2018 year-end tax considerations for businesses

Legislative changes and other tax concerns that may affect planning

This guide reflects the tax considerations and developments that we believe may create risk or opportunity for businesses in 2018 and beyond. It is not a holistic list of all tax issues that may affect your business, but it is designed to help you make informed decisions related to year-end tax planning.

Please see our website for additional information on many of these issues.

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Introduction

The end of 2017 was filled with uncertainty as Congress worked on significant tax law changes, finalized and signed into law H.R. 1 (PL 115-97) on Dec. 22, 2017, commonly known as the Tax Cuts and Jobs Act (TCJA). As the end of 2018 approaches, taxpayers are still waiting on administrative guidance for some measures passed into law as part of the TCJA, while Congress considers additional changes under Tax Reform 2.0.

Even though taxpayers anticipate administrative guidance or legislative changes to eliminate uncertainty, action may be required before year-end to fully take advantage of benefits or mitigate unintended consequences enacted as part of the TCJA.

The following is a list of major tax law changes enacted as part of the TCJA that impact 2018 and beyond:

- A temporary reduction in personal income tax rates and limitation on state and local tax deductions
- Reduced tax rates for repatriated foreign earnings
- A move toward a territorial tax system for foreign corporate subsidiaries engaged in foreign business activities
- Reduced corporate tax rates and repeal of the corporate alternative minimum tax
- A qualified business income deduction for many owners of pass-through businesses
- Limitations on business interest deductions
- Changes favorable to capital cost recovery for full expensing for all depreciable assets, including qualifying used assets.

Additionally, in response to changes in federal tax law, 2018 has brought about significant changes at the state and local level as states move to conform or decouple from these changes.

We have compiled this guide to help companies make informed decisions related to year-end tax planning. In a year with many changes, many introducing additional complexities, planning becomes all the more important.

General considerations

Deduction and revenue planning

For companies looking to reduce taxable income (e.g., to minimize current taxes payable) or accelerate income (e.g., in order to use expiring net operating losses), there are several accounting method approaches that may help accomplish those goals. A few of these include:

- Changing from the cash basis to the accrual basis of accounting, or vice versa
- Conducting inventory planning (e.g., performing a uniform capitalization [UNICAP] review or electing new last-in, first-out [LIFO] sub-methods)
- Accelerating certain deductions or electing to capitalize prepaid expenses for the current year under the 12-month rule
- Electing to recover over 36 months or currently deduct self-developed software costs
- Deferring amounts received from advance payments for goods or services
- Properly using the recurring-item exception for taxes, rebates and refunds
- Shoring up bonus plan requirements to substantiate deducting in the year employees provide the related services
- Accelerating recovery of real property through cost segregation and/or repair studies

Small taxpayer designation

The TCJA increased the threshold for defining a small-business taxpayer to include those with average annual gross receipts of $25 million or less for the three prior tax years, for tax years beginning after Dec. 31, 2017. This amount is expected to be indexed yearly for inflation. Those qualifying under the small business taxpayer designation may be able to use the overall cash method, be exempt from applying certain inventory rules and be exempt from the limitation on interest deductions.

Changes in financial statement treatment for revenue and leases under ASC 606 and 842

As taxpayers begin implementing new audit standards, they often overlook the federal tax implications. To the extent that taxpayers change the timing of an item on their financial statements (such as lease payments or revenue recognition), the taxpayer may have to file Form 3115 before the tax treatment can mirror the financial statement change.

Bonus depreciation

One hundred percent additional first-year (bonus) depreciation is available for qualified property acquired and placed in service after Sept. 27, 2017. The IRS has issued proposed regulations related to when taxpayers acquire an asset under a written, binding contract. In addition, bonus depreciation now applies to qualifying used property. The expansion to used property may allow certain business acquisitions to recover a portion of the purchase price immediately through 100 percent bonus depreciation.

Fringe benefits and related issues

The TCJA made changes to the treatment of various fringe benefits that are generally effective for the 2018 tax year. As the end of the year approaches, companies need to make sure that the changes in treatment were captured for payroll tax and income tax deduction purposes, as appropriate. Some of these provisions require significant changes in the company's record-keeping processes:

- Loss of the tax exclusion for employer payment of employee moving expenses under section 132(g)—Remember to make sure all employee moving expenses incurred in 2018, paid or reimbursed by an employer, are reported as taxable compensation, subject to FICA/Medicare and federal income tax withholding, by year-end. Once included in employee income, the amounts are deductible as compensation. Employer payments or reimbursements in 2018 for employee moves occuring in 2017 remain excluded from employee compensation under section 132(g).
- Loss of the employer tax deduction on most entertainment expenses—Verify that time and business expense systems are properly collecting and marking entertainment expenses separately from meals expenses, employee recreational expenses and other business expenses and recorded in separate general ledger accounts. Exceptions to the entertainment expense disallowance may include:
  - Sporting event tickets, concerts, golf tournament amounts that are actual charitable contributions or specific advertising expenses, etc.
  - Expenses for employee events that are nondiscriminatory, broad-based employee social and recreational events that may have an entertainment element
- Reduction of the tax deduction for almost all de minimis fringe benefit food and beverage expenses to 50 percent—Confirm meals and business expense systems are properly collecting all de minimis fringe benefit food and beverage costs and separating them from other business costs (such as invoices that bill for both office supplies and coffee and snacks for an office pantry or break room).
- Loss of the tax deductions for employer-provided parking and transit benefits under section 132(f)—Determine the fair market value of parking and transit benefits provided to employees and whether the employer is directly or indirectly using section 132(f) to exclude the value of the benefit from employee taxable compensation. This provision also creates unrelated business income tax for tax-exempt employers that need to account for these benefits. The following items should be reviewed to ensure proper treatment:
  - Free parking for employees
  - Pre-tax employee elections to pay for parking or mass transit
  - Free bus or van service for employees commuting to and from home (unless specifically for safety reasons)

