>$850,000</td>
</tr>
<tr>
<td>UBIA</td>
<td>$-</td>
<td>$-</td>
<td>$-</td>
<td>$-</td>
</tr>
</tbody>
</table>

### QBI Deduction

<table>
<thead>
<tr>
<th></th>
<th>Business X</th>
<th>Business Y</th>
<th>Business Z</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tentative deduction</td>
<td>$-</td>
<td>$-</td>
<td>$-</td>
<td>$400,400</td>
</tr>
<tr>
<td>50% of W-2 Wages</td>
<td>$-</td>
<td>$-</td>
<td>$-</td>
<td>$425,000</td>
</tr>
<tr>
<td>QBI Deduction</td>
<td>$-</td>
<td>$-</td>
<td>$-</td>
<td>$400,400</td>
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</tbody>
</table>

### Taxable income

- $2,850,000

### Maximum QBI Deduction

- $570,000

### Actual QBI Deduction

- $400,400
But be careful!!

Ex. F, a single taxpayer, owns 100% of X and Y.

- Business X – QBI of $1,000,000 and $500,000 in wages
- Business Y – QBI of $1,000,000 and $4,500,000 of UBIA

Taxable income after removing any capital gain is $2,200,000
## Aggregation Example

<table>
<thead>
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<th>Total</th>
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<tbody>
<tr>
<td>QBI</td>
<td>$1,000,000</td>
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<tr>
<td>W-2 Wages</td>
<td>$500,000</td>
<td>$-</td>
<td>$500,000</td>
</tr>
<tr>
<td>UBIA</td>
<td>$-</td>
<td>$4,500,000</td>
<td>$4,500,000</td>
</tr>
</tbody>
</table>

**QBI Deduction**

- **Tentative deduction**: $400,000
- **Greater of:**
  - 50% of W-2 Wages: $250,000
  - 25% wages/2.5% UBIA: $237,500

**QBI Deduction**

- **Total**: $250,000

**Taxable income**: $2,200,000

**Maximum QBI Deduction**: $440,000

**Actual QBI Deduction**: $250,000
# Aggregation Example

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>W-2 Wages</td>
<td>$500,000</td>
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<td>$-</td>
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<tr>
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<td><strong>$500,000</strong></td>
<td><strong>$4,500,000</strong></td>
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<tr>
<td><strong>QBI Deduction</strong></td>
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<tr>
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<td>$200,000</td>
<td>$200,000</td>
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<tr>
<td>Greater of:</td>
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<td></td>
</tr>
<tr>
<td>- 50% of W-2 Wages</td>
<td>$250,000</td>
<td>$-</td>
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<tr>
<td>- 25% wages/2.5% UBIA</td>
<td>$125,000</td>
<td>$112,500</td>
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<td><strong>QBI Deduction</strong></td>
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<td><strong>$112,500</strong></td>
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<tr>
<td>Taxable income</td>
<td>$2,200,000</td>
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<tr>
<td>Maximum QBI Deduction</td>
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<tr>
<td>Actual QBI Deduction</td>
<td>$312,500</td>
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</table>
U.S. International Tax Reform
Aerial View
## Primary International Tax Law Changes of the TCJA

<table>
<thead>
<tr>
<th>Tax Law Change</th>
<th>Code Section(s)</th>
<th>Guidance Issued</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Intangible Low-Taxed Income (GILTI)</td>
<td>§§ 951A, 250</td>
<td>Proposed regulations issued under § 951A on 9/13/18 Draft Form 8992; Draft Form 5471, Sch. I-1</td>
</tr>
<tr>
<td>Participation Exemption (aka, DRD)</td>
<td>§ 245A</td>
<td>Proposed regulations issued under § 956 on 10/31/18 to address DRD overlap</td>
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<tr>
<td>Foreign Derived Intangible Income (FDII)</td>
<td>§ 250</td>
<td>No guidance issued Draft Form 8993</td>
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<tr>
<td>Modifications to Subpart F</td>
<td>§§ 951(a), 958(b)</td>
<td>Notice 2018-13 addresses repeal of Section 958(b)(4) (1/19/18)</td>
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## Primary International Tax Law Changes of the TCJA (cont’d)

