THE MARSTON GROUP

TAX REFORM ISSUES BUSINESS OWNERS NEED TO KNOW ABOUT

Selected Business Tax Law Changes Under the Tax Cuts and Jobs Act of 2017

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Presented By:

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"As long as you live, keep learning how to live."
–Lucius Annaeus Seneca

Mr. Chip Marston is the Founder and CEO of The Marston Group, PLC, a CPA and advisory firm with offices in Memphis and Nashville. Chip's practice focuses on advisory, tax, and transaction-related financial reporting matters. He serves as an advisor in closely held business ventures and works with companies and their leadership teams in all phases of business, including formation, growth and exit strategies. Chip also has extensive experience in the real estate development and management, professional services, aviation, music and entertainment, venture capital, and agriculture industries. In addition, he works with individuals and family groups in the development and execution of tax, estate and gift, and business transfer / legacy planning strategies. He serves as an advisor to a number closely-held companies, families, trusts, and foundations, and serves on the Boards of several well-known nonprofit organizations.

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The Promise: A Tax Return the Size of a Postcard

Form **1040** Simplified — Department of the Treasury—Internal Revenue Service — **U.S. Individual Income Tax Return** — 2018 — OMB No. 1545-0074 — IRS Use Only—Do not write or staple in this space.

☐ Married filing separate return ☐ Qualifying widow(er) ☐ Head of household

Your first name and initial	Last name	**Your social security number**

Standard deduction: ☐ Someone can claim you as a dependent ☐ You were born before January 2, 1954 ☐ You are blind

Spouse or qualifying person's first name and initial (see inst.)	Last name	**Spouse's social security number**

Standard deduction: ☐ Someone can claim your spouse as a dependent ☐ Your spouse was born before January 2, 1954
☐ Your spouse is blind ☐ Your spouse itemizes on a separate return or you were dual-status alien

Home address (number and street). If you have a P.O. box, see instructions.	Apt. no.	**Presidential Election Campaign.** ✓ if you want $3 to go to this fund (see inst.) ☐ **You** ☐ **Spouse**
City, town or post office, state, and ZIP code. If you have a foreign address, attach Schedule 6.		☐ Full-year health care coverage (see instructions)

Dependents (see instructions): (1) First name	Last name	(2) Social security number	(3) Relationship to you	(4) ✓ if qualifies for (see inst.): Child tax credit	Credit for other dependents
				☐	☐
				☐	☐

Sign Here — Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately reflect all amounts and sources of income I received during the tax year. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparers

Print/Type preparer's name	Preparer's signature	PTIN	Check if: ☐ 3rd Party Designee
Firm's name ▶		Firm's EIN ▶	☐ Self-employed

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2018)

Standard Deduction for—
- Single or married filing separately, $12,000
- Married filing jointly or Qualifying widow(er), $24,000
- Head of household, $18,000
- If you checked any box under Standard deduction, see instructions.

1	Wages, salaries, tips, etc. Attach Form W-2				1
2a	Tax-exempt interest	2a	b	Taxable interest	2b
3a	Qualified dividends	3a	b	Ordinary dividends	3b
4a	IRAs, pensions, and annuities	4a	b	Taxable amount	4b
5a	Social security benefits	5a	b	Taxable amount	5b
6	Additional income and adjustments to income. Attach Schedule 1				6
7	Adjusted gross income. Combine lines 1 through 6				7
8	Enter the standard deduction; otherwise, attach Schedule A				8
9	Qualified business income deduction (see instructions)				9
10	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-				10
11	Tax (see instructions). Attach Schedule 2 if required				11
12	If your only nonrefundable credit is the child tax credit and/or credit for other dependents, enter the total here; otherwise, attach Schedule 3				12
13	Subtract line 12 from line 11				13
14	Other taxes. Attach Schedule 4				14
15	Total tax. Add lines 13 and 14				15
16	Federal income tax withheld from Forms W-2 and 1099				16
17	Refundable credits: **a** EIC (see inst.)		**b** Sch 8812		
	c Form 8863		**d** Other payments or refundable credits from Schedule 5		
18	Add lines 16 and 17 a through d. These are your total payments				18

Refund

19	If line 18 is more than line 15, subtract line 15 from line 18. This is the amount you **overpaid**	19
20a	Amount of line 19 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐	20a
b	Routing number ▶ **c** Type: ☐ Checking ☐ Savings	
d	Account number	
21	Amount of line 19 you want **applied to your 2019 estimated tax** ▶ 21	

Direct deposit? See instructions. ▶

Amount You Owe

22	**Amount you owe.** Subtract line 18 from line 15. For details on how to pay, see instructions ▶	22
23	Estimated tax penalty (see instructions) ▶ 23	

THE NEW TAX LAW WAS AIMED AT SIMPLIFICATION……

BUT IN REALITY, IT IS ANYTHING BUT THAT…….

