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FEI 2018 Financial Leadership Summit

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1. Tax reform changes impacting individuals
2. Tax reform changes impacting businesses
3. Tax reform changes impacting employee benefits
4. State tax implications of federal tax reform
5. Key takeaways
6. Questions

Tax reform changes impacting individuals

Tax rates
Itemized deductions
Estate and gift tax

Overview of changes – Individuals

Basic changes

- Overall rate reduction
- No change to capital gain/ qualified dividend rate
- NIIT still applies
- AMT changed, but retained for individuals
- Doubled standard deduction, repealed personal exemptions

Itemized deductions

- State and local taxes limitation
- Mortgage interest
- Miscellaneous itemized deductions
- Repeal of PEASE phase-out

Estate and gift taxes

- Estate and gift tax changes No repeal of estate tax and GST
- No change to the estate, gift and GST rate of 40%
- Doubled lifetime exemption to $11.18M/person
- Step up at death still in effect
- Current gift tax annual exclusion is $15K/donee

What has changed?

Tax rates

Tax rates

Married individuals filing joint returns and surviving spouses

If taxable income is between	The tax due is
$0 - $19,050	10% of taxable income
$19,051 - $77,400	$1,905 + 12% of the amount over $19,050
$77,401 - $165,000	$8,907 + 22% of the amount over $77,400
$165,001 - $315, 000	$28,179 + 24% of the amount over $165,000
$315,001 - $400,000	$64,179 + 32% of the amount over $315,000
$400,001 - $600,000	$91,379 + 35% of the amount over $400,000
$600,001+	$161,379 + 37% of the amount over $600,000

What has changed?

Itemized deductions

Major changes to itemized deductions?

- Repeal of 3% PEASE phase-out
- $10,000 limitation on state and local income taxes, property taxes, and sales taxes
- Repeal of miscellaneous itemized deductions subject to 2% AGI floor
- Changes to mortgage interest rules
  - Reduced cap for acquisition debt to $750,000 (grandfathering applies)
  - Repeal of deduction for home equity debt
- Increased AGI limitation for cash charitable contributions from 50% to 60%

What has changed?

Estate and gift tax

Estate and gift tax matters

- Increased lifetime exemption to $11,180,000 per person
  - Portability still applies between spouses
- Annual exclusion gifts indexed to $15,000 per donee
  - Exception for educational and medical transfers still applies
- Step up (or down) in basis at death
- Potential clawback concerns when law sunsets in 2026

Tax reform changes impacting individuals

Tax rates
Bonus depreciation
Interest deduction limitation
International considerations

What has changed?

Tax rates

Overview of rates going forward

Tax reform has **widened the difference in federal tax rates**, particularly for income generated overseas

	C corporation*	Pass-through
Domestic business	**21%**	**29.6%** (top indiv rate, full QBI deduction)
Domestic exporter	**13.1%**	**29.6%** (top indiv rate, full QBI deduction)
International business	**23.75%** Non-US OECD Avg (subject to Subpart F and GILTI inclusions)	**37+%** (highest marginal rate for individuals)

* Does not include second layer of tax on distribution to shareholder.
Note:
1. This chart is not reflective of all provisions/calculations that may apply. Chart shows general, average, minimum rates for high-level discussion purposes only.
2. Rates do not include NIIT

20% deduction – What's the new law?

The Act provides that individual taxpayers generally may deduct up to 20% of combined **qualified business income** from a partnership, S corporation, or sole proprietorship that is not engaged in **specified service activities**.

Sunset: Effective for tax years beginning after December 31, 2017 and before January 1, 2026.

- Deduction not permanent, sunsets December 31, 2025.
- Could bring top individual effective income tax rate to 29.6%. (20% deduction x 37% new top tax rate)
- The deduction does not reduce net investment income (NII)
- It's expected that the deduction does not reduce self employment taxes
- The deduction is a partner/shareholder level deduction and does not decrease basis
- Losses from a previous year are netted with current year income when determining qualified business income

What is qualified business income?