<table>
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<th>Tax Law Change</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Base Erosion and Anti-Abuse Tax (BEAT)</td>
<td>§ 59A</td>
<td>Proposed regulations rec’d by OMB on 11/6/18</td>
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<tr>
<td>Hybrid Dividends and Payments</td>
<td>§ 267A</td>
<td>Proposed regulations rec’d by OMB on 11/13/18</td>
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<tr>
<td>Modifications to Foreign Tax Credit</td>
<td>Primarily, §§ 902 (repealed), 904, 960</td>
<td>Proposed regulations issued on 11/28/18</td>
</tr>
<tr>
<td>Modification of Interest Expense Deduction Limits*</td>
<td>§ 163(j)</td>
<td>Proposed regulations issued under § 163(j) on 11/26/18</td>
</tr>
</tbody>
</table>

*Impacts domestic tax planning as well.*
Other Notable International Tax Law Changes of the TCJA

<table>
<thead>
<tr>
<th>Tax Law Change</th>
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<tbody>
<tr>
<td>Repeal of 367(a) active trade or business exception</td>
<td>§§ 367(a)(3)(C), 91</td>
</tr>
<tr>
<td>Expanded definition of intangible property</td>
<td>§ 936(h)(3)(B)</td>
</tr>
<tr>
<td>Repeal of FMV method of interest expense apportionment</td>
<td>§ 864(e)(2)</td>
</tr>
<tr>
<td>Modification of source rule for income from sales of inventory (location of manufacturing)</td>
<td>§ 863(b)</td>
</tr>
<tr>
<td>Modification of PFIC insurance exception</td>
<td>§ 1297(b)(2)(B), 1297(f)</td>
</tr>
</tbody>
</table>
Mandatory Repatriation
Mandatory Repatriation – Overview

- As part of the transition to the “territorial tax system,” all foreign earnings accumulated offshore by certain U.S. shareholders are mandatorily deemed repatriated to the United States at the following rates:
  - Corporate Shareholders
    - 15.5% for amount up to foreign cash position
    - 8% for other earnings
  - Individual Shareholders – The rate of tax can be higher for individuals because the rate is computed using a deduction tied to the corporate tax rates in Section 11, rather than the individual rates in Section 1.
- “Net” concept; positive E&P and E&P deficits are netted at the shareholder level
- This one-time "toll charge" is imposed regardless of whether the earnings were actually distributed
- The U.S. shareholder recognizing the deemed or actual repatriation may elect to pay the tax liability over an eight-year period, in annual installments
Mandatory Repatriation – Mechanics

- Any “U.S. Shareholder” of (i) any controlled foreign corporation (CFC), and (ii) any foreign corporation which has one or more domestic corporations as a U.S. Shareholder (a Specified Foreign Corporation or “SFC”)
  - U.S. Shareholder – A U.S. person who directly, indirectly or constructively owns 10% or more of a foreign corporation
- Must increase its subpart F inclusion by its pro rata share of accumulated post-1986 “deferred foreign income”
  - Deferred foreign income is the greater of the post-1986 accumulated foreign earnings as of 11/2/2017 or 12/31/2017
    - This amount is not reduced by certain distributions
    - Prevents reduction of deferred foreign income via distribution after tax reform was proposed
- Foreign tax credits are available (but individuals need to make a 962 election to obtain)
- The availability of the foreign tax credit against the mandatory repatriation tax is reduced
  - 55.7% of the foreign tax credit is disallowed for earnings attributable to cash position
  - 77.1% of the foreign tax credit is disallowed for other repatriated earnings
Section 965(h) Installment Election

- Election to Pay Mandatory Repatriation Liability in Installments:
  - A U.S. Shareholder may elect to pay its net tax liability on the one-time deemed repatriation in eight installments equal to:
    - 8% of the net tax liability for each of the first five years,
    - 15% in the sixth year,
    - 20% in the seventh year, and
    - the remaining 25 percent in the eighth year.
  - Can be revoked by making a full payment for remaining installments
  - Deficiency or additional liability prorated among the installments; however, full acceleration if incremental tax is attributable to negligence, intentional disregard, or fraud
Section 965(h) Installment Election (cont’d)

- Acceleration of payments:
  - Failure to pay an installment in a timely manner (though, FAQs provide some leniency for late first installment)
  - A liquidation, sale, exchange, or other disposition of substantially all of the assets (for individual includes death)
  - For non-individual, a cessation of business
  - Taxpayer no longer a U.S. person, including resident alien becoming a non-resident alien
  - Non-member of consolidated group becoming a member
  - Consolidated group ceases to exist
  - Determination by the Commissioner of material misrepresentations/omissions