Timeline of Enactment – Jobs Act of 2017

The new tax law had its beginnings in June 2016 with the release of the House GOP "Blueprint" on tax reform. This Blueprint never progressed beyond conceptual form, but it did begin to build Republican consensus for certain major revisions to the tax code, centering on a reduction of the corporate tax rate and the taxation of international business income.

Momentum for tax reform increased with the November 2016 election of Donald Trump and continued GOP majorities in the House and Senate. Tax reform, a major Republican campaign issue, became a top agenda item for Congress.

Most of 2017, however, saw little progress on tax reform, although work continued behind the scenes. The Republican-controlled Congress chose to focus on healthcare issues instead, but when healthcare legislation efforts failed late in the summer of 2017, Republicans moved tax reform to the "front burner."

Timeline of Enactment – Jobs Act of 2017 (cont'd)

On September 27, 2017, the so-called "Big Six" Republican tax reform principals released a "Uniform Framework on Tax Reform," which identified broad areas of tax policy agreement between the House, Senate, and Administration. House and Senate Republicans began to work separately on tax bills consistent with that Framework.

Developments accelerated dramatically in November 2017, when the legislative process began to move at a pace that may be unprecedented given the size and scope of these new law changes.

On November 2, 2017, Chairman Kevin Brady released the legislative proposal for the tax act and after several amendments; it was approved by the full House on November 16, with no Democratic support. Meanwhile, on November 9, Chairman Orrin Hatch released similar legislation which, after its own amendments, was passed by the Senate on December 2 by a vote of 51-49, with no Democratic support.

Timeline of Enactment – Jobs Act of 2017 (cont'd)

A joint House-Senate conference committee reconciled the differences between the two bills and produced a conference agreement, which was passed by the House on December 19. On that same day, the Senate made several additional modifications to the bill and passed it, returning the modified bill to the House, since the House and Senate must pass identical versions of legislation before it is transmitted to the President. The House considered the legislation during the afternoon of December 20 and approved it by a vote of 224-201. President Trump then signed the legislation into law on December 22, 2017.

Given the sheer size of the new law and the rapid pace of the enactment process, clarifications and corrections will likely be needed for some provisions. However, enacting "correcting" legislation may not be easy, as it generally takes 60 votes for legislation to pass the Senate, and it is unclear whether changes to the new law would be able to garner that level of support. Moreover, using budget reconciliation procedures that would allow corrective legislation to move through the Senate with only 51 votes could be challenging as well.

Timeline of Enactment – Jobs Act of 2017 (cont'd)

The "Big Six" tax negotiators consisted of Paul Ryan, Speaker of the House; Rep. Kevin Brady of Texas, House Ways & Means Committee chairman; Senator Mitch McConnell of Kentucky, the Senate majority
leader; Senator Orrin Hatch of Utah, the Senate Finance Committee chairman; Steve Mnuchin, the Treasury Secretary; and Gary D. Cohn, the National Economic Council director.

Tax Reform 2.0

On July 24, 2018, Rep. Kevin Brady unveiled the Republican "Tax Reform 2.0" framework, which outlines three key focus areas:

1) Making permanent the individual and small business tax cuts enacted under TCJA 2017
2) Promoting family savings by streamlining retirement savings accounts and creating a new Universal Savings Account (USA); and
3) Spurring business innovation by allowing new businesses to write off more initial start-up costs.

Brady has said that making permanent the TCJA's individual and small business tax cuts, which were enacted in 2017 as temporary provisions expiring at the end of 2025, will be the "centerpiece" of the next tax reform package. He also said that he anticipates Tax Reform 2.0 to move forward as three separate bills. A House vote on the package is expected sometime in September.

