

# 2019 MANUFACTURING SUMMIT

---

AUGUST 2, 2019

# GROWING YOUR RESOURCES: MAKING THE MOST OF TAX REFORM

---

William Davis, Partner, Capitol Tax Partners

# TAXES AND BUSINESS GROWTH

---

- Cover life cycle of business, from formation to liquidation
- Highlight recent changes in the tax laws, why they were made, and possible changes moving forward
- Provide overview of legislative landscape through next year
- Please join in with questions

# HYPOTHETICAL

---

- Two individuals living in Washington, DC – Donald and Nancy
- Nancy has developed an innovative way to build newspaper machines after social media backlash
- Donald has capital and strong business sense
- Both decide to commit full-time to their new business venture

# CHOICE OF BUSINESS ENTITY

---

- The business form you choose can have significant impacts
- Need to think about all phases of business cycle
- General partnership
- Limited partnership (LLC)
- S corporation
- C corporation

# WHAT MATTERS?

---

- Rate
- Raising capital
- Flexibility
- Levels of tax
- Tranches of ownership
- International considerations
- Earnings distributions

# PASSTHROUGH ENTITIES

---

- Single-level tax (“Aggregate”)
- Maximum flexibility
- Limited liability
- Qualified business deduction
- Includes general partnerships, limited liability companies

# S CORPORATION

---

- Single layer of tax
- Limited liability
- Self-employment taxes
- Qualified business deduction
- Limited to 100 U.S. shareholders

# C CORPORATION

---

- 21 percent rate
- Easier to sell ownership
- No limits on shareholders
- Limited liability
- IPO
- Qualified small business stock
- Double taxation
- Must use accrual method (unless under \$25 million threshold)

# QUALIFIED BUSINESS INCOME DEDUCTION

---

- Corporate rate down to 21 percent
- Top individual at 37 percent
- 2017 Tax Law dealt with the disparity by offering a 20 percent deduction for qualified business income
- Also applies to REIT dividends and publicly traded partnership income
- Does not apply to certain services businesses
- No limit for income below \$315,000 (phase out at \$415,000)

# MAKING INVESTMENTS

---

- Donald and Nancy have formed their business as joint owners
- Now they must build that business
- To begin they have no employees because Nancy can build the newspaper machines herself in her apartment
- Donald handles sales, marketing, accounting
- Together they purchase \$1.5 million of equipment that they intend to use for several years

# DEDUCTIONS FOR SMALL BUSINESSES

---

- 179 deduction
  - Immediately expense purchases of depreciable assets
  - Thresholds increased in 2017 Tax Law
  - Expanded to include improvements to commercial property
- Bonus depreciation
  - 100 percent expensing
  - Applies to used equipment
- Debt-financed investment
  - Small business exemption for deduction interest expense
- Exception from UNICAP rules

# SMALL BUSINESS THRESHOLD

---

- Increased to \$25 million a year in receipts
- Expanded the benefits of small business
- Cash accounting, no interest limitation, exception from UNICAP rules, expanded expensing

# ACCOUNTING METHODS

---

- Cash method
  - Applicable to small businesses
  - Simple, e.g. don't have to keep bad debt records
  - Tracks cash flow
- Accrual method
  - Required for larger businesses
  - Threshold for C corporations increased in 2017 tax bill

# NEED TO EXPAND

---

- After six months of dedicated work, Donald and Nancy realized that they need to expand their operations to keep up with their growing business
- This means hire more people, raise capital, and find a facility

# HIRING PEOPLE

---

- Work opportunity tax credit
- Paid family leave credit
- Qualified business income deduction
- R&D tax credit

# WORK OPPORTUNITY TAX CREDIT

---

- Retained in 2017 tax bill
- Veterans, low-income individuals, summer youth employees, SNAP recipients, ex-felons, disabled
- Covers portion of first year wages
- Expires at end of 2019

# PAID FAMILY AND MEDICAL LEAVE CREDIT

---

- Created in 2017 tax bill
- Provides credit for up to 50 percent of wages paid to an employee for a period of 12 weeks
- Covers FMLA leave

# QUALIFIED BUSINESS INCOME DEDUCTION

---

- For taxpayers with incomes above \$415,000 phaseout, deduction limit based on percentage of wage income
- Deduction limited to 50 percent of wages paid to employees
  - Incentive to put profits into people

# RESEARCH AND DEVELOPMENT TAX CREDIT

---

- Credit for spending on research and experimentation
- Increases with more wages paid to researchers
- Approximately 100,000 taxpayers claim the credit
- Majority from manufacturing sector