- Exceptions to certain acceleration of payments available if:
  - Acceleration event is a “covered” acceleration event; and
  - Transfer agreement is filed within 30 days of acceleration event
    - Under transfer agreement, transferor or successor remains jointly and severally liable for installment payments, penalties
    - Temporary guidance provided in update to FAQs
Section 965(i) Deferral Election

- Deferral of 965 tax liability for SFCs held through an S corporation until a triggering event
- Triggering events are:
  - Entity ceases to be an S corporation
  - Liquidation, sale, exchange, or other disposition of the S corporation
  - Cessation of business
  - S corporation ceases to exist
  - Transfer of any share of S corporation (if partial transfer, then only with respect to portion of 965 liability)
- May enter into a transfer agreement
  - Transferee may not be a domestic pass-through entity
- 965(h) election may be made upon a triggering event
Mandatory Repatriation Tax – Continuing Relevance

- Fiscal year SFCs with respect to which transition tax calculations have yet to be made
- Many taxpayers who incurred mandatory repatriation tax liability elected to pay on installment over 8 years; now a continuing compliance issue
- Mandatory repatriation tax is now an M&A diligence issue; many common transactions will now require filing of a transfer agreement if one of the parties has made an installment election or deferral election
- Computational issues with respect to future distributions (e.g., stock basis adjustments)
The GILTI Regime
## GILTI – Overview

**GILTI** = Net CFC Tested Income – [(10% x QBAI) – Specified Int. Exp.]

New Code §951A imposes annual inclusion of GILTI on *each person who is a U.S. shareholder of a CFC* for taxable years of foreign corporations beginning after 12/31/2017 and taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end

- **“Net CFC Tested Income”** consists of the aggregate of the U.S. Shareholder’s pro rata share of the tested income of each CFC, minus aggregate pro rata share of tested loss
- **“Tested income”** is the excess of gross income over deductions, where gross income disregards:
  - Income effectively connected with U.S. trade or business (“ECI”);
  - Subpart F income;
  - Income excluded from subpart F under the § 954(b)(4) high-tax exception;
  - Dividends from related persons defined in § 954(d)(3); and
  - Foreign oil and gas extraction income defined in § 907(c)(1).
- **“Tested Loss”** means the excess, if any, of deductions (including taxes) properly allocable to gross income (without regard to tested income exceptions) over the tested income; to deny double benefit of losses, § 952(C)(1)(A) increases the E&P of the CFC by the tested loss
- **“Qualified Business Asset Investment”** (QBAI) consists of the CFC’s average aggregate adjusted bases in specified tangible property used in the trade or business and of a type with respect to which a deduction is allowable under § 167
- **“Specified Interest Expense”** is excess of Tested Interest Expense over Tested Interest Income of a CFC
- **“Tested Interest Expense”** is interest expense paid or accrued by a CFC in determining tested income or tested loss from the CFC inclusion year; in the case of a CFC that is an insurance company or engaged in a banking, financing or similar business, tested interest expense is reduced by “qualified interest expense”
- **Relationship to Other Code Sections.** GILTI inclusions are generally treated in the same manner as subpart F inclusions for purposes of applying Code §§ 168(h)(2)(B), 535(b)(10), 851(b), 904(h)(1), 959, 961, 962, 993(a)(1)(E), 996(f)(1), 1248(b)(1), 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D), and 6655(e)(4)

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GILTI – Corporate Shareholders

**U.S. SHAREHOLDER IS DOMESTIC “C” CORPORATION**

- Include Subpart F in gross income ($951)
- Include GILTI in gross income ($951A)
- Deduct amount equal to 50% of GILTI inclusion; reduced to 37.5% for taxable years beginning on or after 2025 ($250)
- Foreign tax credit up to 80% of CFC tested income ($960(d)); allocated to a separate FTC basket, without carryover or carryback ($904(c), (d))

**For the domestic “C” corporation**, if QBAI is zero, the domestic C corporation’s GILTI inclusion is 100% of the CFC’s tested income

- **10.5%** federal effective rate for taxable years beginning before 2026 (based on 50% deduction)
- **13.125%** federal effective rate thereafter (based on 37.5% deduction)