Qualified business income effectively connected with a trade or business within the US

REIT dividends, cooperative dividends, and qualified publicly traded partnership income are qualified income not subject to the wage limitations and are limited to 20% of such income

This does **not** include:

- Income from 'specified services trades or businesses' (for taxpayers with income above the income thresholds)
- Individuals' share of S corp reasonable compensation and partnership guaranteed payment income
- Investment-type income (e.g., capital gains and dividends)

What are specified service activities?

Any activity involving the performance of services including:

- Investing, trading, or dealing in securities (as specifically defined), partnership interests, or commodities

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
- Any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees

Activities **not** included:

- Engineering
- Architecture

Note: The provision may provide a benefit to certain labor income (e.g., specified services below the income thresholds $157,500 single)/ $315,000 (MFJ))

How is the deduction calculated?

Full 20% deduction for taxpayers with taxable income under $157,500 (single) and $207,500 (MFJ)

W-2 wage limit phases in for taxpayers with taxable income between $157,500 (single)/$315,000 (MFJ) and 207,500/$415,000, respectively

Taxpayers above, $207,500 (single)/ $415,000 (MFJ) the amount of the **deduction is capped at the greater of**:

- 50% of the W-2 wages paid with respect to the qualified trade or business, or
- The sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property

Choice of entity considerations

Tax specific

- How much income qualifies for the pass-through deduction?
- Is the pass through deduction limited due to specified services or W-2 limitations?
- How impactful is the loss of state tax deductions or miscellaneous itemized deductions?
- What is the impact of international operations on US tax?
- Will losses be incurred and what is the potential utilization?
- Is there confidence that corporate rate will stay low and what are the potential costs to exit corporate form if rate changes?
- Is there confidence that the pass-through deduction will be made permanent beyond 2025?

Business related

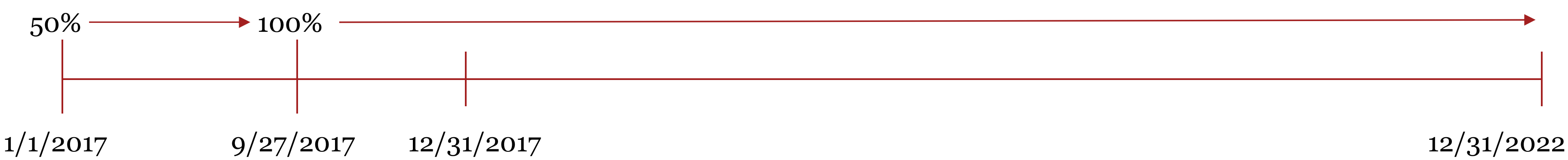
- What will business profit be used for (business growth or shareholder distributions)?
- What are the potential exit plans?
- What is the perceived value of tax basis step up to a buyer?
- What is the future/necessity of international operations?
- What is the cost/benefit of relocating operations?
- How does capital structure/financing impact tax structure?
- How important is the administrative burden of tax and legal compliance?

What has changed?

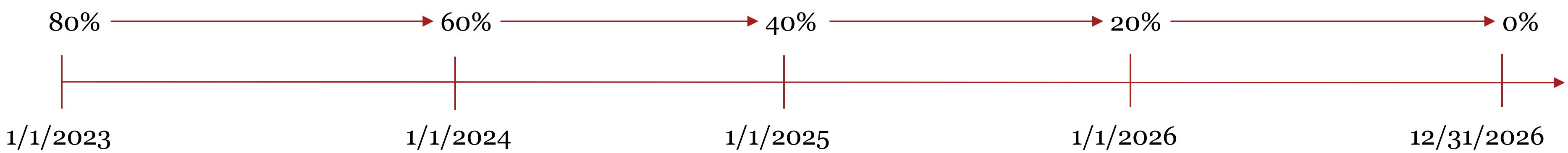
Bonus depreciation

Bonus depreciation – Timeline
(Does not reflect possible elections)

For qualified property acquired after 9/27/2017 and placed in service through 2022



For qualified property acquired after 9/27/2017 and placed in service from 2023 through 2026



Note: The law allows an additional year for placing in service certain aircraft and longer period production property (i.e., through 2023 and 2027, respectively).

