YEAR-END PLANNING OPPORTUNITIES FOR BUSINESSES

November 21, 2019

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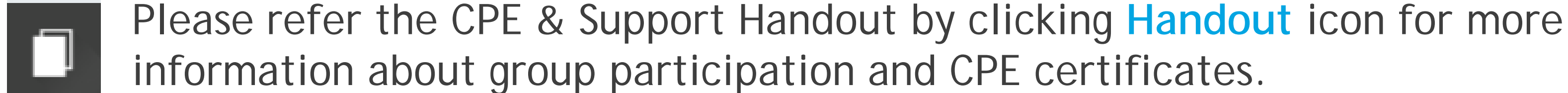

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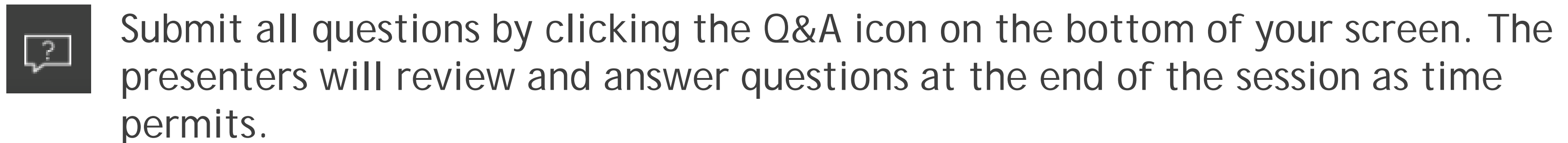

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With You Today

RANDY SCHWARTZMAN
Corporate Technical Practice Leader
National Tax Office
Corporate and Mergers and Acquisitions

(631) 927-1159
rschwartzman@bdo.com

KEVIN AINSWORTH
Tax Managing Director
National Tax Office

(617) 239-7013
kainsworth@bdo.com

KEVIN ANDERSON
Tax Managing Director
National Tax Office

(202) 644-5413
kdanderson@bdo.com

With You Today

JEFF BILSKY
National Tax Partner
National Tax Office

(404) 979-7193
jbilsky@bdo.com

TOMMY ORR
Senior Manager
National Tax Office

(202) 644-5434
torr@bdo.com

Introduction

Introduction

- As the end of the year approaches, now is a good time to think of planning moves that will help lower our clients' tax bill for this year and possibly next year.

- Year-end planning for 2019 continues to take place against the backdrop of new tax laws that make major changes to the rules for individuals and businesses. The new law is herein referred to as the "Tax Cuts and Jobs Act," "TCJA," or simply the "Act."

- While we are covering businesses today, flow through entity owners are subject to the individual tax rates. For individuals, 2018 brought about, lower income tax rates, a substantially increased standard deduction, substantially limited itemized deductions, no more personal exemptions, and an alternative minimum tax (AMT) that will affect a lot less taxpayers, and many more changes that we will hear about today.

Introduction - *continued*

- For businesses, the corporate tax rate was reduced to a flat 21% rate, the corporate AMT was eliminated, and there are new limits on business interest deductions.
- Most business taxpayers will now benefit from significantly liberalized expensing and bonus depreciation rules.
- In addition, there is a 20% deduction for non-corporate taxpayers with qualified business income (QBI) from a flow-through entity (FTE). The QBI deduction reduces the highest effective tax rate for individuals with QBI from 37% to 29.6%.

Introduction - *continued*

- Since the 2019 and 2020 rates will remain the same, the time-tested approach of deferring income and accelerating deductions to minimize taxes still works for many taxpayers, along with the tactic of “bunching” expenses into this year or into the next year, whichever is more beneficial in order to get around those remaining deduction restrictions that are based on a percentage of adjusted gross income.

- In some instances, threshold amounts are adjusted for inflation from year-to-year, which should be taken into account when running projections.

- We have compiled a list of tax saving moves and action steps that should be presented and applied based on unique taxpayer dynamics to help achieve meaningful tax savings with proper tax planning.

Tax Law Changes Affecting Businesses

Business Tax Law Changes

Provision	2019/2020 Law
Corporate Tax Rate	The top corporate tax rate has been permanently reduced from 35% to a flat tax rate of 21%. The prior corporate tax brackets have been reduced to a single flat rate, thereby converting the corporate progressive tax system into a flat tax system. Personal service corporations are now taxed at the same 21% tax rate as other C corporations.
Repeal of Alternative Minimum Tax	In the past, the corporate AMT was levied at a 20% rate, but it was repealed effective for tax years beginning after Dec. 31, 2017. Going forward, any prior AMT liabilities may offset the regular tax liability for any taxable year after 2017. In addition, the AMT credit is refundable for any taxable year beginning after 2017 and before 2022 in an amount equal to 50% (100% for taxable years beginning in 2021) of the excess credit for the taxable year.