**80% Foreign Tax Credit.** The Treasury Explanation states that the CFC’s minimum foreign tax rate on GILTI, after which no U.S. federal tax is due, is 13.125% through 12/31/2025 and 16.406% thereafter; however, this will not be true in all cases, because expense allocations may cause available foreign tax credit limitation under the § 904 to be reduced
GILTI – Non-Corporate Shareholders

**U.S. SHAREHOLDER IS INDIVIDUAL, PARTNERSHIP, RIC, REIT, OR “S” CORP**

- Include Subpart F in gross income (§951)
- Include GILTI in gross income (§ 951A)
- No deduction (§ 250 deduction applies only to domestic corporations)
- No foreign tax credit (unless a § 962 election is made)

**For the domestic non-corporate shareholder**, if QBAI is zero, the GILTI inclusion is 100% of the CFC’s tested income

- **Federal Income Tax Rate.** Maximum individual income tax rate applies, up to 37%
- **No Foreign Tax Credit.** There is no indirect foreign tax credit available
- **NIIT.** Applicable to receipt and not inclusion, similar to Subpart F

- The Joint Explanatory Statement of the Conference Committee, footnote 1524, confirms that deductions for GILTI and FDII are not available to S corporations, RICs, or REITs
GILTI – Implications & Planning Considerations

- Impact on individuals and other non-corporate U.S. Shareholders
  - Direct ownership by these shareholders is highly inefficient; highest ordinary rates apply and foreign tax credits generally not available
  - Other options include pass-through structures, C corp holding companies, Section 962 elections
- QBAI planning
  - Opportunities to maximize QBAI (in order to minimize GILTI inclusions)
  - Proposed regulations directly address; provide anti-abuse rules relating to assets held temporarily and assets acquired in “disqualified transfers”
- Remaining technical issues (e.g., E&P adjustment for tested losses; ownership of CFCs through partnerships)
Domestic Partnerships and Their Partners

- Hybrid approach of Prop. Reg. § 1.951A-5:
  - Domestic partnership that is a U.S. shareholder with respect to one or more CFCs must compute partnership-level GILT inclusion amount
  - Any partner of such domestic partnership that is not itself a U.S. shareholder of any CFC of the domestic partnership takes into account its distributive share of the partnership-level GILT inclusion amount
  - Any partner who is independently a U.S. shareholder of a CFC of the domestic partnership determines its share of CFC tested items as if the domestic partnership were a foreign partnership

- New reporting requirements:
  - K-1 will be required to include each partner’s share of a domestic partnership’s GILT inclusion
  - For partners that are U.S. shareholders with respect to a CFC of the partnership, K-1 must also provide partner’s proportionate share of partnership’s pro rata share of tested items with respect to the CFC
Ownership of CFCs Through Partnerships – Example 1

Key Facts:

- Ownership interests are as set out on the left; assume each corporation has a single class of stock outstanding
- Each entity uses the calendar year and the US dollar as its functional currency
- Tested income/loss for 2018 is as indicated on the left
- None of CFC 1, CFC 2, or CFC 3 has any QBAI
Ownership of CFCs Through Partnerships – Example 1 (cont’d)

<table>
<thead>
<tr>
<th>Domestic PRS - GILTI Inclusion Amount</th>
<th>CFC 1</th>
<th>CFC 2</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pro Rata Share of Tested Income</td>
<td>20</td>
<td>8</td>
<td>28</td>
</tr>
<tr>
<td>Pro Rata Share of Tested Loss</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Net CFC Tested Income</td>
<td>20</td>
<td>8</td>
<td>28</td>
</tr>
<tr>
<td>Less NDTIR</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>GILTI Inclusion Amount</td>
<td>20</td>
<td>8</td>
<td>28</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>US Corp - GILTI Inclusion Amount</th>
<th>CFC 1</th>
<th>CFC 3</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pro Rata Share of Tested Income</td>
<td>12</td>
<td>0</td>
<td>12</td>
</tr>
<tr>
<td>Pro Rata Share of Tested Loss</td>
<td>0</td>
<td>(100)</td>
<td>(100)</td>
</tr>
<tr>
<td>Net CFC Tested Income</td>
<td>0</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Less NDTIR</td>
<td>0</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>GILTI Inclusion Amount - Direct</td>
<td>0</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Distributive Share of PRS GILTI</td>
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<td></td>
<td>4.80</td>
</tr>
<tr>
<td>Total GILTI Inclusion</td>
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<td></td>
<td>4.80</td>
</tr>
</tbody>
</table>
Ownership of CFC Through Partnerships – Example 2

