

# **H.R. 1 – THE TAX CUTS AND JOBS ACT: IMPACT ON BUSINESS PLANNING**

**Presented by: Kurt F. Tjaden, Brandon D. Hamm, Richard D.  
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**January 9, 2018**

**KOLEY ■ JESSEN**

ATTORNEYS

# *Speaker Introductions*

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# *Agenda*

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- **Modifications that impact estate and business succession planning**
- **Employee benefits and compensation implications**
- **Exempt organizations**

# *Estate and Business Succession Planning*

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- Federal estate tax
  - Tax on right to transfer property at death
  - 3 ways to avoid estate tax
    - Transfer assets to qualified charity (using “charitable deduction”)
    - Transfer assets to spouse (using “marital deduction”)
    - Estate tax exemption
      - 2018 exemption increased from \$5.6M to \$11.2M (adjusted annually for inflation)
  - Tax rate of 40%
  - Basis adjustment on assets at date of death to full market value as of date of death (commonly a “step-up” in basis)

# *Estate and Business Succession Planning*

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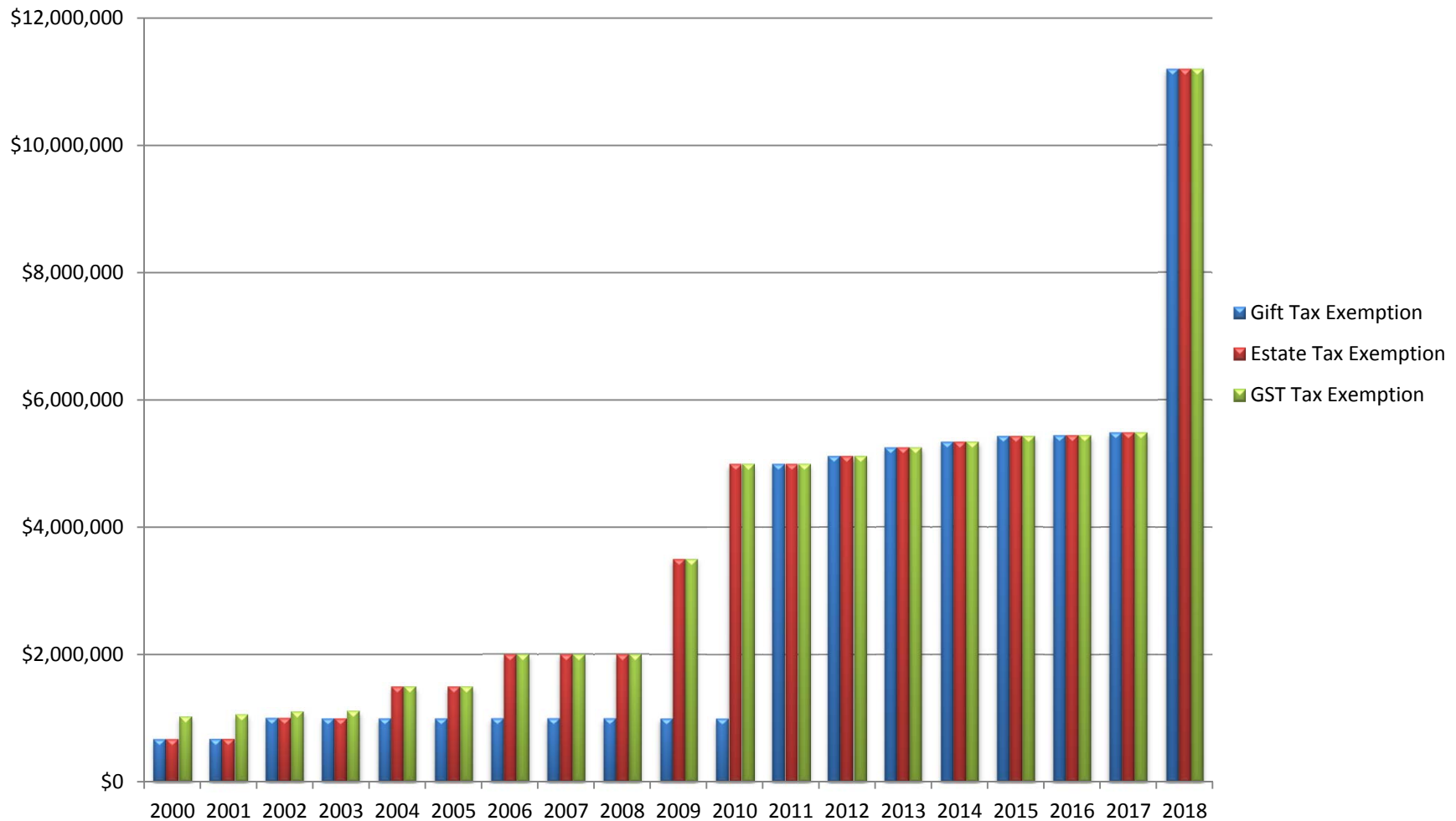
- Federal gift tax
  - Tax on gratuitous lifetime transfers of property
  - 2 ways to avoid gift tax
    - For small annual gifts – “annual gift tax exclusion”
      - 2018 = \$15K / donee
    - For larger gifts – lifetime gift tax exemption
      - 2018 exemption increased from \$5.6M to \$11.2M (adjusted annually for inflation)
      - Use reduces estate tax exemption on a \$-for-\$ basis
  - No basis adjustment (*i.e.*, “carry-over basis”)
  - Tax rate of 40%