Business Tax Law Changes

Provision	2019/2020 Law
Reduction of Dividends Received Deduction (DRD)	For dividends paid to companies in which it has an ownership interest, a C corporation could claim 65% DRD for ownership of 20% to under 80%, and 50% DRD for ownership under 20%. A 100% DRD is available for ownership between 80% and 100%.
Bonus Depreciation (Full Expensing)	Allows 100% expensing for the cost of qualified property acquired and placed in service after Sept. 27, 2017; gradually reduced for property placed in service after Dec. 31, 2022 and before Jan. 1, 2027, with no expensing available for property placed in service after Dec. 31, 2026. The new rules apply to most new <u>and</u> used property.

Business Tax Law Changes

Provision	2019/2020 Law
Section 179 Expensing	Business taxpayers could elect to expense the cost of qualifying property, with an annual limit of $1 million. The $1 million (increased to $1,020,000 in 2019 and $1,040,000 in 2020) limitation was reduced by the amount by which the cost of such property placed in service during the taxable year exceeded $2.5 million ($2,550,000 in 2019 and $2,590,000 in 2020).

Business Tax Law Changes

Provision	2019/2020 Law
Limitation on Business Interest Expense Deduction	Limits the interest expense deduction for every business, regardless of its form, with average annual gross receipts over $26 million for 2019 and 2020, to the sum of: i. Business interest income and ii. 30% of the business's "adjusted taxable income" (ATI). iii. Floor plan financing interest expense ATI excludes: • Income and deduction items not related to a trade or business and business interest income. • Any net operating loss (NOL) deduction that could offset taxable income, and any deduction allowed under new Section 199A for non-corporate taxpayers. • Deductions for depreciation, amortization and depletion, but only for taxable years beginning on or after Jan. 1, 2022.

Business Tax Law Changes

Provision	2019/2020 Law
Net Operating Losses (NOLs)	Under the TCJA, NOL deductions are limited to 80% of taxable income for tax years beginning after Dec. 31, 2017. The new law also eliminates the carryback of NOLs and allows unused NOLs to be carried forward indefinitely. Pre-TCJA NOLs had a carryback period of 2 years and a carryforward period of 20 years. NOLs generated before 2018 will not be subject to the 80% of taxable income limitation.

Business Tax Law Changes

Provision	2019/2020 Law
Section 199A Deduction	The new law provides individuals, estates and trusts with a deduction of up to 20% of their qualified business income (QBI), regardless of whether it is attributable to income earned through an S corporation, partnership, sole proprietorship, or disregarded entity. Eligible taxpayers may also be entitled to a deduction of up to 20% of their combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income. For taxpayers whose taxable income does not exceed \$160,700 (or \$321,400 for married filing jointly or \$160,725 for married filing separately), the deduction is equal to the lesser of 20% of QBI or taxable income. For taxpayers whose taxable income is at least \$210,700 (or \$421,400 for married filing jointly and \$210,725 for married filing separately), two additional provisions apply: (1) A limitation based on W-2 wages may reduce the deduction percentage below 20% (50% of W-2 wages or 25% of W-2 wages plus 2.5% of the unadjusted basis of qualified property held by the business); (2) No deduction may be claimed for income from specified service businesses.

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Business Tax Law Changes

Provision	2019/2020 Law
Excess Business Loss Limitation	For tax years beginning after Dec. 31, 2017, and before Jan. 1, 2026, "excess business loss" of a taxpayer other than a C corporation is disallowed. Under this rule, excess business losses are not allowed for the tax year but are instead carried forward and treated as part of the taxpayer's NOL carryforward in subsequent tax years. An excess business loss for the tax year is the excess of aggregate deductions of the taxpayer attributable to trades and businesses over the sum of aggregate gross income or gain of the taxpayer plus a threshold amount. The 2019 threshold amount for a tax year is $510,000 for married individuals filing jointly and $255,000 for other individuals, with both amounts indexed for inflation. These thresholds increase to $259,000 and $518,000 respectively for 2020. For a partnership or S corporation, the new rule applies at the partner or shareholder level. In terms of ordering, these rules only applies only after the basis limitation rules under Secs. 1366(d) or 704(d) and the at-risk basis rules under Section 465 are applied for active owners and after the PAL rules under Section 469 are applied for passive owners.