- Same facts as Example 1, except that PRS is a foreign partnership:

<table>
<thead>
<tr>
<th>US Corp - GILTI Inclusion Amount</th>
<th>CFC 1</th>
<th>CFC 3</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pro Rata Share of Tested Income</td>
<td>12</td>
<td>0</td>
<td>12</td>
</tr>
<tr>
<td>Pro Rata Share of Tested Loss</td>
<td>0</td>
<td>(100)</td>
<td>(100)</td>
</tr>
<tr>
<td>Net CFC Tested Income</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less NDTIR</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GILTI Inclusion Amount - Direct</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Distributive Share of PRS GILTI</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Total GILTI Inclusion</td>
<td>0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Subpart F Modifications
# Key Modifications of Subpart F

A CFC is any foreign corporation more than 50% of voting power or value of which is owned directly, indirectly, or constructively on any day of the taxable year by U.S. shareholders.

## Prior Law

### Definition of U.S. Shareholder
- Any U.S. person (citizen, resident, or domestic partnership or corporation) holding directly, indirectly or constructively at least 10% of the corporation's voting power.

### 30-Day Rule
- Subpart F income of a CFC is not includable in the income of its U.S. Shareholders unless the CFC has been a CFC for an uninterrupted period of 30 days or more during any taxable year.

### Constructive Ownership and Stock Attribution
- **Partnerships and Estates:** Stock owned directly or indirectly by or for a partner of a partnership or a beneficiary of an estate is considered to be owned by the partnership or the estate.
- **Trusts:** Stock owned directly or indirectly by or for a beneficiary of a trust is considered to be owned by the trust (unless the beneficiary's interest is a remote contingent interest); stock owned directly or indirectly by or for a foreign person who is considered the owner of any portion of a grantor trust shall be considered to be owned by the trust.
- **Corporations:** If 10% or more in value of the stock in a corporation is owned directly or indirectly by or for any person, such corporation will be considered as owning the stock owned, directly or indirectly by or for such person.
- **However:** the above rules do not apply to attribute stock owned by a person who is not a U.S. person to a U.S. person (§ 958(b)(4)).

## Current Law

### Expanded Definition of U.S. Shareholder
- A U.S. Shareholder under subpart F will now include any U.S. person who owns 10% or more of the vote or value of shares of all classes of stock of a foreign corporation.

### 30-Day Rule Eliminated
- The requirement that a corporation must be a CFC for an uninterrupted period of 30 days as a prerequisite to subpart F inclusions is eliminated.

### Stock attribution rules for determining CFC status modified
- By the repeal of § 958(b)(4)
  - Stock of a foreign corporation owned by a foreign person may now be attributed to a partnership, estate, trust or corporation in which such person is a partner, beneficiary or shareholder (as applicable) for purposes of determining whether the related U.S. person is a U.S. Shareholder of the foreign corporation.
  - The pro rata share of a CFC's subpart F income that a U.S. Shareholder must include currently in gross income will continue to be determined based on direct or indirect ownership of the CFC, without application of the new downward attribution rule.
  - Pending further guidance, Treasury has provided an exception to certain Form 5471 filing requirements expanded by the repeal of § 958(b)(4), and suspended application of the repeal for purposes of certain source rules; see Notice 2018-13.
Section 958(b) imports § 318 attribution rules into subpart F, but § 958(b)(4) previously barred § 318(a)(3)(C) attribution, where the result would be to treat stock owned by a foreign person as owned by a U.S. person.

The TCJA removes the rule that prohibits downward attribution from a foreign person to a U.S. person in § 958(b)(4) (as applicable prior to the Act).

As a result, in Scenario A, Foreign Parent’s 90% interest in FC is attributed to USCo and FC is now a CFC.

Under the Act’s expanded attribution rules, FC stock held by FP in Scenario B is attributed to USCo.