- Loss of the deduction for employee commuting expenses (except where necessary for ensuring safety of the employee)—Confirm that any expenses incurred to cover or reimburse employee commuting costs are accounted for.

Like-kind exchange changes

As a result of the TCJA, deferral of gain under section 1031 is now limited to real property transactions. This change is effective for transactions on or after Jan. 1, 2018, although certain transitional rules described below may allow for the completion of exchanges that began in 2017. Real estate exchanges are subject to the same rules and regulations as under pre-TCJA rules.

Transitional rules permit exchanges of property other than real property to be completed in 2018 if the taxpayer either sold the relinquished property in 2017 or acquired the replacement property in 2017.

For tangible personal property, the full expensing election may provide relief for those taxpayers affected by this change. Although the gain from the sale of personal property may no longer be deferred in a like-kind exchange, the full expensing deduction may be used to offset the gain triggered.

Affordable Care Act (ACA) update

Although the TCJA eliminated the penalty on individuals without health insurance starting in 2019, the TCJA did not repeal the employer penalty. Therefore, applicable large employers (ALEs) that fail to offer employee health insurance that meets ACA standards may be assessed a shared responsibility payment by the IRS. A company is an ALE if it averaged at least 50 full-time employees (including full-time equivalents) during the preceding calendar year, or was in a group of related companies that met the large employer criteria.

In order to avoid this penalty, a large employer must offer minimum essential health coverage to substantially all (95 percent) of its employees and their dependents. This coverage must be affordable and provide minimum value (by covering a certain percentage of all medical expenses incurred by employees).

To determine which employers owe the penalty, the IRS requires ALEs to file Forms 1095-C and 1094-C to report workforce and health plan information. For 2018, the due date to provide employees with Form 1095-C is Jan. 31, 2019 (just like Form W-2), and an employer must file Form 1095-C and the related Form 1094-C to the IRS by Feb. 28, 2019, if filing on paper (or April 1, 2019, if filing electronically).

The IRS is currently assessing penalties on ALEs that did not offer ACA-compliant coverage to their employees starting in 2015. In addition, the IRS is pursuing ALEs who failed to file Forms 1095-C and 1094-C in prior years. Since the penalties can be substantial, companies subject to these ACA requirements should review their compliance efforts and understand any potential risk for noncompliance.

Research and development tax credit

The research and development tax credit continues to be one of the most popular incentives in the tax code. The repeal of the alternative minimum tax as part of the TCJA will make it easier to utilize the research and development tax credit to reduce current tax liabilities starting in 2018.

A small business start-up may claim a credit of up to $250,000 against its FICA payroll tax liability if it had less than $5 million in gross receipts for the current taxable year and no gross receipts for any taxable year prior to the five-taxable-year period ending with the current taxable year. If you wish to make this election and are using an outside payroll provider, it is important to discuss this with them as soon as possible, because there are certain forms the payroll provider must file on your company's behalf.

In addition, the Alternative Simplified Credit (ASC) continues to be the preferred method elected by many taxpayers, because it relies only upon the prior three years' qualified research expenses to compute the base amount, where the regular credit method requires a much more complex base amount computation that can be difficult to document. The ASC election should be made by completing section B on Form 6765 on the original tax return.

Work opportunity tax credit (WOTC)

The WOTC program was designed to encourage employers to hire and retain individuals from specific target groups with employment barriers and is available through 2019. The program now also applies to employers that hire qualified long-term (27 weeks or more) unemployed individuals on or after Jan. 1, 2016.

The WOTC equals 40 percent of the first $6,000 of wages with higher wage limits for long-term family assistance recipients and qualified veterans for the first tax year an employee is hired. The credit is reduced to 25 percent for individuals who work at least 120 hours but less than 400 hours during the one-year period beginning on the employment date.

There is no credit for individuals who work less than 120 hours in their first year of employment. The WOTC also includes 50 percent of second-year wages for the tax year for wages paid to long-term family assistance recipients.