# RAISING CAPITAL

---

- Equity
  - Transfer tax benefits to equity investors with tax liabilities from other ventures
  - Business loss limitation
  - Owners have to give up some control
- Debt
  - Small businesses fully deduct interest expense
  - Don't give up control

# FINDING A NEW LOCATION

---

- Purchasing or leasing building
- Opportunity Zones
- Rehabilitation tax credit
  - Lessee may claim credit
- New markets tax credit

# OPPORTUNITY ZONES

---

- Invest in one of 8,700 designated low-income zones
- Capital gains deferral and basis step-up
- Exclusion of gains for long-held investments
- Leverage private capital to increase investment in areas not receiving the investment
- Example – Alaska broadband expansion in Fairbanks
- \$100 billion of investment
- Administration committed to success

# INTELLECTUAL PROPERTY

---

- One hire came up with a great new idea and the company receives a patent
- This particular employee continues to develop innovative ideas, hires a team
- Company begins selling across the country its intangible products as well as printing machines
- R&E expense, capitalize

# BUSINESS IS GOING WELL

---

- Because of the quality of its machines, and success of new innovative products, the business is doing very well
- Now that the business is profitable, business owners need to do something with profits

# REINVEST PROFITS?

---

- Incentives to hire top talent, expand operations
- Return capital to owners?
- Purchase other business?
  - Depreciate purchase

# NOW THEY ARE MAKING MONEY

---

- What impacts does the new income have on the individual owners of the business?

# 2017 TAX BILL CHANGES TO INDIVIDUAL TAX

---

- Lower rates
- Increased standard deduction, elimination of personal exemptions
- Expansion of child tax credit
- SALT cap
- Limit impact of AMT
- Mortgage interest deduction

| Previous Law |                     | 2017 Tax Cuts and Jobs Act |                     |
|--------------|---------------------|----------------------------|---------------------|
| 10%          | \$0-\$19,050        | 10%                        | \$0-\$19,050        |
| 15%          | \$19,050-\$77,400   | 12%                        | \$19,050-\$77,400   |
| 25%          | \$77,400-\$156,150  | 22%                        | \$77,400-\$165,000  |
| 28%          | \$156,150-\$237,950 | 24%                        | \$165,000-\$315,000 |
| 33%          | \$237,950-\$424,950 | 32%                        | \$315,000-\$400,000 |
| 35%          | \$424,950-\$480,050 | 35%                        | \$400,000-\$600,000 |
| 39.60%       | \$480,050+          | 37%                        | \$600,000+          |

\*Rates reflect married filing jointly taxpayers

# ALTERNATIVE MINIMUM TAX

---

- Increased exemption to over \$109,000 (previously \$84,500)
- Increase exemption phaseout to \$1,000,000 (previously \$160,900)