Change to Ownership Attribution Rules – Examples

<table>
<thead>
<tr>
<th>Scenario A</th>
<th>Scenario B</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Individual</td>
<td>Foreign Person</td>
</tr>
<tr>
<td>Foreign Partnership (FP)</td>
<td>Foreign Corporation (FC)</td>
</tr>
<tr>
<td>Foreign Parent</td>
<td>USCo</td>
</tr>
<tr>
<td>90%</td>
<td>50% Vote &amp; Value</td>
</tr>
<tr>
<td>10%</td>
<td>90% Vote &amp; Value</td>
</tr>
<tr>
<td>USCo</td>
<td>Foreign Corporation (FC)</td>
</tr>
<tr>
<td>50%</td>
<td>Foreign Partnership (FP)</td>
</tr>
<tr>
<td>Increased Subpart F Income</td>
<td>10% Vote &amp; Value</td>
</tr>
</tbody>
</table>
Disposition of ECI Partnerships by Foreign Partners
Disposition of ECI Partnerships by Foreign Partners

Prior Law and Legislative Response:
- Revenue Ruling 91-32, 1991-1 C.B. 107
- *Grecian Magnesite Mining, Industrial & Shipping Co. v. Commissioner*, 149 T.C. No. 3 (2017)
- Legislative response: Codification of RR 91-32 principles (§ 864(c)(8)) and enactment of corresponding withholding rules (§ 1446(f))

864(c)(8):
- Foreign transferor of an interest in a partnership that is engaged in a U.S. trade or business must treat as ECI the amount of gain/loss that would have been allocated to that partner if the partnership had sold all of its assets for fair market value
- Numerous unresolved issues (e.g., method for computing ECI gain; not clear how 864(c)(8) interacts with non-recognition provisions)
Disposition of ECI Partnerships by Foreign Partners (cont’d)

1446(f) Statutory Provisions:

- Requires transferee to withhold 10% of foreign transferor’s amount realized on disposition of a partnership interest if any portion of transferor’s gain is treated as ECI under 864(c)(8)
- If transferee fails to withhold, partnership must withhold on distributions to transferee
- Not coordinated with non-recognition provisions
- Applies to partnership distributions
- Treasury has authority to create exceptions or reduce withholding amount
- Numerous technical issues that must be resolved (e.g., how does partnership establish whether transferee properly withheld?)
- Unmodified, would likely result in substantial overwithholding in many cases

Notice 2018-8:

- Suspends 1446(f) withholding requirements with respect to dispositions of PTP interests, pending guidance
Disposition of ECI Partnerships by Foreign Partners (cont’d)

Notice 2018-29:

- Intended to facilitate administration of 1446(f) withholding, and minimize occasions of overwithholding
- Provides framework for transferees required to withhold; generally, follow rules under Section 1445 (FIRPTA withholding)
- Transferor may certify non-foreign status by providing IRS Form W-9 to transferee or providing a modified 1.1445-2(b) certification
- Transferor may certify to transferee that there is no gain realized on the transaction (in which case withholding is not required)
- Pending further guidance, no withholding is required in connection with nonrecognition transactions; Notice provides
- Establishes exceptions for cases involving ECI below certain thresholds (currently using a 25% threshold in each case, but announcing intent to reduce threshold in future guidance)
  - Transferor certification
  - Partnership certification
- Provides mechanism for limiting withholding obligation to amount of payment (i.e., excluding the portion of amount realized attributable to decrease in the transferor’s share of partnership liabilities
- Rules to facilitate 1446(f) withholding determinations with respect to partnership distributions
- Suspension of “backup” withholding by the partnership, pending further guidance
Bryan Kelly is a member of Venable's Tax and Wealth Planning Group. A substantial part of his practice focuses on tax considerations relating to various cross-border transactions, and advising U.S.-based and non-U.S.-based multinational organizations across a number of industries, and high-net-worth individuals and families. In his role as an international tax advisor, in addition to providing U.S. tax advice, Mr. Kelly regularly coordinates with advisors across multiple jurisdictions to manage the global design and implementation of structuring and restructuring projects.

Mr. Kelly also works with both sponsors and investors in connection with the establishment and operation of various types of investment funds, and has substantial experience working with clients across a number of industries and geographies to plan and negotiate the tax aspects of mergers and acquisitions, joint ventures, and financings.

