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

Tax reform is likely to curtail some credits and incentives

By: Talia Schechter, Supervisor; and Tom Windram, Partner

With the inauguration of President Donald Trump and Republicans in control of the House of Representatives and the Senate, it is likely that a combination of Trump's campaign tax proposals and House Republicans' tax proposals will come together in a legislative package in 2017. Consequently, many tax professionals are eager to learn how the expected tax reform package will affect their own taxes and those of their clients.

At the top of the list of tax reform proposals is a substantial reduction in corporate tax rates and a reduction in the individual tax rates applied to business income from flow-through entities. Another anticipated reform concerns the business tax structure. In addition to lowering business tax rates, other anticipated changes include the repeal of the corporate and individual alternative minimum taxes and the elimination of many business tax expenditures.

A common tactic used in tax reform to offset revenue lost from tax rate reductions is to broaden the tax base by eliminating certain "special interest" tax breaks. This means there are, inevitably, winners and losers as credits and incentives that benefit certain

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industries are reduced or eliminated. Following is a discussion of several popular tax credits and incentives and their potential future in light of the latest tax reform proposals.

Sec. 41: Research and development tax credit

The research and development (R&D) tax credit is a federal incentive that encourages businesses to invest in technological innovation for products or processes developed within the United States. Businesses engaged in qualified research activities can use the credit to offset their regular federal tax liability, as well as state tax liabilities if the qualified research is performed within states that offer similar incentives. Currently, 38 states offer research credits, many of which are similar to the federal R&D tax credit.

While Trump and many Republicans in Congress favor reducing corporate tax expenditures, the R&D tax credit is one provision that does not seem to be in danger of elimination. Both Trump and House Republicans have stated that they would maintain the R&D tax credit.

With a Republican administration in place, many believe the R&D tax credit may be in line for expansion or improved efficiencies. Enhancements to the credit may include:

- Increasing the alternative simplified credit rate from 14 percent
- Increasing the qualified research percentage of contract research expenses from 65 percent to correspond to the reduction in the corporate tax rate
- Increasing the general business credit limitation to enable an offset against the full regular tax liability instead of the current excess of regular tax over tentative minimum tax for businesses with average gross receipts of $50 million or more for the prior three years
- Other potential changes to reduce IRS controversy and improve administration of the R&D tax credit

Sec. 199: Domestic production activities deduction

The sec. 199 domestic production activities deduction (DPAD) is a federal incentive established by the American Jobs Creation Act of 2004, P.L. 108-357. The deduction is offered to certain businesses engaged in the following domestic activities:

- The lease, rental, license, sale, exchange or disposition of:
  - Products manufactured, produced, grown or extracted by the taxpayer within the United States
  - Qualified film productions
  - Electricity, natural gas or potable water produced by the taxpayer within the United States
- The construction of real property in the United States
- Engineering or architectural services related to the construction of real property

As outlined in House Republicans' "Better Way" blueprint, Congress is expected to take the position that "the domestic production (section 199) deduction would no longer be necessary" (*A Better Way: Our Vision for a Confident America, Tax*, June 24, 2016, p. 27). The move away from the sec. 199 deduction would be for simplicity, as the deduction calculation is often complex and a frequent issue in IRS examinations. The blueprint also notes that the effective tax incentive from the deduction would be included in the lowered corporate tax rates.

While the elimination of the sec. 199 deduction would remove a major incentive for corporations to manufacture domestically, the expectation is that a reduced overall corporate tax rate would encourage increased production. All other things being equal, manufacturers may receive less of an overall benefit from tax reform than other industries because they would lose a deduction that could be as much as 9 percent of taxable income.

To read more, go to: http://rsmus.com/what-we-do/services/tax/credits-and-incentives/tax-reform-is-likely-to-curtail-some-credits-and-incentives.html

TRENDING IN TAX

Canadian Revenue Agency issues statement on US partnership taxation

By: Kyle Brown, Manager; and Jamison Sites, Manager

In a recent non-binding statement, representatives from the Canadian Revenue Agency (CRA) said that they will now prospectively employ an approach called 'administrative grandfathering' regarding the treatment of Florida and Delaware Limited Liability Partnerships (LLPs) and Limited Liability Limited Partnerships (LLLPs) for Canadian tax purposes. While the statement limited its discussion to Florida and Delaware, the CRA policy is expected to have a broader impact on all U.S. LLPs and LLLPs.