# *Estate and Business Succession Planning*

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- Federal generation-skipping transfer (“GST”) tax
  - Tax on transfers during life or at death to person assigned to generation two or more below transferor
  - 2 ways to avoid GST tax
    - For small annual gifts – “annual GST tax exclusion”
      - 2018 = \$15K / donee
    - For larger gifts – GST tax exemption
      - 2018 exemption increased from \$5.6M to \$11.2M (adjusted annually for inflation)
  - Tax rate of 40%

# *Estate and Business Succession Planning*



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Note: As of 1/1/10, the estate and generation-skipping transfer (GST) taxes were repealed for 2010. On 12/17/10, the 2010 Act retroactively reinstated both taxes for 2010, with a \$5M exclusion / exemption for each, a top estate tax rate of 35% and a 0% GST tax rate. Taxpayers given choice to have estate tax apply and receive basis adjustment, or not apply and have carry-over basis.

# *Estate and Business Succession Planning*

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- Inflation adjustments
  - For tax years beginning after 2018, inflation adjustments based on “Chained Consumer Price Index for All Urban Consumers” (CCPI-U)
  - “Chained” CPI adjustments is new methodology that is expected to slow rate of increases in exemptions
  - Base year set at 2016



# *Estate and Business Succession Planning*

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- Portability
  - Allows a deceased spouse's unused estate tax exemption to be allocated to surviving spouse for possible use at surviving spouse's subsequent death
  - Retained in new tax law
  - Only applies to estate tax exemption...not GST tax exemption

# *Estate and Business Succession Planning*

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- Trust income taxes
  - Lower individual tax rates apply to trusts, so max rate for trust income retained or distributed is 37%
  - Elimination of itemized deductions applicable to individuals also affects trusts

# *Estate and Business Succession Planning*

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- **Sunset**
  - Increased transfer tax exemptions set to expire on December 31, 2025
  - On January 1, 2026, exemptions will revert to \$5M per person, as indexed for inflation since 2011
  - Sunset generates great uncertainty and hesitancy to make significant changes to planning approaches

# *Estate and Business Succession Planning*

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- “Clawback”
  - Refers to concern about tax risk where someone uses higher gift tax exemption to make large gift and then dies when estate tax exemption has reverted to lower amount (e.g., due to sunset of 2017 Act)
  - Example:

Client makes \$11M gift to children when gift tax exemption is \$11.2M. Client dies 10 years later when estate tax exemption has reverted to \$5.6M.

*Does IRS assess estate tax on “excess” gift of \$5.4M made when law allowed for larger gift?*

# *Estate and Business Succession Planning*

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- **Clawback**
  - 2017 Act directs that regulations be implemented to prevent additional exemption used from being "clawed back" at death, even if increase in exemption sunsets
  - Despite 2017 Act language, some commentators expressing concern that uncertainty remains about potential of clawback

# *Estate and Business Succession Planning*

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- So what does the 2017 Act mean for clients?
  - Clients should review and update estate plans
    - All plans are customized, so generalizations about impact of 2017 Act for individual clients is dangerous
    - May allow clients to simplify planning
    - BUT...with sunset, clients need to be thoughtful about future tax laws
  - Probably means less focus on estate tax planning for an even larger portion of the population
  - Increased emphasis on income tax and basis planning
    - “Upstream” planning to get stepped-up basis by including assets in estates of ancestors

# *Estate and Business Succession Planning*

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- So what does the 2017 Act mean for clients?
  - More clients will pursue asset protection planning through lifetime trust arrangements
  - State death tax planning continues to be relevant in certain states (CT, DC, HI, IL, MA, MD, ME, MN, NY, OR, PA, RI, VT, WA)
  - For high net worth and ultra-high net worth clients:
    - Continued / accelerated wealth transfer planning
    - May see increase in wealth transfer planning just prior to sunset to take advantage of \$11.2M exemptions

