

# Navigating Tax Reform for Manufacturers and Owners

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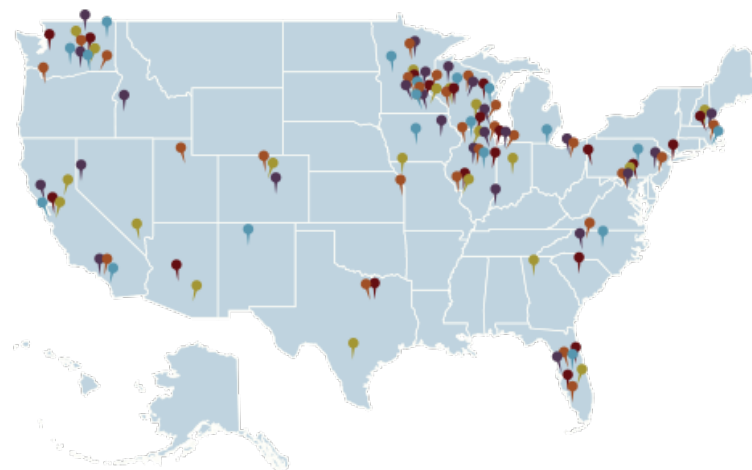
# Speaker Introductions

- **Nick Romanelli, CPA, MST, Principal**

Nick is a tax principal in our industry group in Oak Brook, IL and has over 11 years of experience in public accounting focusing on family owned/closely held manufacturing and distribution businesses. Nick manages federal and state tax advisory and compliance for all types of entities and their owners. Nick has first hand experience in the unique and rewarding operations of a family owned manufacturing business. His Grandfather started a stainless steel pipe fittings and flanges company in Carol Stream, IL where he used to work during his summers off from school.

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# Learning Objectives

- At the end of this session, you will be able to:
  - Identify key points related to the new tax plan
  - Understand how tax reform impacts you and your business
  - Develop planning strategies relevant to your business and personal tax situation

# H.R.1 – Tax Cuts and Jobs Act (TCJA)

- **H.R.1 Official Title:** “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.”
- **December 22, 2017:** Signed into law by President Trump (Public Law No. 115-97)



# Tax Cuts and Jobs Act (TCJA)

## Key Aspect Comparison: Tax Rates



# Individual Tax Rates

## 2017 Individual Tax Rates (Pre-TCJA)

Tax Bracket	Single	MFJ	H of H
10%	9,325	18,650	13,350
15%	37,950	75,900	50,800
25%	91,900	153,100	131,200
28%	191,650	233,350	212,500
33%	416,700	416,700	416,700
35%	418,400	470,700	444,550
<b>39.6%</b>	<b>EXCESS</b>		

## 2018 – 2025\* Individual Tax Rates (Under TCJA)

Tax Bracket	Single	MFJ	H of H
10%	9,325	19,050	13,600
12%	38,700	77,400	51,800
22%	82,500	165,000	82,500
24%	157,500	315,000	157,500
32%	200,000	400,000	200,000
35%	500,000	600,000	500,000
<b>37%</b>	<b>EXCESS</b>		

\* Barring further legislation, the TCJA individual rate changes will expire (sunset) after 2025



# Corporate Tax Rates

## Corporate Tax Rate Under TCJA:

2017 Corporate Tax Rates (Graduated)	
Tax Bracket	Taxable Income
15%	50,000
25%	75,000
34%	100,000
39%	335,000
34%	10,000,000
35%	15,000,000
38%	18,333,333
35%	EXCESS
Corporate AMT Tax Rate = 20%	

- **Flat 21% Rate, effective for tax years beginning after December 31, 2017\***
- **20% Corporate AMT Repealed**  
*(Prior AMT Credits refundable up to 50% of excess AMT credits > regular tax liability for 2018 – 2020; Remaining AMT credit refunded in 2021)*

\* Blended tax rate for corporations with fiscal years beginning before 12/31/2017

# Estate & Trust Tax Rates

**2017 Estate & Trust Tax Rates (Pre-TCJA)**

Tax Bracket	Taxable Income
15%	2,550
25%	6,000
28%	9,150
33%	12,500
<b>39.6%</b>	<b>EXCESS</b>
2018 Indexed Estate Exemption = \$5,600,000 (per individual)	

**2018 – 2025\* Estate & Trust Tax Rates (Under TCJA)**

Tax Bracket	Taxable Income
10%	2,550
24%	9,150
35%	12,500
<b>37%</b>	<b>EXCESS</b>
2018 - 2025 Estate Exemption Doubled (Presumed 2018 exemption = \$11.2M per individual) *2019 – 2025 Indexed for Inflation	