# INTERNATIONAL EXPANSION

---

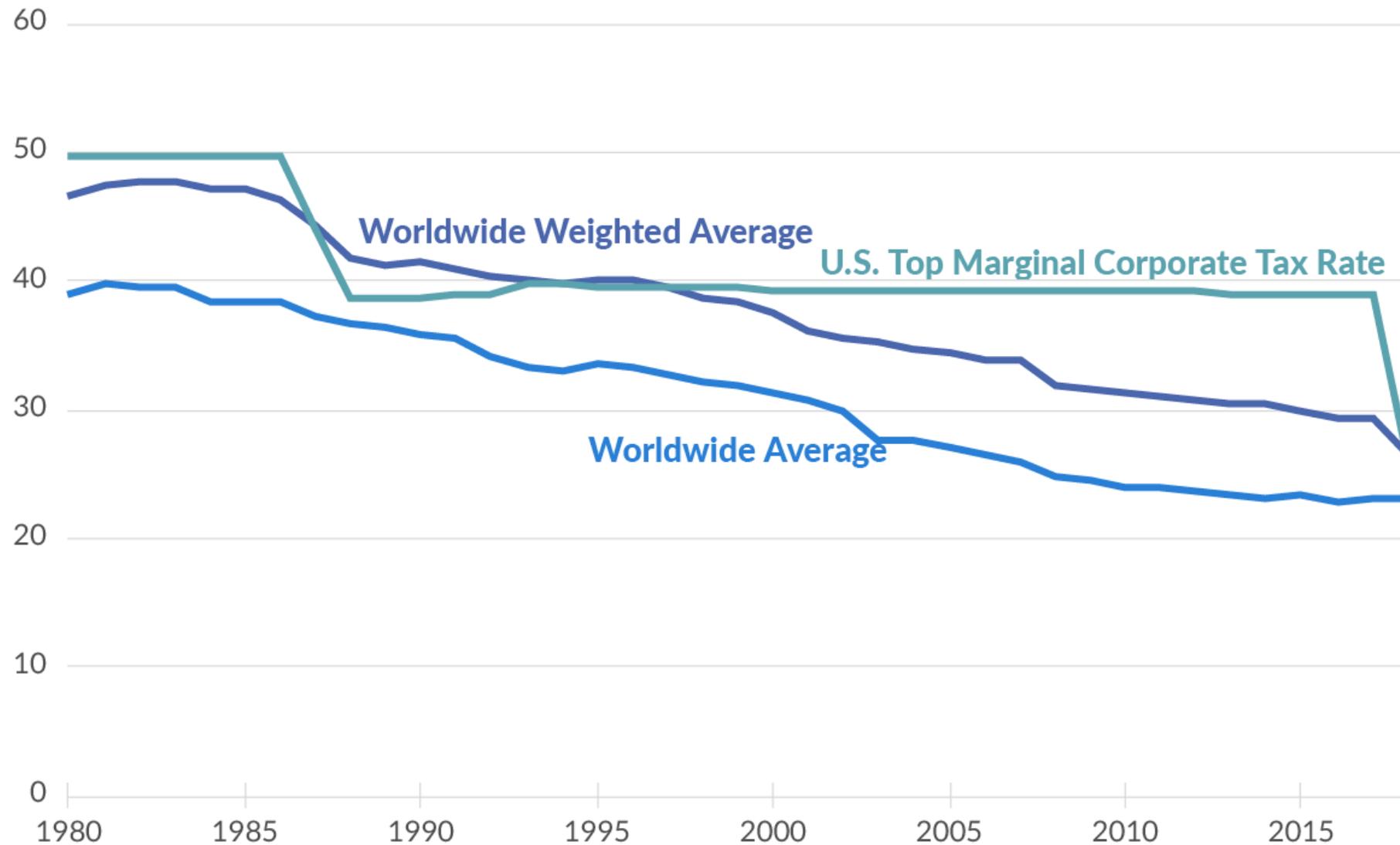
- Business is going well, but now need to expand markets and reduce costs of production
- Explore setting up manufacturing outside the United States
- Goal to sell to non-U.S. markets, but keep U.S. as primary market