While the Tax Reform 2.0 framework did not include a proposal to further reduce the corporate tax rate, as President Trump has suggested, Brady did say that House Republicans and the White House are continuing discussions on that idea.

Tax Reform 3.0, 4.0, etc.?

The Tax Reform 2.0 framework states that 2.0 "is a new commitment to improve the tax code each and every year to American families and local businesses." Congress will examine the tax code each year to identify areas of needed improvement, according to the outline. Additionally, Brady has said he hopes to see a Tax Reform 3.0, 4.0, and so forth.

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leader; Senator Orrin Hatch of Utah, the Senate Finance Committee chairman; Steve Mnuchin, the Treasury Secretary; and Gary D. Cohn, the National Economic Council director.

1. Corporate Tax Rates Reduced

The new law eliminates the graduated corporate tax structure (15% / 25% / 34% / 35%), and replaces it with a **flat tax rate of 21%** for tax years beginning after December 31, 2017. In addition, the new law eliminates the special corporate tax rate of 35% on personal service corporations (PSC). (A personal service corporation is a corporation created for the purpose of providing personal services in the fields of accounting, engineering, architecture, consulting, actuarial science, law, performing arts, and health.) Therefore, PSCs are now also taxed at the 21% flat rate.

Observation: The corporate rate reduction is intended to make the U.S. corporate tax rate more competitive with rates imposed by other countries, and to increase international investments in the U.S. In addition, it is expected to spur economic growth and jobs creation because U.S. companies will have more money to invest. Finally, the lower rate will provide less incentive for U.S. companies to shift operations and employees abroad.

2. Alternative Minimum Tax for Corporations Repealed

The alternative minimum tax (AMT) for corporations has been repealed for tax years beginning after 2017. Thus, the AMT is only applicable to individuals, trusts and estates after 2017. (The AMT exemption amounts and thresholds for individuals (not estates and trusts) are temporarily increased beginning in 2018. Partnerships and S corporations are not subject to AMT, but instead a partner or S corporation shareholder computes AMT liability separately by taking into account their share of partnership or S corporation items.)

Observation: Repealing the corporate AMT eliminates some of the complexity inherent in U.S. corporate taxation, while allowing corporations with significant AMT credit carryovers to use those credits to reduce/eliminate tax liability, and obtain refunds to the extent that AMT credit carryovers exceed regular tax liability.

3. Increased Section 179 Expensing

Section 179 expensing is modified to increase the maximum amount that may be deducted to $1 million (up from $510,000 in 2017). This limit is reduced dollar-for-dollar to the extent the total cost of Section 179 property placed in service during the tax year exceeds $2.5 million (up from $2.03 million in 2017). In addition, the new law significantly expands what is included in "qualified real property" that is eligible to be expensed under Section 179 if the taxpayer makes the required election.

Observation: These increases are permanent and will be inflation-adjusted for tax years beginning after 2018. The increases will benefit many medium to large sized companies, since they were previously constrained by the annual limits on the deduction and the phaseout caps. Further, the expansion of the definition of qualified real property to include certain items related to buildings and structures should incentivize owners to make investments in their properties.

4. Additional Depreciation Allowance (Bonus Depreciation)

The new law extends and modifies the additional first-year depreciation deduction (bonus depreciation). Generally, the bonus depreciation percentage is increased from 50% to 100% for property acquired and placed in service after September 27, 2017 and before 2023. The additional depreciation deduction is allowed for new and used property. Used property must have been acquired by purchase from a non-related party, and the taxpayer must not have used it previously. After 2023, it provides a phase-down of the bonus depreciation percentage for property placed in service in each year, allowing an 80% deduction in 2023, 60% in 2024, 40% in 2025, and 20% in 2026. This first-year bonus depreciation sunsets after 2026.

Observation: The change in the definition of qualified property could have an important effect on M&A transactions. It increases the incentive for buyers to structure taxable acquisitions as asset purchases rather than stock acquisitions, by enabling the purchasing entity in an asset acquisition to immediately deduct a significant portion of the purchase price, possibly generating net operating losses in the acquisition year that could be carried forward.