# *Estate and Business Succession Planning*

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- So what does the 2017 Act mean for clients?
  - Fewer estate tax returns will be filed and far less estate tax will be paid
  - Historical context:

Federal Estate Tax Returns			
	2001	2016	2017*
Estate Tax Returns	109,600	12,411	11,300
Taxable Returns	50,500	5,219	5,500
Estate Tax Liability	\$23.74B	\$18.3B	\$19.95B

\* = Projected

- Sources
  - Internal Revenue Service, Statistics of Income Division. "SOI Tax Stats - Estate Tax Year of Death Tables."
  - Urban-Brookings Tax Policy Center.



# *Estate and Business Succession Planning*

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- Putting the previous \$5.5M exemption in perspective
  - For 2017, it was projected that:
    - 2.7M people would die
    - 1 in 237 would file estate tax return
    - 1 in 487 would pay estate tax
  - So...0.2% of population would actually pay estate tax

# *Estate and Business Succession Planning*

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- With \$11.2M exemptions:
  - Joint Committee on Taxation (“JCT”) estimates:
    - Between 2018-2023, there will be 4,600-5,100 estate tax returns filed
    - 1,800-1,900 of them will pay tax
  - If we assume 2.7 million people die in 2018:
    - Estimated 850 will file estate tax return
    - Estimated 317 will pay tax
  - So...0.01% of population would actually pay estate tax
  - JCT estimates IRS will collect \$68.7B less in estate / gift / GST tax from 2018-2025

# *Estate and Business Succession Planning*

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- So what does the 2017 Act mean for clients?
  - Lesser need for liquidity planning
    - Life insurance to fund estate tax bill
    - Irrevocable life insurance trusts

# *Estate and Business Succession Planning*

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- Concluding comments
  - Uncertainty reigns due to “sunset” of increased exemptions
  - Generalizations about impact of 2017 Act on estate plans are dangerous
  - Clients should meet with attorneys to review estate plans to assure they are still appropriate

# **H.R. 1 – THE TAX CUTS AND JOBS ACT: EXECUTIVE COMPENSATION AND EMPLOYEE BENEFITS OVERVIEW**

**Presented by Richard D. Vroman and Adam L. Cockerill  
January 9, 2018**

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# *Cap on Executive Compensation Deduction – Public Employers*

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- Applies to public employers (i.e., those who are required to register and/or file reports with the SEC).
- Broadens the existing limitation under Section 162(m).
  - Still eliminates deduction for compensation above \$1M
  - Expanded definition of Compensation by eliminating the exceptions for:
    - Commission based compensation
    - Performance based compensation

## *Cap on Executive Compensation Deduction – Public Employers (Cont)*

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- Expanded the definition of covered executive by
  - Including any individual who would be a covered executive in any tax year beginning after December 31, 2016 is a covered executive for purposes of the limitation for all future years.
  - Certain third-parties, such as former spouses or beneficiaries are included.
- Effective December 31, 2017
- Not applicable to binding written contracts in place prior to November 2, 2017 that are not modified thereafter.

# *Tax on Excessive Compensation for Non-Profits*

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- **Adds Section 4960**

- Applies to Tax-Exempt Organizations (501(a); farmer's cooperatives – 521(b)(1); political organization – 527(e)(1); or political subdivision – 115(1)).
- Creates an excise tax on excess compensation and parachute payments to executives (5 highest paid)
  - Once a covered employee, always a covered employee – (December 31, 2016).



## *Tax on Excessive Compensation for Non-Profits (Cont)*

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- Excess compensation = remuneration in excess of \$1M
- Parachute Payment = excess post-termination payments (i.e., severance, deferred compensation) above 3Xbase value.
  - Rules will be similar to 280G (amount above 3Xbase)
- Remuneration is received when there is no longer a substantial risk of forfeiture (457(f)).

## *Tax on Excessive Compensation for Non-Profits (Cont)*

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- Tax on such excess amounts = 21%
- Tax is paid by employer (or pro rata by employers, if more than one).
  - Looks to relationships with related, controlled or controlling entities or individuals.
- Coordinated with Section 162(m) (not double taxed)
- Effective December 31, 2017

# *Qualified Equity Grants*

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- **New Section 83(i)**
  - Effectively, allows an employee to defer tax on recognition of compensation received from an Eligible Corporation in the form of Qualified Stock.
  - “Eligible Corporation” - Applies to private corporations that have a written plan to grant stock options (“Options”) or restricted stock units (“RSUs”) to at least 80% of the corporation’s full-time employees who provide services in the U.S.