# INTERNATIONAL REFORM

---

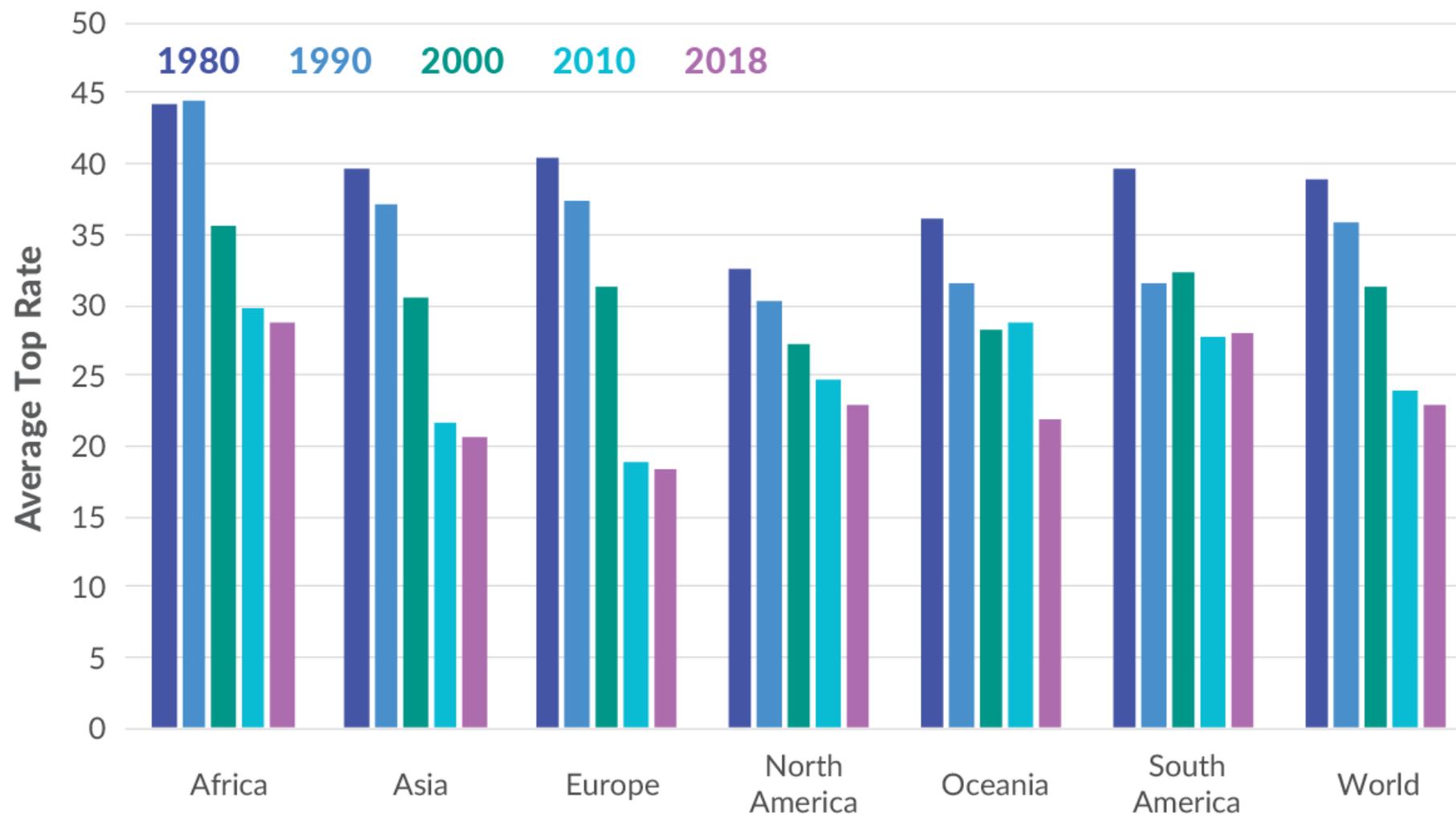
- Worldwide to territorial
- Base erosion measures
- Deemed repatriation
- Dividend deduction

# Top Marginal Corporate Tax Rates Have Declined Since 1980



Source: Tax Foundation. Data compiled from numerous sources including: PwC, KPMG, Deloitte, and the U.S. Department of Agriculture.

# Average Top Corporate Income Tax Rate by Region and Decade



Source: Tax Foundation. Data compiled from numerous sources including: PwC, KPMG, Deloitte, and the U.S. Department of Agriculture.

# FOREIGN DERIVED INTANGIBLES INCOME

---

- 37.5 percent deduction for U.S. goods and services sold to foreign businesses or customers (13 percent effective rate)
- Foreign purchaser must use goods or services outside the U.S.

# GLOBAL TAX AND BASE EROSION

---

- Global Intangible low-taxed income (GILTI)
  - Minimum tax on worldwide income attributable to intangibles
- Base erosion and anti-abuse tax (BEAT)
  - Prevents ability for taxpayers to strip earnings from U.S. tax base
- Designed to put U.S. companies on level playing field