5. Limits on Deduction of Business Interest

For tax years beginning after 12/31/2017, every business, regardless of its form, is generally subject to a disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income. Any disallowed interest generally may be carried forward indefinitely. Adjusted taxable income is computed without regard to (1) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the amount of any net operating loss deduction; (4) the 20% deduction for qualified business income of a passthrough entity under Code Sec. 199A; and (5) deductions for depreciation, amortization, or depletion. Under a small business exception, the interest limitation does not apply to taxpayers for a tax year if the taxpayer's average annual gross receipts for the three-tax-year period ending with the prior tax year do not exceed $25 million. In the case of a partnership, LLC, or S corporation, the deduction limitation applies at the entity level, except that disallowed interest of the entity is allocated to each partner or shareholder as excess business interest. The allocated excess business interest is treated by the partner or shareholder as business interest paid by the partner or shareholder in

5. (cont'd)

the next succeeding year in which the partner or shareholder is allocated excess taxable income from the entity. The adjusted basis of the partner's or shareholder's interest in the entity is reduced by the amount of excess business interest allocated to that partner or shareholder.

Observation: The limitation on the deduction of business interest, along with the reduction of income tax rates for corporations and the business income deduction for passthrough entities, helps to reduce the differences in marginal tax rates based on different sources of financing and in the choice of business entities.

Observation: A taxpayer can elect to exclude from this limitation any real property trade or business as defined under the passive activity rules, including any real estate development, construction, acquisition, rental, operation, management, leasing, or brokerage trade or business. Similarly, a taxpayer may elect to exclude from the limitation any farming business (as defined). Either election, once made, is irrevocable, and other rules and restrictions may apply.

6. Modification of Net Operating Loss (NOL) Deduction

Previous law generally allowed a net operating loss (or "NOL," the amount by which a taxpayer's business deductions exceed its gross income) to be carried back two years and then carried forward 20 years to offset taxable income in those carryback and carryforward years. Under the new law, NOLs arising from a tax year ending after 2017 are generally not allowed to be carried back, but may only be carried forward indefinitely. Further, an NOL may only reduce 80% of taxable income in a carryforward year. (Carryback periods for farming losses and certain insurance companies do retain certain carryback provisions).

Observation: The new law requires corporations to track NOLs arising in tax years beginning on or before 12/31/2017 and after 12/31/2017 separately, as only the latter category of NOLs would be subject to the 80% limitation. The changes to the NOL carryover provisions may have a significant effect on the financial statement treatment of loss carryovers incurred in future years, given that unused loss carryovers no longer will expire.

7. Like-Kind Exchange Treatment Limited

The new law limits the like-kind exchange rules of Code Sec. 1031 to only exchanges of real property that is not held primarily for sale. Thus, no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment, if that real property is exchanged solely for real property of like kind held for one of the same uses. As under the old law, real property located in the United States is not considered like-kind to real property located outside the United States. Like-kind exchanges are not allowed for depreciable tangible personal property, and intangible and nondepreciable personal property after 2017. Thus, exchanges of personal property such as planes, fleet vehicles, highway construction equipment, and so on, will now be taxable.

Observation: Retaining the like-kind exchange rules for real property is considered a win for the real estate industry. The Joint Committee on Taxation had previously proposed eliminating Section 1031 in its entirety, or limiting the annual deferral of gain recognition to $1 million.

8. Limitation of Deduction by Employers of Entertainment and Certain Fringe Benefit Expenses

The new law repeals deductions for entertainment, amusement, and recreation even when directly related to the conduct of a taxpayer's business. The law provides that no deduction is allowed for (1) an activity considered entertainment, amusement, or recreation; (2) membership dues for any club organized for business, pleasure, recreation, or other social purposes; or (3) a facility or portion of a facility used in connection with entertainment, amusement, or recreation. Previously, expenses for entertainment were deductible at 50% of the expense to the extent that they were "directly related to" the active conduct of the taxpayer's business, or "associated with" the active conduct of the taxpayer's business, AND the expense item directly preceded or followed a "substantial and bona fide business discussion." Strict substantiation requirements were required, including the amount, time and place of entertainment, business purpose, and business relationship of the person entertained.

8. (cont'd)

The 50% deduction limit for food and beverage expenses associated with a trade or business is generally retained. However, the 50% limit is expanded to apply to food and beverages provided to employees as de minimis fringe benefits (those benefits that are so small as to make accounting for them impractical or unreasonable). Previously, employer-provided meals that were de minimis fringe benefits were 100% deductible.