Business Tax Law Changes

Provision	2019/2020 Law
Electing Small Business Trusts (ESBTs)	A nonresident alien may now be a potential current beneficiary. Since the tax is imposed on the S corporation portion of an ESBT, it is the final incidence of taxation of such income, there is no further taxation on any amounts distributed to a beneficiary of an ESBT. ESBTs are subject to the limitation applicable to individuals; as a result, ESBTs are allowed a 5-year carryforward of amounts in excess of the annual limitation. In the past, no carryovers were allowed as the charitable deductions limits for ESBTs were under the general rules for trusts.

Business Tax Law Changes

Provision	2019/2020 Law
S-to-C Corporation Conversions	The TCJA makes two modifications for a C corporation that (a) was an S corporation on Dec. 21, 2017, and revokes its S corporation election after Dec. 21, 2017, but before Dec. 22, 2019, and (b) has the same owners of stock in identical proportions on the date of revocation and on Dec. 22, 2017. If an S corporation and its shareholders determine that it is advantageous to revoke the S election, two new provisions cushion the impact of the revocation: 1. After the expiration of the post-termination transition period (at least one year after revocation), a distribution of money by the corporation is allocated between the accumulated adjustments account (AAA) and the accumulated earnings and profits (AE&P) of the corporation in the same ratio as the amount of the AAA bears to the amount of the AE&P as of the effective date of the revocation election. 2. If a terminated S corporation using the cash method is required under Section 448 to adopt the accrual method, the resulting Section 481(a) adjustment is taken into account ratably over 6 taxable years beginning with the year of change. These provisions incentivize S-to-C conversions so taxpayers can benefit from the 21% corporate tax rate and the accompanying deferral provided to shareholders until distributions are made. A more comprehensive discussion of the choice of entity decision is provided in a later section.

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Business Tax Law Changes

Provision	2019/2020 Law
Entertainment Expenses	Under pre-TCJA law, no deduction was allowed for ordinary and necessary expenses for an activity of a type generally considered to be entertainment, amusement, or recreation, or for a facility used in connection with such an activity, unless the taxpayer established that the expense was directly related to or associated with the active conduct of the taxpayer's trade or business or income-producing activity. The TCJA repeals the rule that allowed a deduction for entertainment, amusement, or recreation expenses that were directly related to or associated with the active conduct of the taxpayer's trade or business. A deduction for any food or beverage expense, even in connection with entertainment, continues to be limited to 50% of the otherwise deductible amount.

Business Tax Law Changes

Provision	2019/2020 Law
Advance Payments	In general, for a cash basis taxpayer, an amount is included in income when actually or constructively received. For an accrual basis taxpayer, however, an amount is included in income when all the events have occurred that fix the right to receive that income and the amount of that income can be determined with reasonable accuracy, unless an exception permits deferral or exclusion. Accrual taxpayers with an applicable financial statement are also subject to a general rule that precludes the deferral of income recognition beyond book recognition. Exceptions often allow tax deferral to mirror financial accounting deferral (e.g., income is recognized as the goods are provided or the services are performed) to a limited extent. See Rev. Proc. 2004-34.

Business Tax Law Changes

Provision	2019/2020 Law
Advance Payments	The TCJA codifies the deferral method of accounting for advance payments for goods, services and other listed items under Rev. Proc. 2004-34 by providing that a taxpayer who computes taxable income under the accrual method of accounting and receives any advance payment (defined below) during the tax year, must: (a) Include the advance payment in gross income for that year, or (b) If the taxpayer elects, the taxpayer may: (i) include the portion of the advance payment required to be included under Section 451(b) in its gross income in the taxable year of receipt, and (ii) include the remaining portion of the advance payment in gross income in the tax year following the tax year in which the payment is received. (Section 451(c)(1)(B))

Business Tax Law Changes

Provision	2019/2020 Law
Like-Kind Exchanges	Under Section 1031, a taxpayer doesn't recognize gain or loss on an exchange of like-kind properties if both the relinquished property and the replacement property are held for productive use in a trade or business of for investment purposes. Under pre-TCJA law, property eligible to be exchanged in a tax-free like-kind exchange included real property and personal property, including intangible personal property such as patents and other intellectual property. Section 1031 is now limited to exchanges of real property that is not considered inventory or held primarily for sale. Note: In light of the increased and expanded expensing provisions under Section 179 and bonus depreciation, the elimination of the like-kind exchange provisions' applicability to tangible personal property should be less impactful.