Bonus depreciation – Key considerations

- Bonus depreciation under the tax reform rules applies to qualified property acquired and placed in service after September 27, 2017 and before January 1, 2027
  - 100% for September 28, 2017 through December 31, 2022
  - Phases down by 20% per calendar year after 2022; 0% starting in 2027
  - The law allows an extra year for placing in service certain aircraft and longer period production property
- Used property now eligible, assuming certain other requirements are met
- Taxpayers cannot have a 'written binding contract' to purchase the property prior to September 28, 2017 (if so, pre-tax reform bonus depreciation rules apply)
- Certain elections are available

Bonus depreciation – Qualified property

- What type of property is considered 'qualified property' for purposes of bonus depreciation?
  - Certain property with a recovery period of 20 years or less (i.e., most tangible personal property)
  - Property which is computer software
  - Property which is water utility property
  - Property which is a qualified film or television production
  - Property which is a qualified live theatrical production

Bonus depreciation – Excluded property

- What property is **specifically excluded** from the definition of 'qualified property?'
  - Property used in certain regulated public utility trades or businesses
  - Property used in trade or business that has had floor plan financing indebtedness
- What other types of property are outside the definition of 'qualified property?'
  - Amortizable Section 197 intangibles (e.g., goodwill) are not eligible for bonus depreciation
- What about qualified improvement property (QIP)?
  - 9/28/2017 - 12/31/2017: 39-year property eligible for bonus depreciation because it meets the definition of 'qualified property' under pre-TJCA law
  - 1/1/2018 forward: 39-year property **not** eligible for bonus depreciation because it was not assigned a 15-year recovery period and is not otherwise included in list of 'qualified property' under TJCA
    - Technical correction or clarifying guidance needed for 2018 and forward?

What has changed?

Interest deduction limitation

Limits on deducting interest

General rule:

Limits deduction for business interest expense to sum of business interest income plus 30% of the 'adjusted taxable income' (ATI) of a taxpayer for the taxable year

- ATI is similar to EBITDA for tax years beginning after 2017 and before 2022, and similar to EBIT after 2021.
- Allows disallowed interest deductions to be carried forward indefinitely.

What has changed?

International tax considerations

International overhaul – Toll charge and territoriality

Toll charge/territoriality

	Toll charge Undistributed earnings of CFCs taxable	Territoriality 100% Dividends Received Deduction (DRD) on future dividends from CFCs
C corporations	15.5% cash, 8% non-cash Foreign tax credits	Applicable
Partnerships	17.5%* cash, 9.1%* non-cash No foreign tax credits	N/A
S corporations	Taxable in similar manner as partnerships Election to defer until 'triggering event'	N/A

*Based on highest marginal individual rate; assumes 12/31/17 year end for CFCs and shareholders

International overhaul – GILTI, FDII, and BEAT

GILTI, FDII, and BEAT

	GILTI Income inclusion for income in excess of permitted tangible return	GILTI deduction	GILTI FTC	FDII 37.5% deduction for certain income	BEAT Minimum tax system which adds back certain 'base erosion payments'
C corporations	GILTI income taxable at 21%	50% deduction	80% foreign tax credit available to offset tax	May result in 13.1% ETR for export income	Applicable
Partnerships	GILTI income taxable at 37%	N/A	N/A	N/A	N/A
S corporations	GILTI income taxable at 37%	N/A	N/A	N/A	N/A

GILTI = Global Intangible Low-Taxed Income/**FDII** = Foreign-Derived Intangible Income/**BEAT** = Base Erosion and Anti-Abuse Tax

favorable

unfavorable

Tax reform changes impacting employee benefits

What has changed?

