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AN ALERT FROM THE BDO FEDERAL TAX PRACTICE

# BDO KNOWS: FEDERAL TAX

## SUBJECT

## CHOICE OF ENTITY TOOL

## SUMMARY

On December 22, 2017, President Trump signed into law sweeping tax reform (legislation known as The Tax Cuts and Jobs Act). While the individual and pass-through (e.g., partnerships and S corporation) provisions are generally phased out in less than a decade, the tax cuts for C corporations are permanent changes to the Internal Revenue Code. The reduced tax rate of 21 percent, from 35 percent, may increase the popularity of corporations. The Act also contains a deduction of up to 20 percent of qualified business income ("QBI") of pass-through entities, which will provide substantial benefits for taxpayers operating certain trades and businesses. These and other factors, described in part below, could make choice of entity determinations one of the most important tax decision taxpayers will ever make. While the complexity of these decisions has increased, BDO's team of National Tax Office specialists is ready to assist by simplifying the decision-making process with a clear and focused approach to this critical analysis.

## DETAILS

### *Background*

Like so many business decisions, choice of entity determinations are based heavily on the expected return on investment ("ROI"). Cash tax liabilities may impact ROI significantly, and as a result, often influence business decisions. For example, effective tax rates push companies over local, state, and national borders. The entity selection flexibility provided in the "check-the-box" regulations has largely separated taxes from other business factors in making entity determinations. Further, the Act has largely eliminated disparities in net federal income tax rates. Lowering tax rate disparities between entity-types puts pressure on every significant tax factor, which could control the ultimate decision. Some of these factors that can impact the projected long-term net effective tax rate ("ETR") include: (1) length of the investment period and ultimate exit, (2) special allocations of income/loss amongst partners, (3) method of capitalization (i.e., debt vs. equity), (4) state and local tax, (5) international tax, (6) deductions and losses (e.g., bonus depreciation and expensing, timing generally), (7) character (e.g., capital gain, ordinary losses, or both under section 1231), (8) accounting methods, (9) investor restrictions (e.g., publicly-traded or foreign owned), and (10) compliance costs/tax complexity.

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BDO knows those factors that pose the largest ETR blows; and we've incorporated them into a tool that shows a taxpayer's return on their cash flows. The BDO National Tax Office has developed a Choice of Entity Tool ("CET") to assist in analyzing the most efficient tax structure available to taxpayers based on their business needs. Let's get your CET analysis and results started.

### *The BDO Choice of Entity Process*

The BDO process is premised on a thoughtful, phased approach intended to be a collaboration with the business owners. Through this process, the BDO team will work closely with the business owners to ensure the most relevant and accurate information is uncovered and incorporated into the CET. This yields the most beneficial results with which the business owners can make appropriate choice of entity decisions. The BDO process includes three key phases summarized below:

**Phase 1:** Initial Scoping: In this phase, we *succinctly* review information (e.g., tax returns, financial statements, charts, etc.) to familiarize ourselves with the entity structure, partner/shareholder group, and refine the details of subsequent phases.

**Phase 2:** Data Gathering & Fact Finding: In this phase, we work with the company to better understand specific business operations and future plans. At the conclusion of this phase, we anticipate providing a high level summary of recommendations. The recommendations are premised on observations, information obtained, and our experiences regarding likely outcomes **as to whether** additional benefits may be realized via change of entity structure.

**Phase 3:** Detailed Analysis & Modeling: Based on the information obtained in Phases 1 and 2, using the CET, we model the estimated tax impact to the owners over a pre-determined projection period under the following scenarios: (1) retaining the current structure, (2) utilizing/forming a partnership, C corporation, and/or S corporation, (3) combining and/or separating existing entities, and (4) using multiple entities with bifurcation of business/expense activities. Our deliverable(s) for this phase typically include a comprehensive Excel workbook with accompanying memo(s) outlining our assumptions and an executive summary of our draft conclusions.

Depending upon the results of the initial process, BDO is available to assist with the implementation and follow-up activities that may be necessary. Examples of these additional activities include: (1) domestic and international restructuring planning, (2) development of detailed memoranda and board/owner presentations, (3) implementation assistance, and (4) post-implementation compliance assistance.