Business Tax Law Changes

Provision	2019/2020 Law
Section 162(m)	An employer generally may deduct reasonable compensation for personal services as ordinary and necessary business expense. However, a publicly held corporation is not entitled to deduct applicable employee remuneration in excess of $1 million per year paid to a covered employee unless it met one of a number of exceptions (i.e., it was payable solely on account of performance goals having been reached, and the performance goals were pre-established and objective). A "covered employee" includes the principal executive officer, the principal financial officer, and the three other highest paid officers The TCJA eliminates the exceptions for performance-based compensation and commissions from the definition of "applicable employee remuneration" that is subject to the $1 million deduction limit. Certain grandfathering rules apply to remuneration payable under a written binding contract that was in effect on Nov. 2, 2017, and that is not modified in any material respect on or after such date.

Business Tax Law Changes

Provision	2019/2020 Law
Election to Deter Income from Option or RSU	Section 83 governs the amount and timing of income inclusion for property, including employer stock, transferred to an employee in connection with the performance of services. Under Section 83(a), an employee must generally recognize income for the tax year in which the employee's right to the stock is transferable or isn't subject to a substantial risk of forfeiture (substantially vested). The amount includible in income is the excess of the stock's fair market value (FMV) at the time of substantial vesting over the amount, if any, paid by the employee for the stock. The TCJA allows a qualified employee to elect to defer the inclusion in income of the amount of income attributable to qualified stock transferred to the employee by the employer for up to five years.

C Corporations

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When C Corporations Should Defer or Accelerate Income

- C corporations, like individuals, should consider when and how to shift income and deductions between 2019 and 2020. Cash basis C corporations have greater control over the timing of income and deductions in much the same way as individuals.

- Absent implementing certain automatic tax accounting method change requests for items such as capitalization software development costs, depreciation, prepaid expenditures, and deferral of advanced revenue, it is generally more difficult for accrual basis taxpayers to control the timing of income and deductions. While automatic method changes can be filed by the extended due date of the return, non-automatic tax accounting method change requests must be filed by the end of this year in order to be effective in 2019.

- Favorable tax accounting method changes can result in an immediate tax benefit for the full amount of the change, *i.e.*, balance of prepaid expenses or capitalized (and unamortized) software development costs, or catch-up depreciation as a result of performing a cost segregation study.

Business Tax Planning - Cash Basis Taxpayers

- More "small businesses" are able to use the cash (as opposed to accrual) method of accounting than were allowed to do so in earlier years.
- To qualify as a "small business" a taxpayer must, among other things, satisfy a more liberalized gross receipts test. The gross receipts test is now satisfied if, during a three-year testing period, average annual gross receipts do not exceed $26 million (the dollar amount used to be $5 million and was increased to $25 million by the TCJA and indexed up to $26 million).
- Rev. Proc. 2018-40 provides a procedure that allows taxpayers to change their overall method of accounting to the overall cash basis method of accounting for tax purposes, as well as to meet an exception to capitalize costs for UNICAP under Section 263A, and to change from using inventories to treating such items as non-incidental materials and supplies.
- Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings until next year or by accelerating expenses, for example, by paying bills early or by making certain prepayments.

Income Shifting by Cash Basis Taxpayers

- A cash basis taxpayer can postpone income to the next year as long as it isn't actually or constructively received this year. Income is constructively received if there is no substantial restriction on the time or manner of payment.

- Income earned by a service provider is not taxed until he or she receives payment. If the taxpayer holds off billing until next year — or until so late in the year that no payment can be received in 2019 — he/she will not have taxable income this year.

- In some cases, income can be deferred if payment of a bonus earned in 2019 is delayed until 2020.

How to Shift Expenses for Cash Method Taxpayers

- Pay all bills already received for expenses in 2019 rather than deferring payment until 2020.

- Choose to incur and pay expenses in 2019 that would normally be incurred and paid in 2020. For instance, the taxpayer might have repair and maintenance work performed before the end of 2019 instead of waiting until early 2020.

- Prepay expenses where feasible. Certain other prepayments made by cash method taxpayers, such as prepaid compensation, must be prorated over the period to which they apply.