Employee benefits

Major fringe benefits – Impact on the employee & employer

Entertainment expenses

No deduction with respect to an activity generally considered to be entertainment, regardless of its connection to the employer's trade or business (previously was 50% deductible)

Qualified transportation fringe benefits

- Employer deduction for employee allowances for parking or other transportation to work is repealed.
- Deduction preserved for expenses necessary for employee safety and for reimbursement of travel expenses incurred for travel between home and business. Definition of Safety unclear- consider guidance in Treas. Reg. sect. 1.132-6(d)(2).
- Good News: Employee can still exclude a portion of the transportation fringe other than qualified bicycle commuting expenses which cannot be deducted again until 2026.
- Employees can still set aside pre-tax compensation to pay for certain qualified transportation expenses

Qualified moving expense benefits

- No favorable tax treatment for employer reimbursements of an employee's moving expenses.
- No tax deduction for an employee's relocation for work regardless of whether the employer or employee bear the costs, other than for active duty members of the military
- Favorable tax treatment to revert back in 2026

Meals & entertainment deduction changes

Type of expenses	Old law	New law
Client Business Meals	50% Deductible	50% Deductible
Client entertainment	50% Deductible	0% Deductible
Client entertainment- event tickets	50% Face Value	0% Deductible
Employee Travel Meals	50% Deductible	50% Deductible
Sec. 274(e) – Recreation (i.e., holiday party, summer office picnic etc.)	100% Deductible	100% Deductible
Sec. 132 – de minimis fringe benefits • Overtime meals • Coffee/donuts/break room snacks • General staff/meals provided • Internal employee meetings/conference meals • Meals for training events	100% Deductible	50% Deductible
Meals Provided for Convenience of Employer	100% Deductible	50% Deductible (0% after 2025)
Employer provided on-site eating facility	50% Deductible	50% Deductible (0% after 2025)

State tax implications of federal tax reform

State tax implications of federal tax reform

The first consideration is how a state conforms to the federal tax code

- **Rolling conformity** – State adoption of the IRC conforms to federal date/amendments automatically
- **Annual conformity** – Date is fixed until state legislature adopts a new date – but state typically does so on an annual basis
- **Fixed-date conformity** – Date is fixed until state legislature adopts a new date
- **Federal taxable income w/o IRC adoption**
- **Other**

Key takeaways

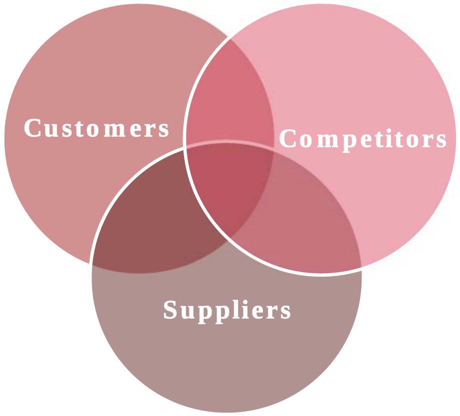
Final thoughts – Keep an eye on what your industry is doing

Actions that your customers and suppliers take may unlock business value or change the competitive landscape

Changes to where customers do business may require suppliers and competitors to adjust operational footprint

Competition for talent could escalate as companies decide how to deploy cash unlocked by tax reform

Accelerated investment in IT could drive higher levels of digital collaboration within the ecosystem and improved cost/effectiveness



Laggards may accelerate investment, changing the supply and competitive market capability profile

Could drive negotiation of longer payment terms, shorter lead times, and higher levels of inventory sharing

May shift M&A target attractiveness/ deal economics

Could reduce transportation component of acquisition as suppliers shrink supply chains

For more information

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Questions?