Previously, the CRA had announced it would consider all Florida and Delaware LLP and LLLP corporations for Canadian income tax purposes, a position that has not changed. However, after analyzing the complexities associated with requiring such entities to transition from partnership to corporate filings, the CRA has decided against it. Instead, the CRA officials have announced that they will apply the rule prospectively through administrative grandfathering to certain Florida and Delaware LLPs and LLLPs.

Under administrative grandfathering, a Florida or Delaware LLP or LLLP formed prior to April 26, 2017 will be accepted as a partnership for Canadian tax purposes for all prior and future years. In order for a Florida or Delaware LLP or LLLP to qualify for administrative grandfathering, the entity must meet the following conditions:

- One or more members of the entity, or the entity itself, may not take an inconsistent position from one tax year to another, or within the same tax year, as to partnership or corporate status

- There must not be significant change in the membership or activities of the entity
- The entity must not be used to facilitate abusive tax avoidance

Florida and Delaware LLPs and LLLPs formed after April 26, 2017 will be treated as corporations by the CRA, and those that have consistently filed as corporations in prior years will be allowed to continue to file on that basis.

While this statement does not alter the CRA's position that Florida and Delaware LLPs and LLLPs are corporations for Canadian tax purposes, it does provide some options for existing entities previously facing a transition from partnership to corporate filings.

To read more, go to: http://rsmus.com/what-we-do/services/tax/international-tax-planning/canadian-tax-services/canadian-revenue-agency-issues-statement-on-us-partnership-taxat.html

Exorcise your ghost assets: Stop paying unnecessary property tax

Outdated and out-of-service fixed assets can haunt your tax profile

By: Chris Atwell, Senior Director

Everyone has ghost assets on their fixed asset systems. You know the ones:

- The computer you placed in service in 2002 that was donated to a local school years ago
- The shuttle that hasn't run in years but is parked... somewhere, maybe
- The kitchen equipment that got replaced, twice

Once these assets are fully depreciated, most companies do not give them a second thought, and expend little, if any, effort to track them down and write them off. But ghost assets can affect your bottom line by taking up space in your servers, adding to your personal property tax base, overstating the cost and accumulated depreciation balances on your financials, and increasing the effort to consolidate or outsource certain functions within your organization.

Here is an example of how quickly a simple business decision can get complicated:

A hotel has a soft goods and/or case goods redo. Virtually everything with a short tax life is being replaced. However, the controller does not dispose of the replaced assets because they are fully depreciated for GAAP and tax, and they were set up as single assets representing multiple quantities, so there is uncertainty that the correct assets would be disposed of. Due to time constraints and to maintain the same method of accounting for the prior short-lived assets, the controller sets up the new assets the same way the original assets were set up. Seven years go by, and another soft goods/case goods redo occurs, and again no dispositions of the replaced assets occurs. Now the hotel has three generations of assets on its books, which needlessly increases its basis for personal property tax purposes.

Even in a scenario where the controller tries to do the right thing and dispose of the replaced assets, will the controller know which assets to dispose of, and which ones to keep? What can be done to simplify the process of retiring assets when they are no longer in service? How can the controller avoid the pain of culling through hundreds or thousands of lines of assets when a transition of an internal function occurs?

To read more, go to: http://rsmus.com/what-we-do/services/tax/lead-tax/fixed-assets-ghosts-in-the-machine.html

Nebraska sales tax leaves contractors with questions

By: Brad Hershberger, Partner; and Evan Fullmer, Senior Associate

Unique to Nebraska, the state's framework for imposing sales and use tax on contractor activity requires construction contractors to select one of three classification options. Each option presents different sales and use tax consequences, and for companies based in Nebraska or operating within the state, the options have real implications. Real property construction contractors should be educated on the options to avoid over or underpayment of sales and use tax.