After December 31, 2017, an employer also cannot deduct expenses paid for qualified transportation fringe benefits (including qualified parking, van pools, transit passes, and bicycle commuting).

Observation: The new law substantially affects entertainment expenses. However, expenses for food and beverage expenses associated with operating a trade or business (including meals consumed by employees on work travel) remain deductible. There remains uncertainty regarding whether meals provided during a recreational event fall under the meal or recreational deduction limit, such as a meal in connection with a business meeting at a ballgame.

9. Passthrough Entities & Sole Proprietorships- Deduction for Certain Passthrough Income

For tax years beginning after December 31, 2017 (and subject to sunset at the end of 2025), the new law generally allows an individual taxpayer (and a trust or estate) a deduction for 20% of the individual's domestic qualified business income from a partnership, S corporation, or sole proprietorship. The deduction is subject to a limit based on either wages paid, or wages paid plus a capital element. The limitation is the greater of (1) 50% of the wages paid with respect to the qualified trade or business, or (2) the sum of 25% of the W-2 wages of the business plus 2.5% of the unadjusted basis of all qualified property. This limit may be phased in or eliminated if the taxpayer's taxable income meets certain threshold requirements.

A qualified business generally is any trade or business other than a "specified service trade or business," which is one involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, any business the principal asset of which is the reputation

9. (cont'd)

or skill of its owners or employees (excluding engineering and architecture), or any business whose services consist of investment management of securities, partnership interests, or commodities. However, the deduction may apply to income from one of these specified service businesses if the taxpayer's taxable income does not exceed $415,000 (married filing joint) or $207,500 (all other filing statuses).

The 20% deduction is not allowed in computing adjusted gross income; instead, it is allowed as a deduction reducing taxable income. Therefore, it does not affect limitations that are based on adjusted gross income, or "AGI." The deduction is available to both itemizing and non-itemizing taxpayers.

Observation: Congress enacted Section 199A to provide a deduction from taxable income from trades or businesses conducted by sole proprietorships and passthrough entities that do not benefit from the income tax rate reduction provided to C corporations under the new law. The IRS issued Proposed Regulations on August 8, 2018 regarding this new deduction under Section 199A. At the same time, it issued Notice 2018-64 which provides guidance on how to compute W-2 wages for purposes of the deduction.

10. Some Basics on Cryptocurrency

Cryptocurrency is a digital currency in which encryption techniques are being used to regulate the generation of units of currency and to verify the transfer of funds, operating independently of a central bank. A cryptocurrency is difficult to counterfeit because it uses cryptography (the art of converting data into a format that is unreadable without the aid of a tool or additional information) for security. Cryptography methods use advanced mathematical codes to store and transmit data values in a secure format that ensures only those for whom the data is intended can receive, read, and process it, and ensure the authenticity of the transaction and the participant, like a real-world signature.

The first cryptocurrency to become widely publicly known was Bitcoin, which was launched in 2009. As of May 2018, there were over 17 million bitcoins in circulation with a total market value of over $140 million. (See chart on the following page for more information on types of current cryptocurrency and exchanges).

The IRS and other government agencies generally use the term "virtual currency" instead of cryptocurrency. The IRS' current view regarding the federal taxation of virtual

10. (cont'd)

currency is treated as property. Thus, a taxpayer who provides goods or services and receives payment in virtual currency has gross income equal to the fair market value of the virtual currency. The fair market value of the virtual currency must be measured in U.S. dollars. In addition, much cryptocurrency is held in banks and exchanges that are located in foreign countries and/or hosted on foreign servers. This means taxpayers who hold or deal in cryptocurrency may have to provide information to the IRS under the following rules:

