How Tax Reforms Impacts Your Vineyard

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High level Overview of Tax Reform

- Sweeping changes in tax law, 1,000+ pages of legislation, some hand written in the margin, 15 months of work done in 15 days.
- Historic. We haven't seen this many changes since the 1986 Act—however the 1986 Act was more than a year in drafting. There are unintended consequences.
- Planning and decisions will be very taxpayer specific aligned with strategic goals & objectives.
- This Law may involve more uncertainty than most are accustomed to—Taxpayers and Professionals.
- Expect Technical Corrections to the Law and Regulations.
- We'll cover selective highlights today—we will move quickly.
- Key Planning Take-Aways.

Key Planning Take-Aways

- Reduced Income Tax Rates (net)
- Tax planning will be more critical than ever for all businesses
- Your Business is most likely heading into a lower tax environment
- Transition planning window?
- Some provisions are permanent while others are not
- A lot of uncertainties and unknowns

Individual Provisions

Income Brackets & Tax Rates

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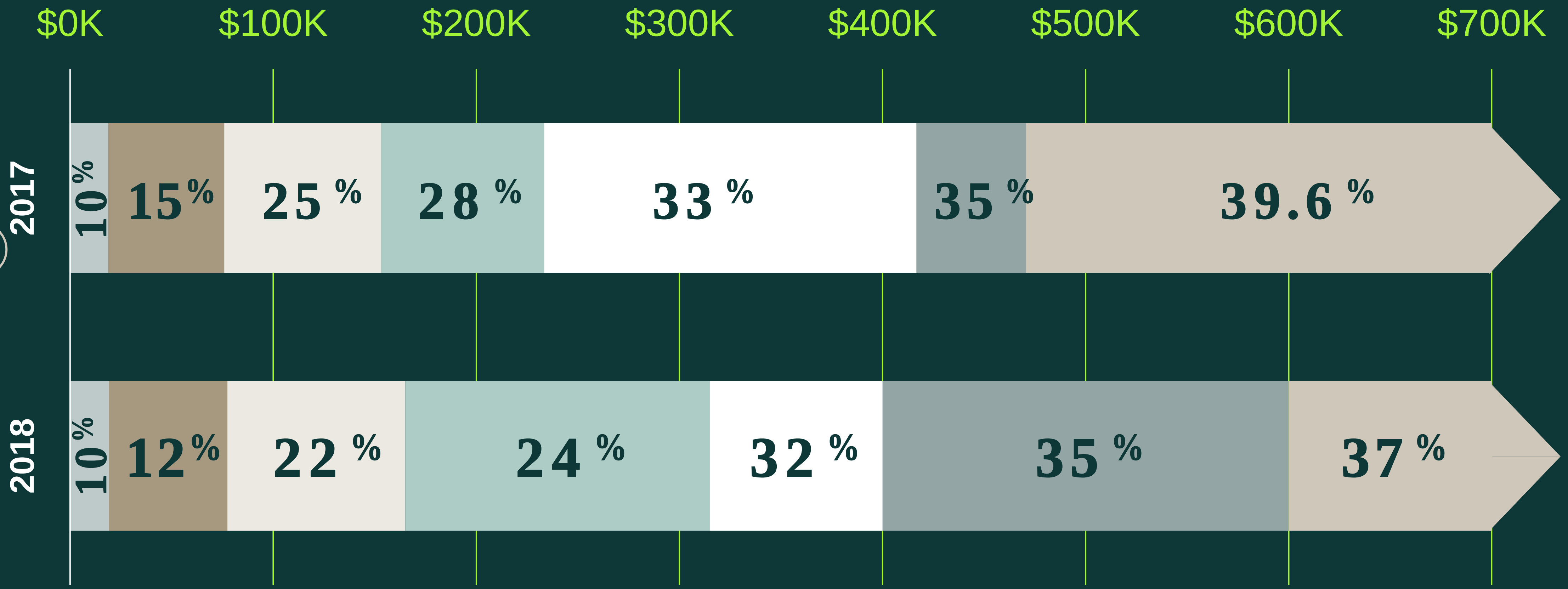