- **Lifetime Estate Exemption Doubled\*: \$5M to \$10M + Indexing**
  - *Presumed 2018 Exemption = \$11.2M*
- **Annual Gift Tax Exclusion of \$15,000 Retained Under TCJA**

\* Barring further legislation, the TCJA estate & trust rate changes and lifetime estate exemption increases will expire (sunset) after 2025

# Capital Gains Tax Rates

## 2017 Capital Gains Tax Rates (Pre-TCJA)

Tax Bracket	Single	MFJ	H of H	Estates & Trusts
0%	37,950	75,900	50,800	2,550
15%	418,400	470,700	444,550	12,500
20%	EXCESS			

## 2018 – 2025\* Capital Gains Tax Rates (Under TCJA)

Tax Bracket	Single	MFJ	H of H	Estates & Trusts
0%	38,600	77,200	51,700	2,600
15%	425,800	479,000	452,400	12,700
20%	EXCESS			

- **TCJA generally retains prior law tax rates and breakpoints on capital gains and qualified dividends.**
  - *Breakpoints at which the 15% and 20% tax rates begin to apply are indexed for inflation for tax years after December 31, 2017.*
- **Ordinary income fills lower brackets first, then capital gains.**
  - *Deductions offset ordinary income*

# Tax Cuts and Jobs Act (TCJA)

## Key Aspect Comparison: Individual Provisions



# Individual Tax Deductions

Tax Bracket	Pre-TCJA	Under TCJA
Standard Deduction	Single: 6,350 MFJ: 12,700 HoH: 9,350	Single: 12,000 MFJ: 24,000 HoH: 18,000
Personal Exemption	\$4,050 per Individual <i>*Subject to AGI Phase-out</i>	<i>Repealed</i>
Mortgage Interest	Debt Limit: \$1.1M 2 <sup>nd</sup> Home Allowed: Yes Home Equity Interest Allowed: Yes	Debt Limit: \$750,000 2 <sup>nd</sup> Home Allowed: Yes Home Equity Interest Allowed: Maybe
Taxes	<u>Itemized Deduction Allowed for:</u> <ul style="list-style-type: none"> <li>Real Estate Tax (U.S. Property Only)</li> <li>Personal Property Tax</li> <li>State/Local Income Tax (or sales tax)</li> </ul>	Itemized Deduction <b>Limited to \$10,000</b> for the <i>Aggregate</i> of State & Local Property and Income Taxes
Charitable Deductions	Limited to 50% AGI	Limited to 60% AGI <i>*80% Deduction for Athletic Tickets Repealed</i>
Miscellaneous Deductions	Itemized Deduction Subject to 2% AGI Floor (includes employee business expense, investment expenses, tax prep fees, professional dues, etc.)	<i>Repealed</i>
Medical Expenses	Subject to 10% AGI Floor	Subject to 7.5% AGI Floor <i>*Retroactive to 2017</i>
AGI Phase-out	Phase-out begins at \$313,800 (MFJ)	<i>Repealed</i>

# Individual Qualified Business Income (QBI) Deduction

- Under pre-TCJA, no special deduction for QBI
- Deduction available for noncorporate taxpayers
  - *Also referred to as the “pass-through deduction” or “199A”*
- Not a deduction to arrive at AGI
- Specified service businesses generally not eligible
- *Sunsets for tax years beginning after 12/31/2025*

# Individual Qualified Business Income (QBI) Deduction

- **Deduction = 20% Non-Wage “Trade or Business” Income**
  - Sole Proprietorships (reported on Sch C)
  - Pass-through entities subject to tax at the individual owner level (from Sch K-1)
  - *Wages paid by S Corp and guaranteed payments paid by partnership not included*

# Individual Qualified Business Income (QBI) Deduction

- **Limited to greater of:**

- 50% of the taxpayer's share of allocable wages from pass-through entities
- Sum of 25% allocable wages + 2.5% unadjusted basis of qualified property

- **Qualified Property Defined:**

- Depreciable tangible property held by and available for use at the close of the tax year
- Included in computation if held at least 10 years or until expiration of recovery period, whichever is longer



# Individual Qualified Business Income (QBI) Deduction

- **Lower Income and Wage Limitation**
  - Wage & investment limitation does not apply for taxpayers below taxable income threshold amounts
    - <\$315,000 MFJ / \$157,500 Single
    - Phase in 20% limit over next \$100,000 MFJ / \$50,000 Single
- **Deduction Allowed Against AMTI**
- **Not Available for Purposes of Self-Employment Tax**
- **Deduction Allowed to Non-Itemizers**