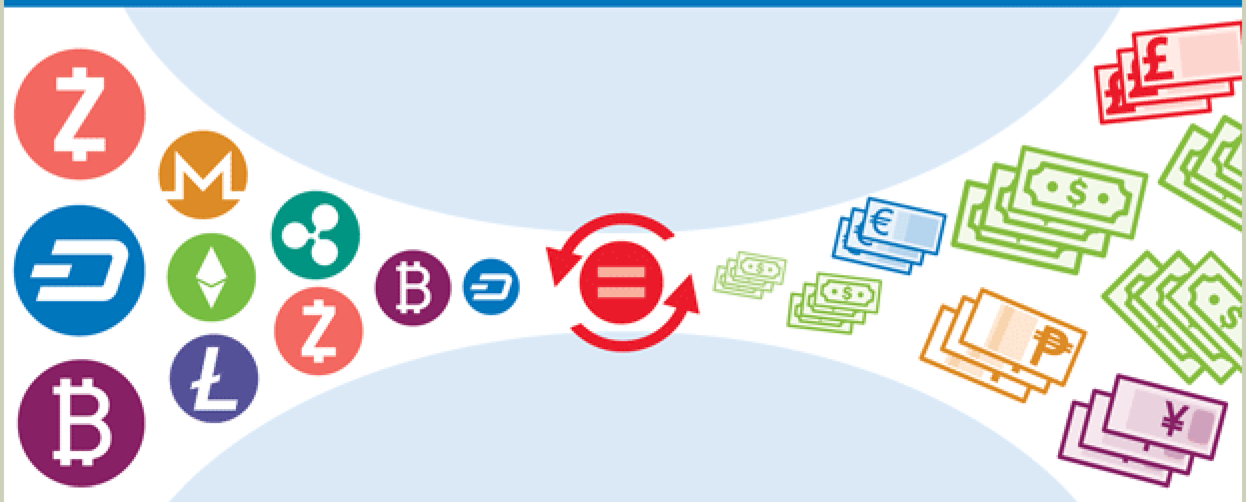
a. A U.S. taxpayer with at least $10,000 in foreign financial accounts may have to file FinCEN Form 114 (Report of Foreign Bank Accounts, or FBAR).

b. A U.S. taxpayer with at least $50,000 in foreign accounts may have to file a statement with the IRS (Form 8938). Withholding agents and foreign financial institutions may also have to file information returns about accounts held by U.S. persons.

10. (cont'd)

This discussion only skims the surface of this relatively new area of virtual or digital currency. Using and owning cryptocurrency can greatly complicate your tax situation. Moreover, because the rules are still quite unsettled, proper communication and planning with a qualified advisor are of paramount importance if you plan to use, own, or invest in cryptocurrency.

Cryptocurrency and Exchanges



CRYPTOCURRENCY

- **Bitcoin** — 21 million
- **Ethereum** — 72 million
- **Ripple** — 100 billion
- **Iota** — 2.8 billion
- **Dash** — 18.9 million
- **Litecoin** — 84 million
- **Zcash** — 21 million
- **Monero** — 18.4 million

EXCHANGES

Bitfinex
Quoine
Coinone
Bittrex
Poloniex
HitBTC
Kraken
Bitstamp
Bithumb
BTC-e/WEX
Gemini

Wolters Kluwer

11. South Dakota v. Wayfair, Inc. et al (2018)

- Prior cases:
  - National Bellas Hess, Inc. v Department of Revenue of Ill. (1967)
  - Quill Corp v North Dakota (1992)
  - These cases established the physical presence rule for nexus. Nexus is the threshold for filing sales tax in a state.
  - Physical presence nexus has created current day conflict between states and online retailers.
- South Dakota v Wayfair – “The Wayfair case”
  - South Dakota enacted a law requiring out-of-state (no physical presence) sellers to collect and remit sales tax if, on an annual basis, the seller delivered more than $100,000 in good or services or engaged in two hundred (200) or more separate transactions.
  - SD State Supreme Court held that Quill (physical presence) is the precedent.
  - South Dakota appealed to the United State Supreme Court (“SCOTUS”) and SCOTUS decided in favor of the state but with limited scope. SCOTUS felt that the South Dakota model would not cause undue burden on small businesses.
  - States will be able to establish substantial nexus provisions (economic nexus).
  - Many states are using the South Dakota model, effective October 1, 2018, with calendar year 2017 as the look-back period.

<u>Disclaimer:</u>

The explanations in this presentation are intended to provide general information only for a sample of selected topics. The full extent of the Tax Cuts and Jobs Act of 2017 is beyond the scope of this presentation. Please consult with a qualified tax advisor if you have questions on how any of these tax provisions may affect you. TCJA statutory provisions, Proposed Treasury Regulations, and interpretations and discussions of the law are related to highly complex legislation, and final interpretations of many of the legislative provisions are not yet available from the Internal Revenue Service. Please continue to monitor developments related to this legislation by maintaining close communication with your professional tax advisors.

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