Income Brackets & Tax Rates

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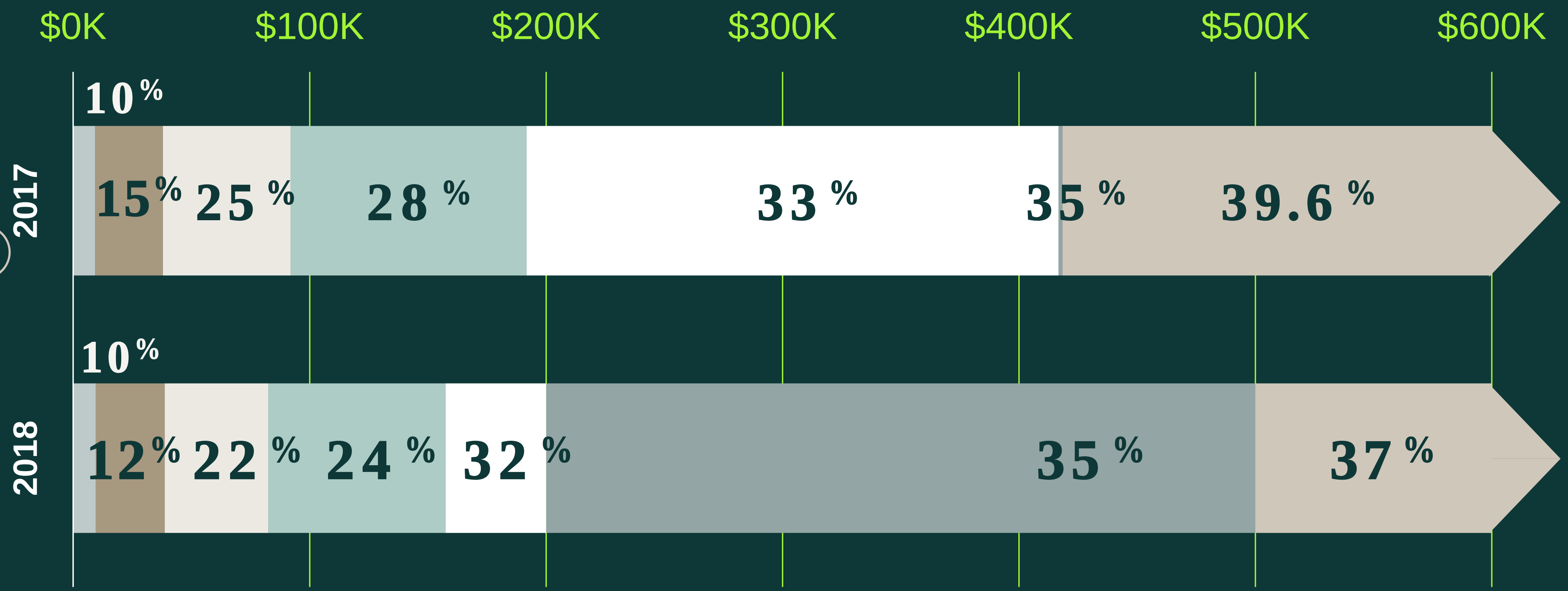

Individual changes

- Personal Exemptions – Suspended until 2026
- Standard Deduction – Raised until 2026

Married Filing Joint	$24,000
Head of Household	$18,000
Individual	$12,000

- Retains enhanced deduction for blind and elderly
- AMT Exemption – Raised Until 2026

	AMT Exemption	Exemption Phaseout
Married Filing Joint	$109,400	$1,000,000
Other Taxpayers	$70,300	$500,000

Itemized Deductions

Provision	Pre-Reform Law	Reform Act
Itemized Deduction Limitation	Total itemized are reduced by 3% of AGI for taxpayers over a threshold	**Suspends** limitation for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026
Charitable Contributions	Limitation of Charitable deduction is 50% of AGI	AGI limitation on deduction **increases to 60%** of AGI in tax years beginning after 2017 and before 2026

Itemized Deductions

Provision	Pre-Reform Law	Reform Act
State and Local Tax (SALT) Deduction	Sales Tax or Income Tax Property Tax	Combination of sales tax or income tax and property tax cannot exceed $10,000 per taxpayer ($5,000 if married filing separately). $10,000 limitation goes away after 2025
Miscellaneous Deductions	Deductible to extent exceeds 2% of AGI	Suspends deductions until end of 2025.