## Other Individual Provisions

- Child Tax Credit Increased from \$1,000 to \$2,000
- American Opportunity Tax Credit Retained
- Alimony no longer deductible/includible in income
  - Applies to divorce/separation agreements executed after 12/31/2018
- Exclusion for Moving Expense Reimbursements Suspended Until 2026
  - Does not apply to members of the Armed Forces on active duty who moved pursuant to military order
  - *Moving Expense Deduction – Suspended Until 2026*
- Individual Mandate Under ACA Repealed
  - Effective 1/1/19
  - 0.9% MCT and 3.8% NIIT remain
- Individual AMT Retained – Exemptions Increased

# Tax Cuts and Jobs Act (TCJA)

## Key Aspect Comparison: Business Provisions



# Bonus Depreciation

- **Pre-TCJA: 50% Bonus Depreciation On New Property Placed in Service During 2017**
  - Scheduled to phase down to 40% in 2018, 30% in 2019 and zero thereafter
- **Under TCJA: 100% Bonus Depreciation**
  - Applied retroactively and effective for property acquired and placed in service after September 27, 2017
  - Phase down beginning in 2023 (fully phased out after 2026)
  - Eligibility expanded to used property

## Section 179 Expensing

- **Pre-TCJA: Section 179 Expensing Limited to \$510,000 (for tax years beginning in 2017)**
  - Asset addition phase-out limit for 2017 begins at \$2,030,000
  - HVAC units only available for Section 179 if treated as “personal property”
- **Under TCJA: Section 179 Expensing Limit Increased to \$1M**
  - Phase-out threshold increased to \$2.5M
  - Eligibility expanded to include roofs, HVAC and fire alarm/security systems for nonresidential property
  - Effective for tax years beginning after 12/31/2017

# Real Property Depreciation

- Retains 39-year recovery period for nonresidential depreciable real property
- Retains 27.5-year recovery period for residential depreciable real property
- Eliminates separate definitions of 15 year property
  - Qualified leasehold improvement property
  - Qualified restaurant property
  - Qualified retail improvement property
- Focus is on qualified improvement property
  - Improvements to interior portion of building
  - Nonresidential
  - Placed in service after date building placed in service
  - Straight-line 15 year, with 20-year ADS

# Disallowed Business Interest Expense

- **Pre-TCJA:** Business interest generally allowed as a deduction
- **Under TCJA: Interest expense limited to interest income + 30% of remaining adjusted taxable income**
  - Remaining business adjusted taxable income
    - Determined w/o interest income, NOL, 199A, depreciation, amortization, depletion
    - Determined at tax filer level (1065, 1120S, 1120)
  - Excess carried forward indefinitely
  - Businesses with <\$25M average annual gross receipts exempt
  - “Real property trade or business” can elect out

# Accounting Methods

- **Cash Method of Accounting (Pre-TCJA)**

- C corporations and partnerships with C corporations as a partner with gross receipts < \$5M.
- Small businesses with gross receipts < \$1M
- Certain industries with gross receipts < \$10M
- Inventory costs may not be deducted until sold

- **Cash Method of Accounting (Under TCJA)**

- Permitted for all businesses with average annual gross receipts < \$25M
- Inventory accounted for as non-incidental supplies (i.e. hold cost until sold) or by conforming to method reflected on financial statements
- *Automatic Consent Accounting Method Change*



# Accounting Methods

- **UNICAP (Pre-TCJA)**

- Manufacturers of inventory required to capitalize indirect costs
- Resellers of inventory with gross receipts > \$10M required to capitalize certain indirect costs
- Applies to real property constructed by taxpayers
- Resellers with average annual gross receipts < \$10M exempt

- **UNICAP (Under TCJA)**

- Gross receipts exemption test increased from \$10M to \$25M
- *Automatic Consent Accounting Method Change*

# Accounting Methods

- **Long-Term Contracts (Pre-TCJA)**

- Generally, Percentage of Completion method required
- Completed Contract method permitted for businesses with gross receipts < \$10M or contracts expected to be completed within 2 years

- **Long-Term Contracts (Under TCJA)**

- Gross receipts exemption test increased from \$10M to \$25M
- *Automatic Consent Accounting Method Change*
- *Conversion is done on a cut-off basis for new contracts*

