A MONTHLY DIGEST OF KEY STATE, FEDERAL AND INTERNATIONAL TAX DEVELOPMENTS TO KEEP YOU ABREAST OF CURRENT AND PENDING TAX CONCERNS

TAX INSIGHTS

Highlighting tax developments of interest to today's companies on the move.

In this issue:

TAX REFORM

Border Adjusted Tax proposals may impact exporters and importers

By: Ben Wasmuth, Manager and Jamison Sites, Manager

Download white paper

As 2017 begins, and a new Congress and president are sworn in, a comprehensive tax overhaul appears to be near the top of the legislative agenda. Included in the tax policy proposals put forward by Speaker Paul Ryan and the House GOP during the election season was a potentially significant change in U.S. international tax policy. They have proposed a destination-based tax, where income from goods and services are taxed based on where they are consumed, as opposed to where they are produced and sold. As described in the House Republican Tax Reform Blueprint, this would be facilitated by so-called border adjustments which would result in generally taxing imported goods and services while exempting exported goods and services from U.S. tax.

While the Blueprint is light on implementation details, the proposal is likely based on a more detailed proposal from the report of the President's Advisory Panel on Federal Tax Reform (issued during the George W. Bush administration), allowing some concepts to be outlined. However, at this time the specific parameters of this border adjusted tax (BAT) are far from clear, with many potential variations possible.

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How a BAT might work

One of the border adjustments that might be included in a destination-based tax system is an exemption for sales of good and services outside the United States. Thus, a domestic manufacturer that sells a product abroad is not subject to tax on the gross revenues from its foreign sales. Under another adjustment, the taxpayer may deduct its domestic cost of goods sold (CGS) but not its foreign CGS. Determining which costs are foreign vs. domestic is easier said than done but presumably actual legislative language will shed light on this point, whenever it emerges.

Just as a destination-based system would exempt exports from U.S. tax, it would likely subject imports to U.S. tax. As set forth in the report of the President's Advisory Panel, "Purchases from abroad are taxed by either making them nondeductible to the importing business or by imposing an import tax." The Blueprint does not suggest which of these methods would be adopted, although it does indicate that the move to a destination-based system will not involve a new tax, suggesting that costs incurred for imported goods would not be deductible.

Royalties on intellectual property held in the United States may become an exempt export, providing a powerful incentive for U.S. companies to keep their intangible assets home, however, this is still unclear.

These rules outline a simple approach to a BAT. The following examples illustrate how it would apply to importers and exporters.

To read more, go to: http://rsmus.com/what-we-do/services/tax/international-tax-planning/border-adjustment-proposals-may-significantly-benefit-export-act.html

TRENDING IN TAX

The importance of pre-transaction sell-side SALT due diligence

Sell-side SALT due diligence is often overlooked but can be advantageous

By: John Wojcik, Senior Manager and John Wozniczka, Partner

Download the article

There has been considerable merger and acquisition activity in the past few years, especially in the middle market. Coupled with the significant multiples being paid for businesses, this activity has owners eyeing the market and wondering if it's time to sell their businesses before the next economic downturn reduces the value. Whether the owners are individuals holding businesses that have been in their families for years or private equity firms, the goal is to maximize the value of the entity being sold.

Although the objective may seem simple, achieving it requires substantial time and effort. While the main focus in a transaction is generally on a selling company's financial statements, there are many components that affect those financial statements. State and local taxes often don't get much attention, but can nonetheless have a substantial impact on the economics of a deal.

In this article, first published in Tax Analyst's *State Tax Notes*, authors John Wojcik and John Wozniczka discuss how pre-transaction state and local tax due diligence can help companies and individuals selling a business:

- Identify and remedy tax exposure before a sale
- Maximize purchase price
- Understand the costs and benefits of common transaction structures

Sell-side SALT due diligence can be highly advantageous to a selling entity. It is a proactive approach, which puts a seller in a better position to discover potential tax issues, control the way to resolve any issues and maximize the expected returns when selling a business. By properly preparing for a sale through pre-transaction sell-side SALT due diligence, a seller can fix issues before they arise.

New revenue recognition guidance is looming. Is your tax process ready?