Understanding the activities that qualify

Before selecting from the construction classification options, contractors should understand if the activities they are conducting in the state subject them to be registered. Construction services are generally defined as the annexation of building materials to real property or repair of real property or its fixtures. While the definition certainly includes new construction that is from the ground up, it is meant to be broad and some contractors may be surprised to find that their repair activities meet the definition for qualification purposes. For example, a contractor company that repairs or annexes property by attaching building materials to real estate through improvement, would be subject to registration requirements. In other words, construction does not need to be new construction, but rather can be repairs or improvements to existing buildings.

Even with the broad definition, there are still exceptions. Separately stated construction labor is generally exempt to the customer, while the sale of building materials may be subject to sales and use taxes depending on the option the contractor chooses. For example, if a contractor itemizes billing invoices, with labor and materials as separate line items with separate costs, the labor will always be exempt. However, whether the materials are taxable is dependent on the contractor option.

The classification options described below are applicable when the contractor is performing work on real property, and not when the contractor is operating as a retail vendor of materials.

Factors that Nebraska contractors should consider when determining if their activities are performed on realty or annexed property include whether the work performed is on a building or structure (opposed to tangible personal property) and whether the materials used become a part of the real property.

To read more, go to: http://rsmus.com/what-we-do/services/tax/state-and-local-tax/sales-and-use-tax/nebraska-sales-tax-leaves-contractors-with-questions.html

EVENTS AND WEBCASTS

IRS penalties: Avoidance and abatement

RECORDED WEBCAST | June 06, 2017

Join Patti Burquest and David Click for the second installment of their 2017 tax controversy webcast series, IRS penalties: Avoidance and abatement. This webcast focuses on delinquency penalties and international information return penalties—both how to avoid them and what to do when they are assessed.

In this one-hour session, we cover:

- Late filing, late payment and late deposits
- Unfiled or late-filed international information returns
- Unfiled, late-filed or late-furnished W-2s or 1099s

Download webcast slides

How does BEPS impact the definition of a permanent establishment?

LIVE WEBCAST | June 21, 2017

As the base erosion and profit shifting (BEPS) action plan continues to be developed and implemented, globally active middle market companies need to understand the implications. With the signing of the multilateral instrument resulting from BEPS Action 15 scheduled for the week of June 5, this webcast will take you through a high-level overview of its content and impact, specifically focused on the definition of a permanent establishment.

In this one-hour program, RSM international tax professionals will share:

- How the multilateral instrument will affect the analysis and presence of a permanent establishment (taxable presence)
- Planning considerations for taxpayers related to permanent establishment taking into account BEPS Action 7 and BEPS Action 15

Presenters:

- Lisa Pinchin (Senior Manager)
- Dan Berman (Principal)
- Adam Tritabaugh (Partner)
- Jordi van der Struis (Senior Manager – RSM Netherlands)

Learning objectives
After attending this course, participants will be able to discuss changes to the permanent establishment rules as introduced under BEPS Action 15.

BUSINESS GROWTH

6 keys to effective tax planning when growing by merger or acquisition

Plan early to manage M&A tax considerations related to your transaction

An acquisition is often the best way to penetrate a new market, increase share in an existing one, or branch out into new product or service areas. If an acquisition is central to your growth strategy, then effective, timely tax planning will play a significant role in the success of your deal. The following six steps will help you boost post-transaction cash flow, maximize tax planning opportunities, and identify and mitigate potential tax liabilities and controversies.

1. Start transaction tax planning early

Often, companies conduct no, or only cursory, tax due diligence prior to issuing a letter of intent. By considering some key tax issues prior to the letter of intent, you can retain some leverage and may be able to realize more beneficial tax results. For example, if you are acquiring an S corporation and wish to treat the purpose as an asset sale, the target will have to make a section 338 election. Since the tax benefits of this move will accrue to the purchaser if you wait until after the letter of intent to make this request, the seller may well negotiate for additional consideration. By anticipating this or other, tax issues in advance and including them in the terms of the offer letter, you can improve your position.

2. Look for credits and incentives that benefit your deal

Federal, state and local taxing jurisdictions offer a wide array of tax credit and incentive opportunities. These can be based on a huge range of activities, from creating or retaining jobs to capital investment. Companies making an acquisition often can capitalize on these options. Don't just look at existing statutory programs—companies are often able to negotiate customized incentives when they are making a sizable investment in a jurisdiction. Check on credits and incentives before you make an offer. These programs are generally designed to attract investment, not to reward companies for deals that are already in place. So investigate your credit and incentive opportunities early.