Itemized Deductions

Provision	Pre-Reform Law	Reform Act
Mortgage Interest Deduction	Deduction on first $1 million that secures primary or secondary residences, plus $100k of home equity debt	**Suspends** deduction for home equity debt and reduces limitation to **$750k** (for debt incurred after 12/15/17) until 2026
Medical Expenses	Deductible to extent exceeds 10% of AGI	Lowers 10% threshold to **7.5%** for tax years 2017 and 2018

Revised Depreciation Rules

Depreciation – Bonus Depreciation

Provision	Current Law	Tax Cuts and Jobs Act
For property acquired and placed in service between 09/27/17 and 1/1/23	50% Bonus depreciation	100% Bonus depreciation
Acquisition of property	New only	Applies to new <u>and used</u> (acquired in arm's-length transaction)
Phase down	Starts in 2018: *2018 = 40%; 2019 = 30%*	20% Phase down starts in 2023: *2023 = $80%; 2024 = 60%, 2025 = 40%; 2026 = 20%*

Depreciation – Section 179

Provision	Current Law	Tax Cuts and Jobs Act
Expensing limit of assets placed in service	$510,000 *(2017 limit)*	$1 million *(taxable years beginning after 2017)*
Phase-out threshold	$2,030,000 *(2017 limit)*	$2,500,000 *(taxable years beginning after 2017)*
Certain improvements to nonresidential real property *(roofs, HVAC systems, fire protection and alarm systems, security systems)*	Excluded	Included

Depreciation – Cost Recovery Changes

- New farming business machinery and equipment is now 5-year property (previously 7-year)
- Repeal of 150% Declining Balance Method for Farmers—200% DB
- Qualified improvement property (QIP) is 39 years and does not qualify for bonus
- ADS recovery period for residential rental property reduced to 30 years
- **Note:** A real property trade or business that elects out of the limitation on the deduction of interest required by Sec. 163(j) must use ADS lives to depreciate nonresidential real property (40 yrs), residential rental property (30 yrs), and qualified improvement property (20 yrs)

Depreciation and Exchanges

- Taxpayers may elect 50% bonus for 2017.
- Removes separate categories of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property.
- Listed property definition no longer includes computer or peripheral equipment.
- Passenger automobile limitations (§280F) are increased for vehicles placed in service after December 31, 2017.
- The Act limits the nonrecognition of gain or loss to like-kind exchanges of real property that is not held primarily for sale (no longer includes personal property exchanges).

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Changes in Accounting Methods for Small Taxpayers

Changes in Accounting Methods for Small Taxpayers

- For taxpayers with average annual gross receipts for the prior three years of less than $25 Million.
- Can use cash method of accounting
- Exempt from requirement to maintain inventories:
  - Inventories can be accounted for as "non-incidental materials and supplies"
  - This change still requires taxpayers to track direct costs and take deduction in year of sale; however, they are relieved from maintaining a formal COGS schedule.
- Exempt from UNICAP rules under Section 263A

Modification of Entertainment Expense and Fringe Benefits

Fringe Benefits

Provision	Current Law	Tax Cuts and Jobs Act
Entertainment Expenses	50% deductible to the extent directly related to active conduct of a trade or business.	Repealed. No deduction allowed for entertainment, amusement, or recreation.
Food and Beverage expenses for employees (in-house cafeteria or on premises)	100% deductible, if considered a fringe benefit.	50% deductible if facility meets *de minimis* requirement and for convenience of employer. **After 2025**, not deductible.

Pass-Through Changes

Qualified Business Income Deduction

Pass-Through Changes - Qualified Business Income Deduction

- One of the most significant changes of the new tax law for pass-through businesses is the new Section 199A deduction.
- Section 199A provides a deduction equal to the lesser of:
  - 20% of certain domestic qualifying income known as qualified business income (“QBI”), or
  - 20% of the excess of the taxpayer’s taxable income determined before applying Sec.199A over the taxpayer’s net capital gain and cooperative dividends.
- The 20% QBI deduction applies to certain pass-through businesses such as sole proprietorships, S-corporations and partnerships including trusts and estates as well as dividend income from REITs.