By: Christian Wood, Principal, Kari Peterson, Senior Manager, Peter Pentland, Manager, and Ryan Corcoran, Senior Manager

As companies begin preparing to implement the new revenue recognition guidance in their financial statements, they may not be focused on the tax implications. As part of the adoption of the guidance, companies should consider whether new book to tax differences will arise or if they will need to prepare a Form 3115 (or multiple forms) for federal income tax purposes.

The effective date for the new revenue recognition guidance (ASU 2014-09 included in ASC Topic 606) is fast approaching. Public entities (i.e., public business entities and certain not-for-profit entities and employee benefit plans) must apply the new guidance in annual reporting periods beginning after Dec. 15, 2017 and the interim periods within that year. For all other entities, the guidance is effective for annual periods beginning after Dec. 15, 2018. Implementing the updated guidance can be a labor and task intensive process as companies review the guidance, assess its impact, and adjust their systems and processes accordingly. In our experience to date, we believe the implementation process for public entities should be well underway and private entities should also be focused on assembling the necessary resources to implement. As companies determine how to best transition from legacy GAAP to the new guidance, the tax implications of the implementation must also be considered.

The core principle underlying the new guidance is to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled. Companies must follow a five-step model when applying the core principle to revenue-generating transactions:

1. Identify the contract with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognize revenue when (or as) each performance obligation is satisfied

Even though the tax rules for revenue recognition have not changed, a change in book recognition could create a change in the tax method of accounting. In addition, companies can take a deeper dive into their revenue recognition process and determine if there are previous book/tax differences that should have been accounted for and make accounting method changes to correct any items of concern.

Items of revenue are to be included in taxable income in the year in which the taxpayer has the fixed right to receive income and the amount can be determined with reasonable accuracy. In straightforward terms, revenue is recognized when it is due, paid or earned. However, tax provisions allow taxpayers to defer certain revenue to the extent deferred in an entity's audited financial statements (with limitations). An example of this would be the deferral of recognition for payments received in advance of delivering goods or performing services. The new revenue recognition guidance states that an entity must identify the performance obligations in a contract and recognize revenue as the entity satisfies each of those performance obligations. In certain situations, this could change the timing of revenue recognition under the new guidance compared to legacy GAAP. Consequently, this change in timing for financial statement purposes could lead to a change in the timing of recognition for tax purposes when the entity receives advance payments.

To read more, go to: http://rsmus.com/what-we-do/services/tax/lead-tax/accounting-methods-and-periods/new-revenue-recognition-guidance-is-looming.html

Section 7520 rate ticks up, will proposals trump sound planning?

If Hippocrates had been an estate planner, what would he advise today?

By: Charlie Ratner, Senior Director

The IRS announced in Rev. Rul. 2017-4 that the section 7520 rate for February 2017 will rise to 2.6 percent from January's rate of 2.4 percent. Applicable rates used in the construct of other interest rate-sensitive wealth transfer and charitable planning vehicles rose in lock step.

Needless to say, with the section 7520 and other 'hurdle' rates on a seemingly inexorable uptrend, the knee-jerk reaction would be to press ahead with those grantor-retained annuity trusts (GRATs) and, circumstances permitting, certain other interest-sensitive planning vehicles now while the pressing is good. Of course, with repeal of the estate tax (but apparently not the gift tax) on the agenda of President Trump and his Republican colleagues, estate planners are uniformly advising individuals to avoid transactions that will or even could potentially trigger a gift tax. For this reason, GRATs have become the preferred wealth transfer vehicle because they can be done without creating anything more than a negligible taxable gift.

So why the reference to Hippocrates? Of his many quotes, two seem particularly applicable nigh these 2500 years later. The first is, 'To do nothing is also a good remedy.' The second is, 'Make a habit of two things: to help; or at least to do no harm.' Let's apply each in turn to estate tax planning in today's environment.

To the notion that the uptrend in the section 7520 rate should spur prompt implementation of GRATs (and other interest-sensitive planning vehicles), Hippocrates might ask, "What's the hurry? Is the need to transfer appreciation out of your estate so great, so urgent, that it's worth parting with control over the asset and its income before you know how your income will be taxed in the years ahead?" He'd have a point, because wealth transfer planning should only be done when and to the extent that an individual's current and projected capacity to accommodate such transfers is clear. We suspect that 'clear' would not accurately describe most individuals' take on what the world will look like a year from now. As we have advised in previous alerts, one way for individuals to get a reasonably good look at their financial future and, therefore, their capacity to make large gifts, is to do a long-range projection of their cash flow and net worth through life expectancy.