Materials and Supplies

- Businesses may be able to take advantage of the *de minimis* safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs don't have to be capitalized under the Section 263A uniform capitalization (UNICAP) rules.
- To qualify for the annual election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS; *e.g.*, a certified audited financial statement along with an independent CPA's report).
- The taxpayer must have written accounting procedures in place at the beginning of the year specifying a dollar amount beneath which amounts will be expensed and books must expense such costs in accordance with the accounting procedures.
- If there is no AFS, the cost of a unit of property cannot exceed $2,500. Where the UNICAP rules aren't an issue, consider purchasing such qualifying items before the end of 2019.

Accrual basis corporations – Bonus deductions

- An accrual basis corporation can take a deduction for its current tax year for a bonus not actually paid to its employee until the following tax year if (1) the employee doesn't own more than 50% in value of the corporation's stock, (2) the bonus is properly accrued on its books before the end of the current tax year, (3) the overall bonus pool is fixed at year-end, and (4) the bonus is actually paid within the first 2 1/2 months of the following tax year (for a calendar year taxpayer, within the first 2 1/2 months of 2020).

- For employees on the cash basis, the bonus won't be taxable income until the following year.

- The compensation must be paid before the end of the year if the bonus is paid by a PSC to an employee-owner, or by an S corporation to any employee-shareholder, or by a C corporation to a direct or indirect majority owner.

Delay Recognition of Corporate Gain by Timing the Distribution of Appreciated Property

- Where a corporate liquidation is planned, delaying distribution of assets (especially built-in gain assets) until 2020 will defer shareholders' gain to next year.

- The same principle applies to distributions of appreciated property out of corporate solution under Section 311(b) for partial liquidations.

- A one-day delay from December 31, 2019, to January 1, 2020, could grant a taxpayer a whole year in which to pay the tax on the gain. This of course assumes that the taxpayer is eligible to base his/her estimated tax liability on the prior year tax liability.

Income Shifting by Accrual-Basis Taxpayers

- The mere fact that the receipt of cash is delayed doesn't defer taxable income for an accrual-basis taxpayer. As soon as an accrual-basis taxpayer's right to the income is fixed, and its amount can be determined with reasonable accuracy, it is taxable.
- The only way an accrual-basis taxpayer can postpone income (other than by using the installment sale method or long-term contract accounting) is to defer the actual right to payment for the services or merchandise delivered.
- One way to do that would be to postpone completion of a job until 2020 so as to have the right to income arise only in 2020, even though most of the actual work is done in 2019

How to Shift Expenses for Accrual Method Taxpayers

- Accrual-basis taxpayers are subject to an economic performance precondition to the deduction of accrued expenses. In the case of liabilities arising out of the provision of services or goods to the taxpayer by another person, economic performance occurs, and the expense is deductible, when the property or services are delivered or performed.

- The Regulations provide a special rule under which an accrual method taxpayer can treat property and services as provided or performed when it is paid for, but only if it can be reasonably expected that the property or services will be provided or performed within 3½ months after payment is made.

How to Shift Expenses for Accrual Method Taxpayers - *continued*

- Electing the recurring item exception allows accrual basis taxpayers to treat certain recurring items as incurred during a tax year even though economic performance has not occurred.

- The deduction is allowed when all events that establish the liability have occurred, and the taxpayer can determine the amount of the liability with reasonable accuracy; and

- Economic performance occurs on or before the earlier of (1) the date the taxpayer files a timely return (including extensions) for that tax year, or (2) 8 ½ months after the close of that year.

How to Shift Expenses for Accrual Method Taxpayers - *continued*

- Besides the fact that the item must be recurring in nature and that each taxpayer must consistently treat similar items as incurred in the tax year in which the all events test is met, another condition must be met to qualify.
- The condition is that (a) the item is not material, or (b) accrual of the item in the year in which the all events test is met results in a better match against income than would result from accruing the item in the year of economic performance.
- The better matching requirement is deemed met in the case of a liability arising out of rebates and refunds, taxes, awards and prizes, insurance, warranty, and service contracts.
- The recurring item exception is not available, in part, for accruals arising out of a workers comp act, tort, breach of contract, or the violation of law.

Corporate Capital Losses Can be Carried Back

- A C corporation carries capital losses, whether long-term or short-term, to other years as a short-term capital loss. This loss can be carried back three years and forward five years until it is used up.

- Corporations should try to time the realization of their capital losses for 2019 or 2020 to get the greatest tax benefit.