Pass-Through Changes - Qualified Business Income Deduction

- Specific service industries, such as health, law, accounting, actuaries, performing arts, consulting, athletics, financial, brokerage and other professional services as well as traders/dealers in securities, partnership interests, or commodities cannot take the deduction unless they meet the small taxpayers exception. However, the deduction **is** available for engineering and architecture services.
- The deduction should be determined by each trade or business and is taking as a below the line deduction when computing taxable income.
- Allowed for both regular and AMT tax.
- Does not apply to tax on net investment income under Section 1411 or self-employment taxes.
- QBI deduction will expire for tax year beginning after December 31, 2025.

Pass-Through Changes – QBI Definitions

- Section 199A (c) defines QBI as:
  - The net amount of qualified items of income, gain, deduction and loss with respect to any qualified trade or business of the taxpayer.
    - Earned income such as salaries and guaranteed payments from partnerships are also excluded.
    - Does not include investment income
  - Income must be effectively connected with a US trade or business.
  - Carryover of Losses
    - Net losses from qualified trades or businesses will be treated as a loss in the succeeding taxable year
- Section 199A(d) defined a qualified trade or business as any trade or business other than:
    - (a) specified service trade or business or
    - (b) the trade or business of performing services as an employee

Pass-Through Changes – QBI Limitations

- Taxpayers with qualified business income can generally take the full 20% QBI deduction from each qualified trade or business with certain limitations.
- W-2 Limitation - General Rule:
  - The deduction is limited to 50% of W-2 compensation paid by the qualified trade or business during the taxable year.
  - The limitation does not apply to taxpayers who are below the threshold amount.
- Alternate W-2 and asset-based limitation:
  - 25% of W-2 wages plus 2.5% of unadjusted basis of all qualified property

CAUTION: The QBI Limitations are detailed and complex. Consultation with your tax advisor to determine the impact of this law to your specific business will be necessary

Pass-Through Changes – QBI Limitations

- Small Taxpayers Exception:
  - Small taxpayers, including those involved in trades or businesses specifically excluded as a qualified trade or business can still take advantage of the QBI deduction if their taxable income before Sec. 199A deduction does not exceed the following thresholds:

Filing Status	Threshold
Married Filing Jointly	$315,000
Other filers	$157,500

- Threshold amounts will be adjusted for inflation
- The deduction limitations phase-in over the next $100,000/$50,000 that the taxpayer's income exceeds the threshold
- The applicable percentage to determine the amount of phase-in is as follows:
  - (Excess amount)/($100k or $50K) = applicable percentage
  - The phase-in applies to all taxpayers

Pass-Through Changes – QBI Limitations

- Multi-entity Structures?
- Tiered Businesses?
- Payments to Related Labor Companies?
- Netting of Pass-Through Losses against Pass-Through Income?
- Impact of Existing IRC Section 469 Grouping Elections and Aggregation?
- Self-Rentals and Operations?

Interest Deduction Limitation

Pass-Through Changes – Interest Deduction Limitation

- Effective for tax years beginning after December 31, 2017, the amount of deductible interest is limited to the aggregate of:
  - The business interest income for the year, plus
  - 30% of the taxpayer's adjusted taxable income for the year, plus
  - The taxpayers floor plan financing interest for the year (financing of motor vehicles held for sale or lease)
- Adjusted taxable income is computed without regard to investment income or deductions, deductions of interest, depreciation, amortization, depletion, NOLs, or the 199A deduction
- **Businesses with average gross receipts of $25M or less are exempted from this restriction:**
  - Entities considered a single employer under Sec. 52(a) or (b) (Controlled Group) or Sec. 414(m) or (o) (Affiliated Service Groups) will need to aggregate their gross receipts for purposes of this test
- Any business interest not deducted currently is treated as paid or accrued in the following taxable year. Any interest disallowed would be carried forward indefinitely.
- For pass-throughs, the limitation is determined at the entity level
- Real estate trades or businesses and farmers can elect out, but will need to use ADS lives for depreciation