Employer credit for paid family and medical leave

This new tax credit was enacted as part of the TCJA and provides a tax credit of between 12.5 and 25 percent for wages paid to qualifying employees on family or medical leave in calendar years 2018 or 2019. To qualify, employers must maintain a written family and medical leave policy providing qualifying employees at least two weeks of paid family and medical leave and paying at least 50 percent of the normal wage rate during the leave period. There are special rules regarding part-time employees, and payments to employees earning above a certain amount are not eligible.

Business taxpayers should review their family and medical leave policies and determine if they qualify, or if not, whether it is feasible to make changes to their leave policy in order to qualify for 2019. Although this is only a two-year tax credit program, legislation has already been proposed to extend this credit for additional years.

Energy credits

Tax credits for many types of renewable energy that had expired were retroactively reinstated by the Bipartisan Budget Act of 2018. The residential energy efficient property credit was extended with certain reduced-rate modifications through 2021. The business energy investment credit was also further extended for solar and extended with a phase-out for other renewables as follows:

- The 30 percent investment tax credit for qualified solar property is available through 2019, with a 26 percent credit available in 2020 and a 22 percent credit available in 2021. After 2023, the credit is reduced to 10 percent.
- The 30 percent investment tax credit for fiber-optic solar lighting, qualified fuel cell property and qualified small wind property is available through 2019, with a 26 percent credit available if construction begins in 2020, a 22 percent credit available if construction begins in 2021 and no credit if placed in service after 2023.
- The 10 percent investment tax credit for qualified microturbine property and combined heat and power system property (with certain rate modifications) is available if construction begins before 2022.
- The credit remains at 10 percent for geothermal equipment with no expiration.

The renewable electricity production tax credit (PTC) and the election to claim the investment tax credit related to qualified wind property is at 18 percent if construction begins in 2018 and 12 percent if construction begins in 2019. Taxpayers who wish to take advantage of the PTC when the property is placed in service should either plan to spend more than 5 percent of the eligible wind farm construction costs by the end of 2018 or take steps to begin physical work of a significant nature on the facility.

Tax credits that expired at the end of 2017

The determination as to whether or not any expired tax credits will be retroactively extended is predicated on what happens with any year-end tax legislation. At this time, it appears unlikely that the credits addressed below will be reinstated. However, refund opportunities may still exist for certain unclaimed $0.50 per gallon alternative fuel credit or $1 per gallon biodiesel and renewable diesel credit for prior years.

There is still an opportunity for qualified sellers or users to register as alternative fuelers by filing Form 637 and, if approved before the end of 2017, file refund claims for open years for an elective income tax credit in lieu of the standard excise tax credit or payment.

IRS account transcripts

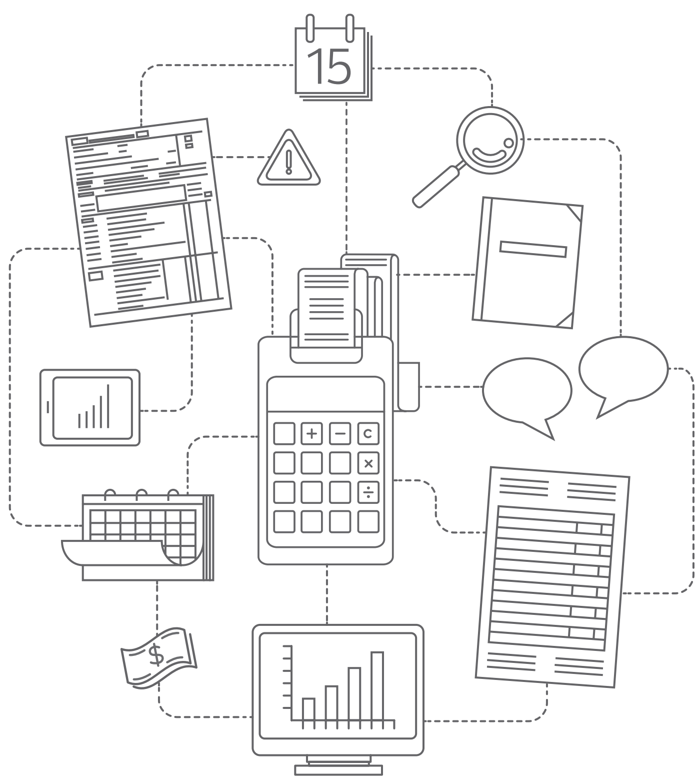
A company's IRS account transcript contains useful information, including the information necessary to confirm estimated payments or credit elects for the 2018 tax year before preparing an extension or filing the return. For prior years, the account transcript can identify items of which the company may be unaware, such as penalty or interest assessments, math error adjustments or examination indicators. Thus, companies should consider ordering an account transcript in January for 2018 and earlier years.

Tax return due date reminders

For tax years beginning after Dec. 31, 2015, tax return due dates changed. Calendar year C corporation returns and most fiscal year returns are due on the 15th day of the fourth month following the end of the fiscal year, and S corporation and partnership returns due on the 15th day of the third month following the end of the fiscal year. Form 7004 provides for an automatic extension of six months after the regular due date.

For C corporations with a fiscal year ending on June 30, the effective date change is delayed until the first tax year beginning after Dec. 31, 2025. Accordingly, those returns are due Sept. 15.