## *Qualified Equity Grants (Cont)*

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- “Qualified Stock” is any stock of the employer (that is an Eligible Corporation”) received by the employee upon exercise of an Option or settlement of a RSU – if such Option or RSU was granted to the employee for the performance of services.
  - Stock is not qualified if redeemable for cash upon recognition of income.
- Normally recognition of such income is taxable when the RSUs vest or Options are exercised.

## *Qualified Equity Grants (Cont)*

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- Must be a “Qualified Employee” (this provision excludes anyone who is or was (within 10 years) a 1% or greater owner, principal officer or one of the 4 highest paid officers. (excluded employee includes constructive ownership – i.e., spouse).
- Within 30 days of grant.
  - Elect to defer tax or pay tax – similar to an 83(b) election.
- Employers have reporting and notice obligations.
  - NOTE: even if elect to defer – the tax is measured on the value of the stock at the time it becomes no longer subject to a substantial risk of forfeiture, even if the value declines before the deferral date.

## *Qualified Equity Grants (Cont)*

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- If election is made –
  - Income will be taxed at the earliest of:
    - The date the stock is transferrable.
    - The date the employee becomes and excluded employee.
    - The date the stock becomes publicly traded.
    - The date that is 5 years after the date the employee's right to the stock is no longer subject to a substantial risk of forfeiture.
    - The date the employee revokes the election.
- Effective December 31, 2017
  - Special Note – Not considered deferred compensation for purposes of Section 409A.

# *Employment Settlement Deductions*

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- **Sexual Harassment Settlements**

- With certain exceptions, a taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.
- The Act provides that
  - No deduction shall be allowed for
    - any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or
    - attorney's fees related to such a settlement or payment.

# *Employee Benefit Overview*

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- Employer Tax Credit – Paid Family and Medical Leave Act – Effective December 31, 2017
  - A tax credit for employers who have a written plan for paid family leave at the rate of not less than 50% the regular rate.
    - 12.5% credit (increased .25% (up to a maximum 25% credit) for each percentage point by which the rate of pay exceeds 50% of the regular rate.
    - Minimum of 2 weeks pay.
    - Up to a maximum 12 weeks.
    - Pro-rated for part-time employees.



# *Employee Benefit Overview*

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- Individual Mandate Eliminated – 2019
- Increase in Unrelated Business Taxable Income – Disqualified Fringe Benefits –
  - Qualified transportation.
  - Parking facilities.
  - On-premises athletic facilities and gyms.
- Loss of Deduction for Moving Expenses.
  - No deduction or reimbursement allowed – 8 years.
  - Still deductible for those in the military.

# *Employee Benefit Overview*

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- **Employer-provided meals**
  - Taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel).
  - The Act expands this 50 percent limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for *de minimis* fringes and for the convenience of the employer. Deduction ends on December 31, 2025.
- **Entertainment expenses**
  - The Act eliminates the deduction for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50 percent limit to such deductions).

# *Employee Benefit Overview*

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- Employee achievement awards
  - Employee achievement awards (i.e., those for length of service, etc.) remain deductible subject to limits on value.
  - The Act clarifies, that cash, gift cards, and other non-tangible personal property cannot be deducted as employee achievement awards.
  
- Medical Expense Deduction
  - For the tax years 2017 & 2018 – reduced to 7.5%
  - 2019 back to 10%

# *Employee Benefit Overview*

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- Extended Rollover Period for Plan Loans
  - The period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a rollover contribution is extended from 60 days after the date of the offset to the due date (including extensions) for filing the Federal income tax return for the taxable year in which the plan loan offset occurs, that is, the taxable year in which the amount is treated as distributed from the plan.

# *Employee Benefit Overview*

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- Roth IRA Re- Characterization
  - The special rule that allows a contribution to one type of IRA to be recharacterized as a contribution to the other type of IRA no longer applies to a conversion contribution to a Roth IRA.
  - Thus, recharacterization cannot be used to unwind a Roth conversion.
  - However, recharacterization is still permitted to recharacterize a Roth IRA contribution as a contribution to a traditional IRA.

# *Employee Benefit Overview*

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- 529 Savings Accounts
  - Modifies section 529 plans to allow such plans to distribute not more than \$10,000 in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a public, private or religious elementary or secondary school. This limitation applies on a per-student basis.