3. Consider your transaction structuring options

In general, an asset purchase provides better tax results for the purchaser. You will be able to accelerate amortization of the acquired assets, which generates significant near-term cash flow benefits. You should also think about where to place acquired liabilities within your new combined entity in order to maximize federal, state and even international tax benefits.

4. Check on viability of target company tax attributes

Net operating losses or other tax attributes of the target company provide key tax benefits, but only if they survive the transaction. For example, section 382 imposes significant limitations on the utilization of net operating losses after certain changes in corporate ownership. Be sure you understand whether and to what extent the target company's tax attributes will survive your deal in order to fully calculate your after-tax benefits.

5. Don't forget target company tax liabilities

Your tax due diligence should explore the target company's current and projected tax liabilities and how they will be addressed in your deal. Most deals include some level of indemnification for undisclosed tax issues. Don't forget to look at state and local and payroll tax issues. Those liabilities are sometimes overlooked in the planning process, but can be significant. In addition to existing liabilities, consider how the new footprint of your organization will affect your state and local tax posture going forward, not just for income taxes, but for sales and use taxes as well.

6. Identify special needs of international deals

Cross-border acquisitions bring special tax challenges, especially if they move you into new tax jurisdictions for the first time. All of the planning issues discussed above now need to be viewed through yet another filter. Corporate structuring issues become increasingly important. If you plan on making additional international deals, this may be the time to consider a holding company structure. This is also the time to think through transfer pricing and other operational tax concerns to understand your tax posture going forward.

SUCCESSION PLANNING

The long-term care insurance decision—a very complex one indeed

While unpleasant, a plan for long-term care key to a sound plan

By: Charlie Ratner, Senior Director

No matter how uncertain the future is for the estate tax and the rest of the wealth transfer tax system, we can say with some certainty that the focus of many individuals who, age wise, are rounding third and heading home, is now the issues associated with the cost of health care in general and long-term care (LTC) in particular.

Conversations about LTC can be fair to partly difficult because, before the topic turns to funding that care with insurance, somebody has to buy into the notion that they will ever need that care in the first place. The statistics say 70 percent of us will need a whole lot more care than being put into a skilled nursing facility. So, with those kind of statistics in favor of needing some level of care for some period of time, we can consider the variety of ways to cover the risk and the considerations involved in making an informed decision to be or not to be insured.

Starting at the beginning, the threshold question is whether an individual is wealthy enough to self-insure. There are a number of rules of thumb about this, but it's best to run the numbers, meaning do a long-term financial projection that builds in some big hits for LTC and see how things look. Maybe that will be the end of the conversation. Maybe not.

If the financial projection leaves the individual uncertain about his ability to safely weather a LTC storm, he might want to consider insurance. It's common, of course, for people to assume that Medicare pays for that coverage. But that would not be a prudent assumption for planning purposes. That's because Medicare covers the cost of a skilled nursing faculty for only 100 days and only if the individual goes there directly from a hospital stay. That might not be likely.

If Medicare is not necessarily a viable alternative to LTC insurance, what about individual LTC policies? This type of coverage generally gives the individual the most flexibility to design the coverage for the individual (and his spouse) in a particular fashion. It also gives the most bang for the buck, something the LTC specialists call "leverage" of the premium dollar. But many people have heard that individual LTC is expensive, pricing has not been a model of stability and, of course, one could pay premiums for 20 years and one day just walk in front of a golf cart and it's over. He never needed the policy! Fortunately, there are alternatives to the individual policy, including annuities with LTC riders, life insurance policies with LTC riders and "hybrid life insurance/LTC policies." These alternatives to the individual policy have one big thing going for them, you know you'll get some benefit for your premium dollar.

To read more, go to: http://rsmus.com/what-we-do/services/tax/private-client/the-long-term-care-insurance-decision-a-very-complex-one-indeed.html

FROM THE BLOG

Can new debt vs. equity regs provide a good guide for S corporations?

Will congress pass mobile workforce legislation in 2017?

Would you take a 13-1 long shot on the taxation of digital goods?

Compensation planning for potential lower tax rates

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