The deadline for filing Forms W-2, W-3 and 1099-MISC (Box 7) reports with the Social Security Administration is Jan. 31 for paper or electronic filing.



Accounting for income taxes under ASC 740

With the passage of the TCJA in late 2017, and the limited guidance on these new laws provided by the IRS, several areas should receive additional review during the preparation of year-end tax provisions. These areas include items likely to be permanent adjustments in nature, primarily section 162(m) and the transaction taxes—section 965, FDII and GILTI. With the changes to net operating loss carryovers and interest expense limitations, companies should consider implications for the possible establishment or release of valuation allowances. Revenue recognition standards for book under ASC 606 should be analyzed in conjunction with section 451(b), the book acceleration rule enacted as part of the TCJA. Book-tax differences are likely to occur and may be either a temporary difference or a permanent difference depending on the book accounting of the change.

To ease concerns regarding the inclusion of the impacts from the TCJA in tax provisions, the SEC issued Staff Accounting Bulletin No. 118, which the FASB adopted as ASU 2018-05. These pronouncements provided guidance on using estimates during a one-year measurement period. Companies should prepare to finalize any provisional amounts used in prior year financials and take steps to ensure the impacts of the TCJA are included in the current-year tax provision as the measurement period comes to an end.

Hurricane relief

Earlier this year, Hurricane Florence devastated large sections of North Carolina and South Carolina. The damage and related cleanup has affected millions of U.S. citizens and businesses located in these areas.

Immediately following this disaster and the related disaster declaration, the IRS announced a variety of relief provisions that affect taxpayers located within the disaster areas, as well as other affected taxpayers located outside the disaster areas but with other ties to the regions.

Taxpayers either located in the affected areas or associated in some other way with the disaster areas should be aware of the various return and payment deadlines that may be postponed until Jan. 31, 2019. In some cases, those relief provisions may provide an opportunity to defer certain payments, even if the taxpayer is not located in the disaster area.

In addition, there are a variety of other tax considerations that those who are located in the affected area should consider, including accelerating casualty loss deductions to generate an immediate refund opportunity, deferring gain on the receipt of insurance proceeds and providing tax-free assistance to affected employees.

Corporate and transactional considerations

Due date for tentative carryback claims of 2017 losses

Net operating losses (NOLs) have historically been carried back first before being carried forward unless a timely election to forego the carryback period is made under section 172(b)(3). Any unused losses can be carried forward. The TCJA eliminated the NOL carryback beginning in 2018 but now provides for an unlimited carryforward subject to an offset limitation equal to 80 percent of taxable income.

A tentative carryback adjustment of a 2017 loss (Form 1139) allows for a refund to be paid within 90 days of filing. However, it is important to ensure that Form 1139 is timely filed and does not omit any critical information to allow the IRS to process it within that 90-day period. The due date of Form 1139 for a calendar year 2017 corporate loss is Dec. 31, 2018. Corporations should consider filing early to allow for the correction of any discovered defects in the filing prior to Dec. 31, 2018.

File Form 4466 in January to obtain a quick refund

Corporations can receive a quick refund (generally in less than 45 days) of federal estimated tax payments in excess of the company's estimate of its tax liability for the year. The company must file Form 4466 after the close of its tax year but before the un-extended due date of its Form 1120 to receive this quick refund. The company can designate that the excess amount be credited to another IRS liability. Penalties may apply if the requested refund (or credit to another liability) leaves the corporation underpaid for estimated tax purposes.

Consider filing an automatic extension even if the return will be filed on time

The timely filing of Form 7004, *Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns,* will provide an automatic six-month extension of time to file a corporate income tax return.

Filing the extension may be beneficial even if the corporation files the return the next day. A valid automatic extension request extends the time for a calendar-year corporation to file its return for six months from the original due date of the return.

The extension period allows companies time to make corrections to the return, up to the extended due date, without penalty—including making timely tax elections or applying automatic accounting method changes if omitted from the initial filing. A subsequently filed return containing these items filed before the extended due date would supersede the previously filed return that omitted them. The superseding return becomes the official return and the statute of limitations on assessment will expire (under normal circumstances) three years from the date the taxpayer files the return.

Accelerating subsidiary stock losses

For consolidated taxpayers, two planning opportunities may be available to accelerate and recognize losses in the current year. Consolidated groups with an insolvent subsidiary should evaluate whether it makes sense to claim a worthless stock deduction. Claiming the deduction may require liquidating the insolvent subsidiary or converting it into a limited liability company.

Accelerating section 481 adjustments in the year of an M&A transaction

Taxpayers have the ability to accelerate income into the year of certain mergers and acquisitions (M&A) transactions and possibly the year prior under rules provided by the IRS. These rules allow for the acceleration of income into the period prior to an acquisition and can provide tax advantages in situations where section 382 limitations would limit the ability to offset such income post-transaction. For certain accounting method changes, a taxpayer must file the method change request prior to the end of the tax year in order to obtain this treatment.