# SELLING THE BUSINESS

---

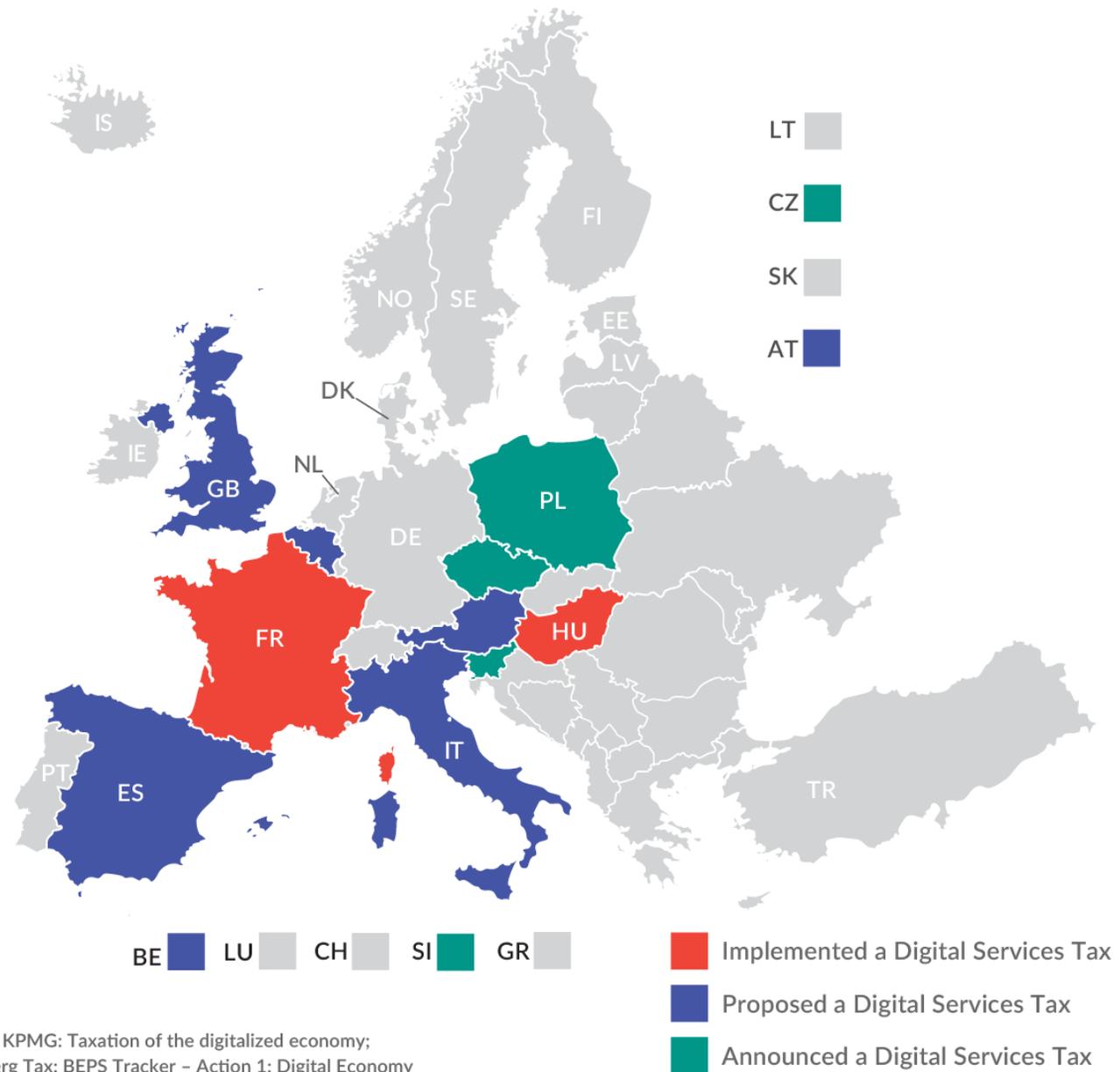
- Qualified small business stock
  - Exclude greater of \$10 million or up to 10 times initial investment
- Sale of international business – allowed 100 percent deduction
  - HOWEVER, if sell business to non-U.S. company, no deduction
- Purchaser expense assets

# DIGITAL TAXES

---

- State Aid Cases
  - Beginning 2013
  - Countries (Ireland, Luxemburg, Netherlands) giving unfair benefits to certain (U.S.?) companies (Apple, McDonalds, Amazon, Starbucks)
- Base Erosion and Profit-Shifting
  - Action I – Challenges of Digital Economy (begins 2015, picks up middle-2017)
- Digital Services Tax
  - Proponents (France, Hungary, UK, Italy, Spain)
  - Tax on tech company revenue (not profits)

# Digital Services Taxes in Europe



Sources: KPMG: Taxation of the digitalized economy;  
Bloomberg Tax: BEPS Tracker – Action 1: Digital Economy

# DIGITAL TAXES

---

- France – retroactive to January 1, 2019
- Subject of recent G-7 conversations
- Recent 301 investigation
- Other U.S. remedies?
- OECD Efforts

# WHAT TO EXPECT (TAX) IN WASHINGTON?

---

- House
  - Democratic priorities (EITC expansion, CTC, renewable energy), ACA taxes
- Senate
  - Extenders, Technical corrections, Retirement
- White House
  - Regulations, Economic growth

# LEGISLATIVE BATTLES

---

- Budget caps, Debt limit
- FY2020 spending
  - Continuing resolution?
- USMCA
- Drug Pricing
- Highway Trust Fund
- FY2021 spending
- Miscellaneous items (flood insurance, Ex-Im Bank, MEP reform)
- White House (Immigration?)

# CONTACT

---

- William Davis, Capitol Tax Partners
- [davis@capitoltax.com](mailto:davis@capitoltax.com)