- If a corporation had capital gains in 2016, 2019 is the last year in which to realize capital losses to recover the tax paid on those gains.

Research Tax Credit

With the new provisions of Tax Reform, taxpayers should evaluate how the changes impact their future tax position and how the Research Tax Credit can help minimize tax liabilities. Key takeaways include:

- The cut of the corporate tax rate increases the Research Tax Credit's net benefit by more than 21%, from its previous amount of 65% to the law's 79%.
- Taxpayers who would have been subject to AMT and who therefore generally wouldn't have been able to use Research Tax Credits to offset their federal income tax liability now will be able to do so.
- NOL taxpayers may find the Research Tax Credit a helpful way to offset the taxes they'll now have to pay given the modification of the NOL deduction.
- Taxpayers seeking to maximize the benefit of immediately deducting R&E expenditures should consider the effective date of the required amortization rule (*i.e.*, December 31, 2021) and, if possible, accelerate their R&D activities prior to December 31, 2021.

S Corporations

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Taking S Corporation Losses

- A shareholder can deduct his/her pro-rata share of S corporation losses only to the extent of the total of his basis in (a) the S corporation stock, and (b) debt owed him/her by the S corporation. This determination is made as of the end of the S corporation tax year in which the loss occurs.
- Any loss or deduction that cannot be used on account of this limitation can be carried forward indefinitely.
- If a shareholder wants to claim a 2019 S corporation loss on his/her own return, but the loss exceeds the basis for his/her S corporation stock and debt, he/she can still claim the loss in full by lending the S corporation more money, or by making a capital contribution by the end of the S corporation's tax year.

Taking S Corporation Losses - *continued*

- A shareholder could free up suspended passive activity losses to the extent that outside tax basis exists, so long as the activity is disposed of before the end of the year.

- The impact of the PAL limitation rules must also be considered. Limited partners generally have passive activity interests unless an individual who is a limited partner meets the material participation test under the 500 hours of participation rule, the five of ten years of material participation rule, or any prior year material participation rules for a personal service activity.

Choice of Entity

Choice of Entity Decision

Introduction

- Choice of entity is among the most important decisions taxpayers can make when doing business.

- The following entities are selected based on a number of factors:

  - Sole Proprietorship
  - Disregarded Entities
  - Partnership
  - S Corporation
  - C Corporation

Choice of Entity Decision

Conversion Transactions

Flow Through Entity to C Corporation

- Sole Proprietorship to C Corporation
- Partnership to C Corporation
- S Corporation to C Corporation

C Corporation to Flow Through Entity

- C Corporation to S Corporation
- C Corporation to Partnership

Choice of Entity Decision

Why Consider Incorporating?

- Lower corporate income tax rates
- Elimination of the corporate AMT
- Section 1202 Benefits
- Tax-free reorganizations
- Favorable state income tax consequences

Choice of Entity Decision

Why Consider Incorporating?

- To facilitate a Roll-up or an IPO
- To facilitate entity structure simplification projects
- To provide easier access to capital
- To avoidance ECI and UBTI
- International tax benefits (subpart F and GILTI)

Choice of Entity Decision

Why Consider Incorporating?

- Reinvestment reduces the need for outside financing
- Facilitates ESOP transactions
- Section 1014 reduces the need for basis build-up
- Expanded Post-Termination Transition Period
- Less restrictions on the use of a fiscal year-end
- NOLs attributable to ESBTs are retained in a complex trust

Choice of Entity Decision

Why Remain a Pass-Through Entity?

- Avoids two levels of taxation on operating income
- Avoids two levels of taxation on exit
- Avoids the loss of basis build-up
- Allows for flow through losses that may offset other income
- Avoids the Net Investment Income Tax

Choice of Entity Decision

Why Remain a Pass-Through Entity?

- To take advantage of the Section 199A QBI deduction
- To secure a higher valuation on exit using DCF models
- To avoid the triggering of the deferred transition tax
- To avoid being subject to the Accumulated Earnings Tax
- To avoid being subject to the Personal Holding Company Tax

Choice of Entity Decision

Why Remain a Pass-Through Entity?

- To avoid triggering Section 357(c) gain on conversion
- To avoid triggering deferred revenue on conversion
- To avoid triggering negative tax capital balances upon conversion
- To avoid the Section 1374 built-in gains tax
- To avoid the Section 1375 sting tax

Choice of Entity Decision

Why Remain a Pass-Through Entity?