Identifying unamortized debt issuance costs

Companies that have refinanced debt or taken out new debt during the tax year should evaluate whether any previously unamortized debt issuance costs are eligible for accelerated tax deduction during the current year.

Federal income tax do-over

While not a new ruling, Rev. Rul. 80-58 allows taxpayers to rescind a transaction. While this is difficult to accomplish and little guidance exists in this area, this ruling does provide an avenue for rescission. However, to successfully complete a rescission, it must occur within the same tax year as the transaction. As a result, this item warrants consideration during year-end planning.

Section 382 closing of the books election

Corporations should carefully monitor changes in stock holdings and stock issuances that occur during the year in order to identify whether the company has undergone a section 382 ownership change. Corporations undergoing a section 382 ownership change may make a closing-of-the-books election. Addressing whether or not the corporation will make the election may result in significant tax benefits.

The corporation may prefer to maximize the amount of its income for the taxable year treated as accruing prior to the ownership change to maximize use of NOL deductions (or certain other deductions). If it files a closing-of-the-books election with its timely filed tax return, the corporation closes its books at the date of change for section 382 purposes, thereby specifically measuring income and deductions pre- and post-change. Without the election, under the default rule, the corporation applies daily proration of the entire year's items of income and deductions.

Addressing the closing-of-the-books election decision before the end of the year can assist with year-end tax planning, since it helps position the company to determine whether acceleration of income or deduction items would be advantageous.

Projecting earnings and profits

During year-end planning, it may be important for a corporation to project the remaining current-year earnings and expected 2019 earnings along with cumulative earnings and profits. These projections can aid companies planning to distribute cash (or other property) to shareholders in deciding the optimal distribution timing.

Form 8937, *Report of Organizational Actions Affecting Basis of Securities*

C and S corporations that take organizational actions that affect the basis of securities in the hands of stockholders generally must file Form 8937 within 45 days of the transaction date, or by Jan. 15 of the year following any such actions that take place in December.

Organizational actions include stock splits, stock dividends and distributions that are fully or partially nontaxable, and some reorganizations. S corporations may report the required Form 8937 information on Schedule K-1 instead of Form 8937, and a company may meet Form 8937 filing requirements through appropriate postings on the company's website.

Realizing maximum benefits through a transaction cost analysis

When a company engages in a transaction such as a merger, sale of an entity, acquisition of an entity or business combination (either on the buy-side or the sell-side), the IRS requires costs incurred to facilitate the transaction to be capitalized. With stock transactions, these costs generally are capitalized into stock basis and are not recoverable until such stock is sold. Alternatively, with asset transactions, these costs generally are capitalized and amortized over a period of time, typically over 15 years on a straight-line basis. In contrast, costs that do not facilitate a transaction can generally either be deducted as incurred or amortized over 15 years.

Performing a transaction cost analysis (TCA) allows a company to identify nonfacilitative costs and maximize tax deductions. A TCA involves a thorough analysis of activities performed and expenses incurred in connection with exploring and entering into a merger or acquisition transaction. The study results in the determination and proper documentation of the appropriate federal income tax treatment of transaction costs. Without proper documentation, all transaction costs generally must be capitalized, rather than deducted during the year paid or incurred.

Section 162(m)

The TCJA affected public companies by significantly changing the rules of section 162(m) for the $1 million limitation on executive compensation. Under the changes, performance-based compensation (other than under limited transition relief) is no longer exempt; a broader group of companies are subject to section 162(m) limitations; and the list of "covered employees" whose compensation is subject to the limitation is expanded. Under the new covered employee definition, once a person is a covered employee in any year after 2017, the employee is always a covered employee, and the company is subject to the limitation on tax deductions for compensation paid to that individual over $1 million, even if the amounts are paid at retirement or death. Companies that do not currently have any employee over $1 million still need to start their list of covered employees (CEO, CFO and the three highest paid employees for the year). Once an employee is a covered employee, he or she will remain a covered employee in future years as long as compensation is received. Thus, the list of covered employees will expand over time.

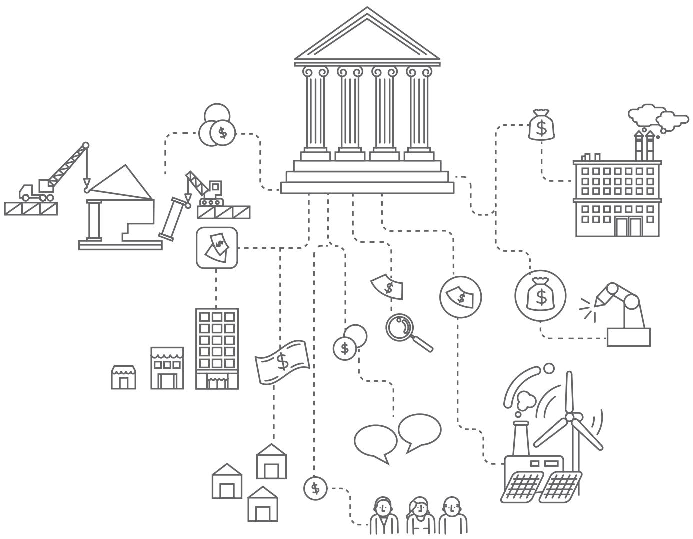
International tax considerations

Monitor for "Tax Reform 2.0"

With the TCJA, Congress enacted many new provisions that will likely affect all companies with foreign business income. Given the complexities of tax reform, it is expected that additional guidance, and potentially technical corrections, will be enacted by Congress or issued by the IRS. Taxpayers should carefully monitor for such guidance and evaluate how any changes will impact their tax liability.