## Section 199: Domestic Production Activities Deduction

- **Pre-TCJA:** Section 199 allows a deduction of 9% of the taxpayer's qualified production activities income for the tax year
- **Under TCJA: Repealed**
  - Effective for taxable years beginning after 12/31/2017

# Meals & Entertainment

- **Entertainment Expense: Non-Deductible!**
  - Transportation passes and parking fringes disallowed
  - Social, athletic and sporting clubs treated as entertainment
- **Employer-provided eating facility limited to 50%**
  - *Pre-TCJA: 100% Deductible*
  - Also repeals employer deduction for employer-provided on premises meals and employer eating facilities after 2025
- **Meals consumed on work travel remain 50% deductible**

# Net Operating Losses (C Corps)

- **Net Operating Losses (Pre-TCJA)**
  - 2 Year Carryback
  - 20 Year Carryforward
  - *AMT NOL – Offset 90% AMT Income*
- **Net Operating Losses (Under TCJA)**
  - Carryback Repealed
  - NOLs generated after 2017 – Carryforward offsets 80% taxable income in future years
  - Carried forward indefinitely
    - *Pre-2018 NOLS retain 20-year carryover restrictions*

# Business Credits

- **Retained:**

- Employer-Provided Child Care Credit
- Research & Development Credit
- 20% Credit for Rehab of Certified Historic Structure
- Work Opportunity Tax Credit (WOTC)
- New Markets Tax Credit
- Investment in Qualified Community Development
- Disabled Access Credit
- Employer Tip Credit

- **Modified:**

- Orphan Drug Credit – Modified from 50% to 25% of qualified clinical testing expenses

- **Repealed:**

- 10% credit for qualified rehabilitation expenditures with respect to pre-1936 buildings

# Business Credits

- **New Credit - Employer-Paid Family and Medical Leave:**

- Credit = 12.5% wages paid to qualifying employees during any period in which employees are on family and medical leave
  - Rate of payment must be > 50% wages normally paid
  - Credit increased 0.25% for each percentage point by which payment rate exceeds 50%
  - Maximum credit = 25%
  - Maximum 12 Weeks
- Not available to the extent that family and medical leave is mandated by state or local law
- Eligible Employer – Requires written policy allowing all qualifying full-time employees not less than two weeks annual paid family & medical leave
- Available for 2018 and 2019 Only
- Allowed Against AMT

# Research Expenses

- **Research Expenses (Pre-TCJA)**

- Deductible in the year incurred

- **Research Expenses (Under TCJA)**

- “Specified R&E Expenses” must be capitalized and amortized over 5 years
  - Includes expenses for software development, exploration expenses related to oil & gas and other minerals
  - Not Included: Expenses for land or depreciable property used in connection with R&E
- Effective for amounts paid or incurred in tax years beginning after 2021



# Choice of Entity

- **Considerations**

- Qualified for 20% pass-through deduction?
- Timing of dividends?
  - Trigger double taxation with C-Corp
- Deductibility of state income taxes
  - Very limited or eliminated at personal level (pass-through)
  - Deductible to C-Corp
- Passive or active owners
  - Passive likely subject to 3.8% NIIT
- Exit strategy
  - Stock v. Asset, potential gain exclusion for certain stock sales
- International issues

# Tax Cuts and Jobs Act (TCJA)

**Key Aspect:  
International**



# International Overview

- **100% Dividend Received Deduction for Foreign Source Portion of Dividends**
  - Pre TCJA
    - Foreign source income of controlled foreign corp. generally deferred from US tax until repatriated
  - TCJA
    - Participation exemption – 100% DRD for domestic C. Corps
    - Applicable to dividends from specified 10% owned foreign corps
    - 1 year holding period
    - No deduction or credit for foreign taxes paid or accrued
    - Distributions made after December 31, 2017
    - Adds new “minimum taxes” on low taxes foreign sourced income



# International Overview

- **Deemed Repatriation Tax**

- Automatically taxes certain offshore earnings of U.S. multinationals
- 15.5% on cash and cash equivalents
- 8% on noncash amounts
- Election to spread repatriation over 8 years
- Applies to specified 10-percent owned foreign corporations by U.S. Corporate Shareholders
- Election to continue deferral for S-Corp owners until “triggering event”



# Summary

- Planning considerations
  - Accelerate deductions into 2017, there is still time
    - Cost segregation study
    - Other automatic method changes
  - Modeling for entity structure
  - Accounting method review
    - Accrual to cash, Inventory, UNICAP
    - Completed contract
    - LIFO methods
  - Capital expenditures
  - Earning and Profits and Transfer Pricing Study
  - IC-DISC Potential





# Questions?

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