- To receive greater discounts for trust and estate planning purposes
- To allow for an UP-C structure on exit
- To eliminate taxation on income that passes through to an ESOP
- To avoid triggering the Transition Tax Liability
- Other tax reform provisions may reduce taxable income

Choice of Entity

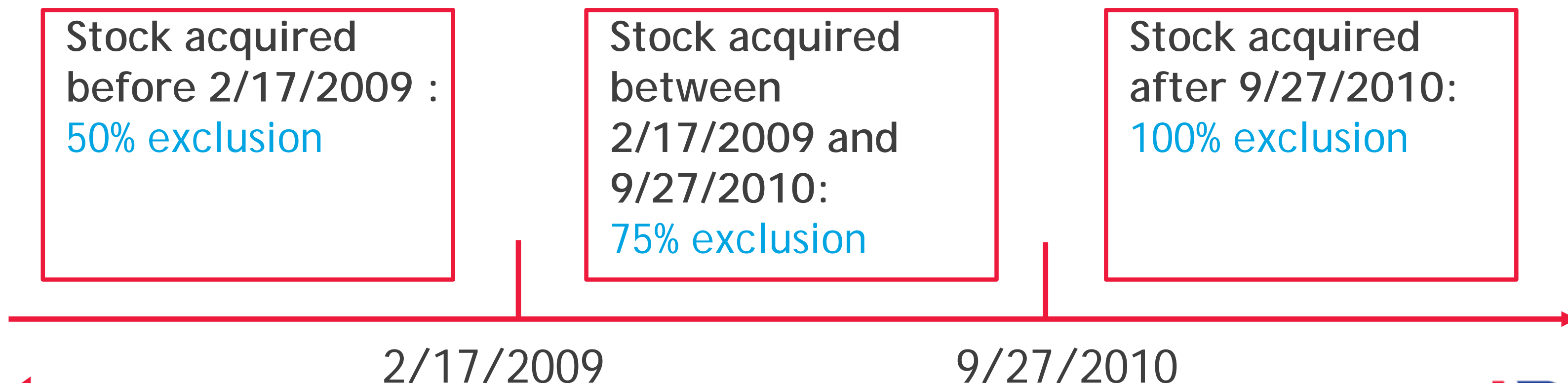
Pros and Cons of Converting to a C Corporation

Pros	Cons
• New lower tax rates • Generally no cost to convert • Corporate AMT has been eliminated • No state tax deduction limitation • Expanded post-termination AAA distribution period • ESOP transactions allow for Section 1042 rollovers • Less year-end restrictions • Section 1202 exemption may be available if conversion is from partnership status • Easier to acquire other corporate entity through tax-free corporate reorganization transactions • International tax benefits for CFCS • Conversion from subchapter S status is generally tax-free • Foreign investors can avoid tax on exit and would have a blocker in place to avoid ECI • Tax-exempt investors avoid UBTI	• Two levels of tax • Would be a taxable liquidation to convert back to partnership status • Section 1374/1375 taxes could apply upon conversion back to S corporation status • Five year period to re-elect S status • Dividends/stock sales subject to the NIIT • AET/PHC considerations • Loss of basis build-up • Losses cannot offset shareholders' other income • No 20% QBI Section 199A deduction • Immediate triggering of transition tax • Negative partnership tax capital could be triggered • Deferred revenue could be triggered • Section 357(c) could trigger gain on incorporation • Two levels of tax on exit for future asset deals • No step-up available to the future buyer, which could result in a reduced valuation • More difficult to achieve estate planning discounts

Section 1202 Stock

Benefits

- Under Section 1202, a non-corporate taxpayer is generally permitted to exclude part or all of the gain from the sale or exchange of "qualified small business stock" held for more than five years.
- The gain exclusion per issuer is limited to the greater of (1) $10 million (2) 10 times of the aggregated adjusted basis of stock disposed.
- The amount of gain exclusion a non-corporate shareholder may be entitled to varies based on when the stock was acquired or when the gain is recognized:



Section 1202 Stock

Major Qualifications

- Stock of domestic C corporations during "substantially all" of the taxpayer's holding period for such stock
- Holding period requirement - 5 years unless tack holding period exceptions apply
- Stock must have been acquired through original issuance for money, other property (not including stock), or services
- Aggregate gross assets do not exceed $50 million between the later of August 10, 1993 or your incorporation date to the stock issuance date