Transition tax planning

One of the most significant international tax provisions of the TCJA was the enactment of a one-time transition tax to pick up certain deferred foreign earnings. For fiscal year taxpayers who have not yet had to calculate their transition tax liability, certain elections and planning opportunities may be available to minimize the current year impact. Calendar year taxpayers who have already calculated their transition tax liability may wish to reevaluate the assumptions used in their calculations. Certain assumptions may no longer be valid, and thus, recalculating the transition tax liability may be required.



Foreign-derived intangible income (FDII) planning

The new FDII rules are an incentive for U.S. companies to sell goods and provide services to foreign customers. By using the new FDII regime, as well as the decreased federal corporate income tax rate, foreign-owned U.S. corporations may be able to significantly reduce the group's overall tax burden where eligible functions such as research and development or certain services are relocated to the U.S.

Further guidance is expected from the IRS to explain the operations of this new regime.

Global intangible low-taxed income (GILTI) planning

The TCJA enacted a new rule that requires certain shareholders of foreign corporations to include into current income their share of GILTI. GILTI can apply to a broad swath of taxpayers in any industry, so U.S. shareholders need to assess whether they may have exposure to this new income inclusion. Planning opportunities to limit a taxpayer's exposure to GILTI are available and should be considered in order to minimize the impact of this new tax scheme.

Base erosion and anti-abuse tax (BEAT) planning

The TCJA introduced the BEAT, an additional tax designed to ensure that corporations with significant base erosion payments made to related foreign parties pay a certain amount of U.S. federal income tax. This tax is in addition to a corporation's regular income tax liability. Taxpayers with more than $500 million of average annual gross receipts and deductible payments to foreign related parties should carefully consider the impact of tax credits (such as the research and development credit) and net operating losses on the likelihood of paying the BEAT.

BEPS and CbCR compliance

In line with the Organisation for Economic Co-operation and Development's base erosion and profit shifting (BEPS) project, the IRS issued final regulations in 2016 requiring annual country-by-country reporting (CbCR) by U.S. taxpayers that are the ultimate parent of a multinational enterprise group. This tax filing requirement applies to companies with $850 million or more in global group revenues.

Taxpayers who wish to avoid filing in non-U.S. countries should consider filing Form 8975, *Tax Jurisdiction and Constituent Entity Information* with the IRS, because filing this form in the United States will satisfy any filing requirements in other countries.

This reporting requirement is still relatively new and may have required taxpayers to significantly change their information reporting processes. Accordingly, affected taxpayers should carefully review the financial and administrative impact CbCR may have had on their compliance function and reevaluate if necessary.

Transfer pricing planning

In addition to considering whether to file Form 8975, taxpayers should consider a variety of important transfer pricing issues before year-end. For example, taxpayers should ensure that year-end true-ups are performed with respect to any cost allocations and should reconcile financial statement results to those required by any relevant transfer pricing documentation that is in place.

Taxpayers should ensure that intercompany transactions are supported by an appropriate agreement. Moreover, taxpayers should conduct a high-level risk assessment of global intercompany activity and consider whether to update any existing transfer pricing documentation, either because of a change in facts or because the documentation is out-of-date.

U.K. VAT deadline

Businesses that have paid United Kingdom (U.K.) value-added tax (VAT) have until Dec. 31 to claim a refund of any VAT incurred during the period July 1, 2017, to June 30, 2018, and should assess whether they wish to pursue a claim as soon as possible.

Planning for foreign branches

Under current law, U.S. taxpayers operating in nondollar economic environments must calculate and take into income an appropriate amount of balance sheet translation gains and losses. In December 2016, the U.S. Treasury Department issued final regulations setting forth complex rules taxpayers must use to calculate this balance sheet gain or loss, and such rules are now scheduled to take effect in 2020 for calendar-year taxpayers. After they take effect, the regulations will likely limit the extent to which taxpayers may recognize built-in losses on existing foreign operations.

The Treasury has identified these regulations as overly burdensome and has recommended that they be significantly modified. In June 2018, the Treasury and the IRS announced that the original 2019 effective date would be pushed back to 2020, in order give sufficient time to consider changes. However, it is likely that final regulations will still limit recognition of built-in losses. In light of this, taxpayers should consider taking such losses this year before future regulatory changes are put in place.

Planning for payments between foreign subsidiaries

U.S. taxpayers generally pay tax on foreign income earned by a non-U.S. subsidiary when the subsidiary makes a distribution of income to the U.S. shareholder. However, payments made between offshore subsidiaries often trigger income inclusions to a U.S. shareholder, even if the U.S. shareholder receives no money.