# *Employee Benefit Overview*

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- Disaster Relief Through Eligible Retirement Plans.
  - Due to an uptick in natural disasters, the Act allowed 401(k) plans and other eligible retirement plans to make “qualified 2016 disaster distributions” of up to \$100,000 per individual prior to January 1, 2018, to victims of federally-declared major disasters occurring in 2016.
  - The distributions will not be subject to the 10% excise tax on early distributions and can be included in income ratably over three years.
  - All or part of the distributions can be repaid to a qualifying plan if the repayment occurs during the three-year period.

# **H.R. 1 – THE TAX CUTS AND JOBS ACT: TAX-EXEMPT ORGANIZATIONS**

**Presented by: Alexander J. Wolf, January 9, 2018**

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# *Tax-Exempt Organizations: Overview*

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- **Charitable Contribution Ramifications**
- **Unrelated Business Taxable Income**
- **Executive Compensation Excise Tax**
- **Other Tax-Exempt Organization Provisions**

# *Tax-Exempt Organizations: Indirect Impact*

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- **Changes to rules on Charitable Deductions are anticipated to reduce overall giving to Tax-Exempt Organizations**
- **Relevant new rules:**
  - Increased standard deduction
  - Increased AGI limitation
  - Increased estate tax exclusion

# *Tax-Exempt Organizations: Ramifications on Annual Giving*

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- **Standard Deduction:**

- Standard deduction for individual taxpayers will roughly double
- A higher standard deduction means fewer taxpayers will itemize deductions, reducing their incentive to make charitable donations

- **AGI Limitation**

- Increases AGI limitation on cash contribution deductions from 50% to 60%, effective for contributions made in tax years beginning after 2017 and before 2026
- Pease Limitation eliminated

## *Tax-Exempt Organizations: Ramifications on Charitable Bequests*

- Federal estate tax rate of 40% remains unchanged
- Contributions to charitable organizations remain deductible for estate tax purposes
- The federal estate and gift tax applicable exclusion amount roughly doubles from \$5.49 million per person to \$11.2 million per person in 2018, with estates over this amount taxed at 40%
- The increased exclusion reduces the incentive for giving to charity at death

## *Tax-Exempt Organizations: Other Charitable Contribution Ramifications*

- Elimination of 80% deduction for contributions made in exchange for college athletic event seating rights
- Elimination of prior exception to contemporaneous written acknowledgment for all contributions in excess of \$250
- Individuals who would have previously given to charity at death may be better served giving those assets to their children and then allowing their children to make the donation to charity (receiving the deduction)

## *Tax-Exempt Organizations: Unrelated Business Taxable Income*

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- **UBI Rate:** Top tax rate for UBI reduced to 21%
- **Isolate income/loss by activity:** Organizations that operate multiple unrelated trade or business activities are no longer able to offset unrelated business income (UBI) from one activity with losses from another. Net operating loss deductions allowed only with respect to the unrelated trade or business from which the loss arose

# *Tax-Exempt Organizations: Executive Compensation Excise Tax*

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- Tax-Exempt Organizations now subject to 21% excise tax on compensation in excess of \$1M (plus any excess parachute payment) paid by an applicable organization or related organization to Covered Employees
  - **Applicable organization:** includes any organization that is exempt from tax under Section 501(a) (e.g., Section 501(c)(3) charitable organizations)
  - **Covered Employees:** one of the organization's five highest compensated employees for the current taxable year, or any covered employee of a preceding tax year beginning after December 31, 2016

## *Other Exempt Organization Provisions*

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- **Excise Tax on Investment Income:** new 1.4 percent excise tax on investment income of private colleges and universities and their related organizations with at least 500 students and FMV of investment assets of at least \$500,000 per student.
- **Electing Small Business Trusts:** charitable contribution deduction of an ESBT determined by rules applicable to individuals, not trusts.
- **Partnership allocations of contributions:** partner's distributive share of loss takes into account partner's distributive share of charitable contributions for purposes of basis limitation on partner losses.
- **Tax-Exempt Bonds:** eliminates ability to undertake "advance refunding" transactions where new tax-exempt bonds are issued to refinance existing tax exempt bonds more than 90 days in advance of the redemption date or maturity date of such existing tax exempt bonds.



*Thank You For Attending!*

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# Questions?

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## *Tax Reform Webinar Series*

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- **Part 3: Considering Whether to Convert a Flow Through to a C Corporation**

11:30 am - 12:30 pm

Wednesday, January 10, 2018

If you registered for Part 3 of our Series you should have received the login information via email. If you have any questions please contact [events@koleyjessen.com](mailto:events@koleyjessen.com)