Section 1202 Stock
Major Qualifications

- Qualified trade or business: any trade or business other than service businesses including health, law, engineering, architecture, accounting, consulting financial services and many others
- Active trade or business requirement: 80% (by value) of assets are used in qualified trade or business during the entire holding period
- Stock and debt conversions
- Exercise of stock options and warrants

Section 1202 Stock

Major Qualifications

- Redemption transactions
- Exchanges of Section 1202 Stock in reorganizations
- Distributions of Section 1202 Stock from a partnership
- Section 1045 rollovers
- Recordkeeping requirements

Partnership Planning Considerations

Draft Disclosure Requirements

Overview

New partnership disclosures will be required by partnerships for 2019 income tax returns

- Tax basis capital reported by partner
- Beginning and ending of year partner share of Section 704(c) built-in gain/loss
- Effect of Section 704(c) on the partner's distributive share
- Partner share of Section 751 ordinary income or loss, as applicable
- Additional liability reporting
- Section 743(b) reporting
- Guaranteed payment for services versus use of capital disclosure
- Disregarded entity disclosure detail

Draft Disclosure Requirements

What does this mean in practical terms?

- Accurate tracking of partnership activities, i.e., Section 704(b) and tax basis capital accounts, is key
- If partner Section 704(b) and tax basis capital accounts have been accurately tracked, gathering the required data should not be overly burdensome
- A lack of capital accounts will require additional services in order to meet these disclosure requirements
- Be wary of shortcuts! We need to be able to support all amounts disclosed on the tax return
- It will be important to evaluate prior recourse vs. nonrecourse liability determinations and allocations under Section 752

Draft Disclosure Requirements

Anticipated Questions

- Why is the IRS requiring this information?
- Is this information already part of the tax return workpapers?
- If the partnership has been maintaining accurate capital accounts, will there be increased work necessary to complete the 2019 tax return?
- How difficult will it be to produce the required information?
- What information will be needed to produce this information?

Section 199A Deduction

Looking back on year 1. . .

- What challenged us the most?
- What was easier than we expected?
- What if we need to change the attributes on a 2018 return?
  - Subject to the Centralized Audit Regime
  - Not subject to the Centralized Audit Regime
- Were we able to recover fees for the value we provided to our clients?
- Revenue Procedure 2019-38 rental real estate safe harbor

Section 199A

Challenging Fact Patterns

- Specified Service Trade or Business
  - Field of Health
  - Consulting
  - Qualified active sale exception for dealing in commodities
- Aggregation
- Multi-Tier Reporting

Section 199A

Looking forward to year 2 . . .

- Threshold Changes
  - $321,400 - $421,400 for married filing joint returns
  - $160,725 - $210,725 for married filing separate returns
  - $160,700 - $210,700 for single and head of household returns
- Suspended losses from years ending after Dec. 31, 2017
- What can be revisited?
- Where can we bring additional value?
  - And in what ways can we do this?
- Managing scope

Section 752 - Liability Allocation Regulations

Overview

- Final regulations closely resemble the temporary regulations
- Important considerations
  - Bottom dollar payment obligation rules expanded
  - Anti-abuse factors defined
  - Obligors required to have a reasonable expectation of ability to satisfy their obligations

Questions?

- Randy Schwartzman - rschwartzman@bdo.com
- Jeff Bilsky – jbilsky@bdo.com
- Kevin Ainsworth – kainsworth@bdo.com
- Kevin Anderson- kdanderson@bdo.com
- Tommy Orr – torr@bdo.com

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Conclusion

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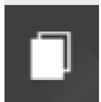

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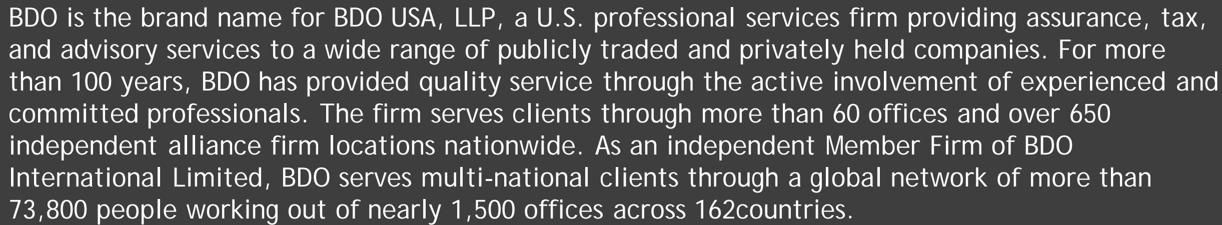

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