The TCJA did not make permanent an exception to the law that allows a foreign subsidiary to pay another foreign subsidiary without triggering income to U.S. shareholders. As a result, the exception is scheduled to expire for taxpayers with tax years starting on or after Jan. 1, 2020. Whether Congress will make this exception permanent as part of Tax Reform 2.0 remains unclear.

In the absence of a permanent exception, taxpayers should consider their planning alternatives in order to mitigate potential income inclusions arising from payments between foreign subsidiaries.

Key global information reporting action points

Prepare to start FATCA withholding on gross proceeds

Withholding agents must begin deducting 30 percent Foreign Account Tax Compliance Act (FATCA) withholding from gross proceeds realized on sales of assets that can produce U.S.-sourced interest or dividends that are paid to non-FATCA compliant investors or account holders starting Jan. 1, 2019. Therefore, companies should evaluate any required modifications to systems and procedures for flagging payments subject to reporting and for calculating and remitting the required withholding. Additionally, sufficient lead-time should be built in for budget requests and approvals, training of key stakeholders, modification of offering and subscription documents, and development of communications to investors and account holders regarding this important change.

Reevaluate the FATCA and CRS status of entities in the group

To the extent that companies have acquired or created new legal entities or restructured the group this year, or moved into jurisdictions that have adopted the Common Reporting Standard (CRS) or entered into an intergovernmental agreement (IGA) under FATCA, the company should plan to reevaluate or confirm the FATCA and CRS status of legal entities in the group. Entities that accept deposits, custody assets, perform investment activities, serve as captive insurance companies or certain holding companies may be considered foreign financial institutions and should prepare to register with the IRS, start collecting W-8s, W-9s and self-certification forms from investors or account holders, and should begin filing FATCA and CRS reports if required next year.

Monitor and implement changes to information returns for the TCJA

Withholding agents should carefully monitor changes in new versions of information returns that have published and should update their systems and any substitute forms or instructions as required. For example, based on early drafts of Form W-9 that were published last month, it is likely that the IRS will finalize and publish a new W-9 form this year reflecting TCJA's new 24 percent back-up withholding rate. Instructions for Forms 1099 and 945 should also be updated to reflect the new 24 percent back-up withholding rate imposed under the TCJA, and companies should begin discussions with their tax operations, technology and legal teams now to plan for these changes.

The IRS has also recently published new versions of Forms 8804, 8805 and 8813 with instructions that reflect significant changes in tax rates and other requirements set forth under the TCJA, and it is expected that new versions of Forms 8288, 8288-A and 8288-B will be published to reflect changes under the TCJA, including the new section 1446(f) withholding. Companies should assess the impact of these changes and update their systems, withholding tables and processes for monitoring changes as soon as possible.

Prepare to begin collecting new W-8s

Companies should also begin requesting new IRS Forms W-8 and CRS self-certifications from customers opening new accounts or those with forms that will expire after Dec. 31, 2018. The IRS published new versions of Forms W-8BEN and W-8BEN-E in July 2018 that must be used starting Jan. 1, 2019. Note, however, that valid unexpired Forms W-8 can still be relied on and do not need to be replaced until they expire (generally within three years) or if there is a change in circumstances that mandates collection of a new form.

Prepare to submit mandatory RO FATCA compliance certifications

Responsible Officers (RO) of registered foreign financial institutions (FFIs) in jurisdictions with model two intergovernmental agreements (IGA) in place and those in jurisdictions with no IGA must prepare to submit mandatory certifications of their compliance with FATCA by as early as Dec. 15, 2018, depending on the date that they registered for FATCA and received a global intermediary identification number (GIIN). The deadline for submission of the mandatory Certification of Pre-existing Accounts (COPA) and the Periodic Certification of Compliance with FATCA is normally July 1 following the third full calendar year after the date the entity registered for and received a GIIN, but the deadline for certifications due this year by July 1, 2018, was extended to Dec. 15, 2018, while the IRS upgraded its systems.

The mandatory certifications require ROs to examine their organizations' FATCA compliance program in detail and to certify its sufficiency to the IRS under penalty of perjury. FFIs in jurisdictions with Model 1 IGAs in effect are not required to submit the certifications, but all other registered FFIs must submit the certifications timely.

In order to file timely, ROs should plan to perform readiness assessments now to identify and remediate any potential gaps in their systems and processes. Failure to timely certify compliance may result in removal from the IRS' published list of valid GIINs and could ultimately result in the FFI being subject to 30 percent FATCA withholding on certain U.S. sourced payments that it receives as well as closure of accounts which may impact the FFIs ability to do business with others.

Prepare to start new section 6050Y reporting of life insurance contracts

The TCJA introduced IRC section 6050Y, which imposes new information reporting requirements for certain life insurance contracts with reportable death benefits paid and reportable policy sales made after Dec. 31, 2017. The IRS has delayed any reporting under IRC 6050Y until final regulations are issued, but companies should begin assessing the impact of these requirements on its operations now and should be prepared to start reporting once regulations are issued.