Before joining Venable, Mr. Kelly was a member of the International Tax Services Group at Ernst & Young. Prior to his tenure there, Mr. Kelly spent nearly a decade in private practice in New York and Los Angeles, where he advised on U.S. tax matters relating to a variety of domestic and cross-border transactions.
Tax Reform One Year Later: Determining the Winners and Losers

TCJA Estate & Gift Tax Provisions & Planning Opportunities

Kelley C. Miller, Esq.
kmiller@reedsmith.com
Key Estate & Gift Tax Changes in the Tax Cuts and Jobs Act (H.R. 1):

- **Key Changes included in the Tax Cuts and Jobs Act (H.R. 1):**
  - Temporarily doubled the base exclusion amount (BEA) for estate and generation-skipping transfers to $10M, which is adjusted for inflation.
  - Section 11061 of the Act amended section § 2010(c)(3) to provide a temporary increase to $10M of the estate tax exemption, effective for estates of decedents dying after 12/31/17, and before 1/1/16. The $10M is indexed for inflation for taxable years beginning after 12/31/17.
  - In 2026, the exemption amounts for estate and generation-skipping transfers will revert back to pre-2018 levels of $5M, which will be adjusted for inflation.
  - Under prior law, each taxable estate was allowed an exemption from the estate tax on up to $5.49M. For 2018, the inflation-adjusted BEA is $11.18M for determining the amount of the unified credit against estate tax of a decedent who passed away in calendar year 2018.
Key Estate & Gift Tax Changes in the Tax Cuts and Jobs Act (H.R. 1):

- Key Changes included in the Tax Cuts and Jobs Act (H.R. 1):
  - No affect to beneficiaries’ requirement to use stepped-up or stepped-down basis
  - No effect to the taxable rate of 40% for estate property valued over the excluded base amount
  - No effect on whom is subject to the generation-skipping transfer tax
  - Any direct transfers to relatives more than one generation younger than the transferor, such as grandchildren or individuals who are at least 37.5 years younger than the transferor, are subject to the generation-skipping transfer tax
- No impact on the per-gift exclusion amount of up to $14k per person annually, which currently totals $15k due to inflation adjustments
Key Estate & Gift Tax Changes in the Tax Cuts and Jobs Act (H.R. 1):

- New indexing scale that is based on “chained consumer price index” (chained CPI)
  - Chained CPI applies to determine the maximum amount qualifying for the gift tax annual exclusion

- Additional authority for the Secretary to prescribe regulations necessary or appropriate to carry out section 2001 with respect to any difference between the BEA applicable at the time of the decedent’s death and the BEA applicable with respect to any gifts made by the decedent.

- Section 11002 of the Act amended section 1(g)(3) of the Code to base the determination of annual cost-of-living adjustments, including those for gift and estate taxes, on the Chained Consumer Price Index for All Urban Consumers for all taxable years beginning after 12/31/17. Also, the section 11002 made conforming changes in sections 2010(c)(3)(B)(ii), 2032A(a)(3)(B) and 2503(b)(2)(B).
Winners?
Estate & Gift Tax Changes Tax Cuts and Jobs Act (H.R. 1):

• Overall, there are major opportunities starting in 2018 to minimize the tax cost of transferring wealth.

• By doubling the exemption base, those who had used their entire $5.49M exemptions through 2017 are able to transfer an additional $5.69M for an individual or $11.38M for a married couple in 2018 without current gift tax or future estate or generation-skipping taxes.

• If a client’s plan uses a tax-based formula, it may need to be reconsidered in light of the double exemptions.
Winners?

Estate & Gift Tax Changes Tax Cuts and Jobs Act (H.R. 1):

• The changes in the base exclusion amount raised several concerns regarding a potential for inconsistent tax treatment and double taxation of transfers resulting from the temporary nature of the increase BEA.

  • Within the proposed regulations, a special rule was established to allow the estate to compute its estate tax credit using the higher of the BEA applicable to gifts during life or the BEA applicable on the date of death. The special rule specifically addressed the concern that an estate tax could apply to gifts exempt from gift tax by the increased BEA.
Winners?
Estate & Gift Tax Changes Tax Cuts and Jobs Act (H.R. 1):

• Within the recently issued proposed regulations (Prop. Regs. Sec. 20.2010-1(c)), a special rule was established where the portion of the allowable credit amount as of a decedent's death is less than the sum of the credit amounts allowable in computing (post-1976) gift tax, the estate tax credit may be based on the greater of the two credit amounts.

• Result? Making large gifts now won't harm estates after 2025 via the decision to not have a clawback.

• Treasury to hold a hearing on the proposed regulations on March 13, 2019, which will more than likely elicit additional comments regarding the TCJA changes.
Planning Considerations

- Choice of entity considerations
- Annual individual tax projections
- Revisit estate planning in light of increased exemption
- Depreciation timing and coordination with S. 199A and S. 163(j)