Pass-Through Changes – Restrictions on Interest Deduction

Planning Considerations:

- Clients should evaluate financing structure to minimize unnecessary debt
- Clients with multiple-entity structures should look to move debt into entities generating taxable income that would minimize the limitations
- Whether or not to elect out if a real estate or farming business
- Complexity in determining or estimating taxable income.
- Ensure that adjustment items (interest, depreciation, amortization, depletion, etc.) are clearly identified in books & records

Excess Business Loss Limitation

Pass-Through Changes – Excess Business Loss Provision

- Nonpassive business loss is limited

Filing Status	Current Limitation	New Limitation
MFJ	Amount of business loss	$500,000
Single	Amount of business loss	$250,000

- The limitation is applied at the taxpayer level rather than entity or business level
- The limitations will be adjusted for inflation
- The calculation is applied after determining allowable passive income/loss under Section 469
- Any disallowed loss is carried forward and treated as part of the taxpayer's net operating loss
- The provision will applies to tax years beginning after December 31, 2017 and ending before January 1, 2026

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Impact for Cooperative Business Structures

Impact for Cooperative Business Structures

What we currently know:

- 20% QBI Deduction to member of Co-op based on gross deliveries to Co-op
- This appears to be an unintended consequence of the Tax Reform
- Expecting a Fix for this via a Technical Correction of some type

To be continued....

Estate Tax Changes

Changes to Estate Tax

Basic Exclusion

- 2017 - $5 million per person + inflation adjustment
- 2018 - 2025 - $10 million per person plus TBD inflation adjustment.
- GST exclusion has also been increased to $10 million per person plus inflation adjustment
- Increased exemptions sunset on December 31, 2025 then go back to $5 million starting January 1, 2026, absent further action by Congress
- The bill directs the IRS and Treasury Dept to draft regulations to deal with the sunset to ensure that there is no double taxation of gifts

Estate Tax Provisions Not Changed

Step-up in basis under IRC 1014(a)

- ➢ Increase in estate assets basis to FMV on DOD (or alternate valuation date, if elected)

Portability Election

- ➢ Regular exemption only. Not GST exemption
- ➢ Make election on Form 706
- ➢ Ported exemption lost if surviving spouse remarries

Estate & Gift Tax Planning Considerations

Planning Strategies

- Gift and/or sale to IDGT – Estate Freeze
- Take advantage of valuation discounts
- GST Planning – GST exemption also increased but no portability
- Include in estate and get "step-up" at death

Take Aways:

- Similar planning techniques as before but much more focus on basis, timing, and each client's specific situation

C-Corporation Changes

C-Corporation Changes

- Effective for years beginning after December 31, 2017, corporate tax rate is <u>permanently</u> changed to a flat rate of 21%.
- Personal Service Corporations “PSC” – no special rate and is taxed the same as any “C” corporation.
- Fiscal Year Taxpayers – Use a blended rate to compute tax. §15(a)
- Corporate AMT has been eliminated:
  - During transition period, existing AMT credits are refundable
  - Taxable years starting in 2018-2020, AMT credits can offset regular tax liability
  - 50% of the excess of the remaining minimum tax credits over the allowable credit is refundable

Corporate Changes - NOL

- Effective for years ending after December 31, 2017, NOLs may be carried forward indefinitely, however, only 80% of taxable income in future years may be reduced by the NOL.

- The new 80% limitation applies to NOLs arising in taxable years beginning after December 31, 2017

- Two years carryback period of NOLs has been repealed.

Corporate Changes – NOL Continued

- Existing NOLs generated prior to January 1, 2018 will continue to have a 20 year carry forward and can offset 100% of regular taxable income.
- Companies need to track carryforward in separate buckets
- Note that Sec. 382 limitations will continue to apply where applicable.
- There are special rules for property/casualty insurance companies and farming businesses.

Recent IRS Audit Activity

- LB&I is very active (greater than $10 M in revenue)
- Higher audit activity in general
- Amended returns are triggering audits
- Have seen an increase focus on S-corporations:
  - Shareholder Stock Basis, Loss Carryovers, Shareholder Loans and Related Party Transactions (Rents and Loans)

Questions?

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