But now let's consider a situation where taxpayers could have some very legitimate reasons to do some wealth transfer planning. Assume that a couple owns a successful business that they fully intend to pass on to their son and daughter. Even before the election, they had been thinking that, for a host of personal, tax and business reasons, it would make sense to get started on the transition, soon. Of course, their children agree wholeheartedly! Then came the election. With the estate tax now in play, maybe transition could be put off for a while. But the parents' advisors point out that they might want to stay on track for an earlier transition because, unlike the estate tax, there are no indications that the gift tax will be repealed. So, if transition is truly a matter of when and not if, now would be a good time to get started. After all, if the business just continues to become more valuable, then the gift tax cost of a lifetime transfer will correspondingly increase over time. What's more, if the estate tax, once repealed, is reinstated, a transition more closely proximate to the parents' own transition could cause some significant tax and liquidity problems. Coupled with the reminders from the children about how they (and their parents) are not getting any younger, the parents realize that there is a pretty strong case for transition now. In other words, doing nothing would not be a good remedy in this case. Of course, the parents will work with their advisors to structure the transition though GRATs, gifts and other techniques carefully, not just to avoid gift tax, but also to further the family's business and personal objectives while protecting against such vicissitudes of life as the children getting divorced.

To read more, go to: http://rsmus.com/what-we-do/services/tax/private-client/estate-and-gift-planning/section-7520-rate-ticks-up-will-proposals-trump-sound-planning.html

EVENTS AND WEBCASTS

RSM is a proud sponsor of the Tax Executives Institute 67th Midyear Conference, March 19–22, 2017 in Washington, D.C.

IN-PERSON EVENT | March 19, 2017

Effective tax planning can significantly impact cash flow and a company's risk profile. RSM professionals collaborate across specialties and regions to provide you with a local touch, backed by the support of a national firm. Our team has experience in areas including, credits and incentives, federal taxation, international tax planning and compliance, tax function optimization, and state and local tax. To see our full range of services, visit our tax services site.

RSM is proud to be a Gold Sponsor of the Tax Executives Institute (TEI) – three days of high-quality programming, powerful networking opportunities and urgent insights tailored to the business priorities of the tax professionals in attendance. Members of our Washington National Tax team will be on hand to lead sessions and answer your questions. You will not want to miss these informative discussions during TEI.

Economic nexus: The assault on Quill and other developments

Event details: Monday, March 20, 2:15—3:30 p.m.

Brian Kirkell, Principal, will discuss federal remote sales tax legislation and how the assault on Quill becomes even more aggressive as states desperately seek to recoup lost remote and e-commerce revenues. The panel will also examine state laws and regulations passed in 2016 that challenge the physical presence standard, and federal proposals such as the Marketplace Fairness Act, and where this will ultimately go.

Federal excise taxes: Navigating the unnavigable

Event details: Tuesday, March 21, 10:00—11:00 a.m.

Tom Windram, Partner, will examine how companies in a variety of industries who use a variety of fuels and pay excise tax (either directly or indirectly) on the fuels may qualify for a number of exemptions for non-taxable use or tax credits for alternative fuels. This session will provide some clarity on the often complex and confusing qualification rules and filing requirements, and provide insights to enable participants to help their companies take advantage of these tax saving opportunities.

BUSINESS GROWTH

Intersection of growth strategy and tax planning

By: Ernest J Nedder, Partner and Tony Urban, Principal

When your business is focused on growth, it needs to consider tax planning and the resulting tax impact of that expansion. In this brief video, E.J. Nedder and Tony Urban share some key tax areas you should consider as part of your business growth planning. Find more about these and other insights in our business growth resource center.

See the video: Intersection of tax planning and growth planning: What you need to know...in a nutshell

Every aspect of growth planning has tax implications that create a lot of risk and opportunity alike. It's very important to incorporate tax planning in your growth planning if you want to achieve your business and economic goals. There are some big picture questions that can help identify those tax planning opportunities.

How are you adding products, services or facilities?

Investing in business activities [can] on one hand create some tax incentive opportunities, but you'll also have to be worried about potential tax filing obligations as well. When you're looking at reporting requirements; there are also potential tax deductions for things like research and development, training, hiring. If you're expanding or renovating for example, there are property tax issues that you need to look at as well as potential cost segregation opportunities. It's vitally important to consider tax planning when you're looking at potential investments or expansion opportunities.

For more insights on how growth plans affect tax strategy, visit our Business Growth resource center

Where are your operations and customers?

As you enter new markets, whether it's in the United States or abroad, you start expanding your footprint from a tax perspective. You need to be looking at issues around state nexus and filing obligations that are created as a result of activities. If you think about it from an international perspective, you may be creating a permanent establishment or be regulated under the BEPS regime. BEPS, which is the Base Erosion and Profit Shifting legislation, is really looking to ensure that every jurisdiction gets their share of the tax base.

You're also seeing, from a state perspective, that states are trying to increase their share of tax base. They are becoming more aggressive in pulling more income into their jurisdiction. As you're entering new markets, you have to be very conscious about the footprint you're creating and the activities that you're entering into in various jurisdictions, whether it's United States or global.

Is an acquisition part of your growth strategy?

Acquisitions bring with them a whole host of tax related issues. Some are great opportunities. On the front end you might be able to create a very tax efficient structure or to accelerate certain deductions. You might also be walking into an opportunity where there are tax attributes related to an organization that give you benefits—perhaps net operating losses or various credits.

You also have the other side though. You might be acquiring an organization that wasn't so diligent in how they handled their filings or how they paid their taxes. There are many taxes that could be impacted beyond just income taxes, such as sales and use tax, property taxes or excise taxes. You really need to be working hard in the acquisition process to not only identify those opportunities that might exist but also know the potential risks that lie within an organization.

How might external factors impact your growth plan?

The only thing we know for certain is that there's really no certainty in the world today. The middle market is very fluid, especially amidst global economic change that's happening and tax reform that undoubtedly is going to happen here soon. It's very important to be comparing your growth planning and growth strategies to the overall economic environment. Tax planning needs to be part of your growth planning, because it's a big part of getting bigger.

SUCCESSION PLANNING

Employee stock ownership from 3 perspectives

By: Anne Bushman, Senior Manager

Would your company benefit from an employee stock ownership plan? Anne Bushman outlines the benefits ESOPs can bring to owners, employees and businesses overall.

See the video: Employee stock ownership from three perspectives: What you need to know...in a nutshell

An Employer Stock Ownership Plan (or an ESOP) can be an attractive option for closely held business owners who are evaluating succession planning options. An ESOP can provide unique benefits to you as a selling shareholder, your employees and your company. All three parties should really be considered to determine if an ESOP is a good fit.

What is an ESOP and why is it a good idea for different stakeholders?

An ESOP is a qualified retirement plan. It's very similar to a 401(k), only it invests primarily in that employer's stock.

As an owner, that creates an available market for you to determine when and what percentage you would like to sell. An ESOP can also mean a smaller likelihood of the company dynamics changing with an ownership transition. Additionally, an ESOP can provide a C corporation shareholder the opportunity to defer tax on any gain on the sale, if certain requirements are met.

For employees, an ESOP is usually an additional retirement benefit on top of other diversified accounts.

According to Department of Labor research, ESOP accounts on average have a higher rate of return, are less volatile and typically more inclusive than 401(k) plans. Plus, an ESOP can even increase employee engagement and loyalty by giving employees a stake in the business.

Finally, the company benefits. Contributions are a tax deductible employee benefit expense and with proper communication, ESOPs can be great for morale.

Learn more: Should you consider an employee stock ownership plan?

How can you tell if a business is a strong candidate for an ESOP?

For one, your company should have good profitability and growth potential to ensure that the ESOP can be funded and that it provides a valuable benefit to employees.

Having qualified management who can support employee ownership and who will be prudent with respect to compliance matters is important. Of course, company culture and the demographics of your employee base need to be right.

These are all things we can discuss to determine if an ESOP is a good choice for your business.

FROM THE BLOG

Final rules require 5472s from foreign-owned disregarded entities

District of Columbia moves one step closer to eliminating so-called "tampon tax"

What will President Trump's tax policy mean for transfer pricing?

New York revises unclaimed property voluntary compliance agreement

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