According to the rules, section 6050Y reporting will be required by (1) anyone who acquires a life insurance contract, or any interest in a life insurance contract, in a "reportable policy sale"; (2) an issuer of a life insurance contract upon notice of a transaction required to be reported above or upon any notice of a transfer of a life insurance contract, or any interest in a life insurance contract, to a foreign person; and (3) any payor of "reportable death benefits."

For purposes of these rules, "reportable death benefits" are defined as the amount paid at the death of the insured under a life insurance contract that was transferred in a reportable policy sale. Likewise, a "reportable policy sale" is defined generally as the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business or financial relationship to the insured.

Companies should evaluate their assets and business activities to ascertain whether they have a section 6050Y reporting obligation and should implement systems and procedures for complying with this requirement going forward as needed.

Intercompany loan planning

Under current law, a loan or equity investment in a U.S. company by a related foreign subsidiary can result in an income inclusion to a U.S. shareholder of the foreign subsidiary. Even a guarantee by a foreign subsidiary can trigger an income inclusion.

Many taxpayers are unaware of this rule and may have such U.S. investments in place at any given time. However, taxpayers can minimize the adverse impact of this rule by reducing or eliminating U.S. investments or guarantees by foreign subsidiaries before the end of the year.

The changes to the anti-deferral rules under the TCJA should result in fewer taxpayers having exposure to this rule; however, taxpayers using a CFC or its assets as collateral for borrowing should remain aware that certain traps remain.

Review cost-sharing agreements

In July 2018, the U.S. 9th Circuit Court of Appeals overturned the U.S. Tax Court's unanimous 2015 decision in Altera v. Commissioner. The 9th Court decision reverses the Tax Court's decision on this issue, holding that the Treasury's rule was not arbitrary and capricious, because the Treasury provided a sufficient basis for its decision making. Many taxpayers have taken positions for financial accounting purposes and in protective tax returns claiming a benefit under the decision of the Tax Court. These taxpayers should immediately evaluate the impact of this appellate decision, because it is unlikely the Supreme Court will entertain an appeal of this decision even if the taxpayer chooses to file a petition. Taxpayers should evaluate whether to adjust their ASC 740 reserves and whether this decision will impact Q3 tax provisions as a potential change in law.

For further information, see IRS wins big in Altera appeal.

Exporters should consider a DISC

The United States provides incentives to boost exports of some domestic goods. Taxpayers may exclude tax commissions paid to a domestic international sales corporation (DISC) for supporting overseas sales.

When ultimately paid to individual DISC shareholders, DISC commissions are taxable at a 20 percent rate instead of the much higher corporate or individual rates that apply to ordinary business income.

DISCs involve little cost, but a new legal entity must be established, and all shareholders must elect DISC status before the tax year begins. Thus, interested taxpayers should make a DISC election for 2019 before Jan. 1, 2019.

Pass-through entity considerations

Consider application of section 199A deduction

New for 2018 is section 199A, which allows for a deduction of up to 20 percent of a taxpayer's "qualified business income." This deduction effectively reduces the top income tax rate applicable to ordinary business income from 37 percent to 29.6 percent. The deduction will not apply to self-employment or net investment income taxes. However, the deduction is applicable in computing Alternative Minimum Taxable Income.

Pass-through owners whose taxable income exceeds $157,500 (or $315,000 for a joint return) are subject to limitations on the deduction. These taxpayers may see the deduction reduced or fully eliminated if the business does not pay a specified amount of wage to its employees, does not hold sufficient amounts of tangible, depreciable assets, or conducts business activities considered in whole or part to be a "specified service" business described in the new law.

While beneficial to many, this new deduction brings with it new reporting requirements and complexities for pass-through entities and their owners. Proposed regulations have added clarity in many areas, but taxpayers must still comply with complicated rules regarding which types of businesses and income qualify, as well as the computational aspects of the deduction.

Given the complexity, pass-through business owners should seek advice from their tax advisors when evaluating their eligibility for the 20 percent deduction and considering whether changes to their business could enhance the benefit.

Bonus depreciation available for certain "step-up" transactions

Historically, purchasers of partnership interests were able to generate additional depreciation deductions through step-up elections; however these deductions were not eligible for bonus deprecation, as they generally represented the indirect purchase of a used asset. As noted above, the TCJA changed this rule to allow bonus depreciation for purchases of used assets.

Recently proposed regulations provide guidance for how the rule changes impact step-up deprecation generated by the acquisition of an interest in an existing partnership and similar transactions. In many, but not all, cases, the purchaser will benefit from this immediate deduction to the extent its share of the step-up is allocable to qualified assets.

Taxpayers considering transactions that may generate a step-up in the basis of assets potentially eligible for bonus depreciation, or transactions that could be restructured to generate such a step-up, should pay particular attention to these proposed regulations. Each proposed transaction structure should be analyzed to determine whether and to what extent expensing is available, as well as the tax consequences to the seller. In addition, some transactions that have already closed, but are subject to the new bonus depreciation rules, should be reviewed to ensure that the optimum allowable tax treatment is obtained.

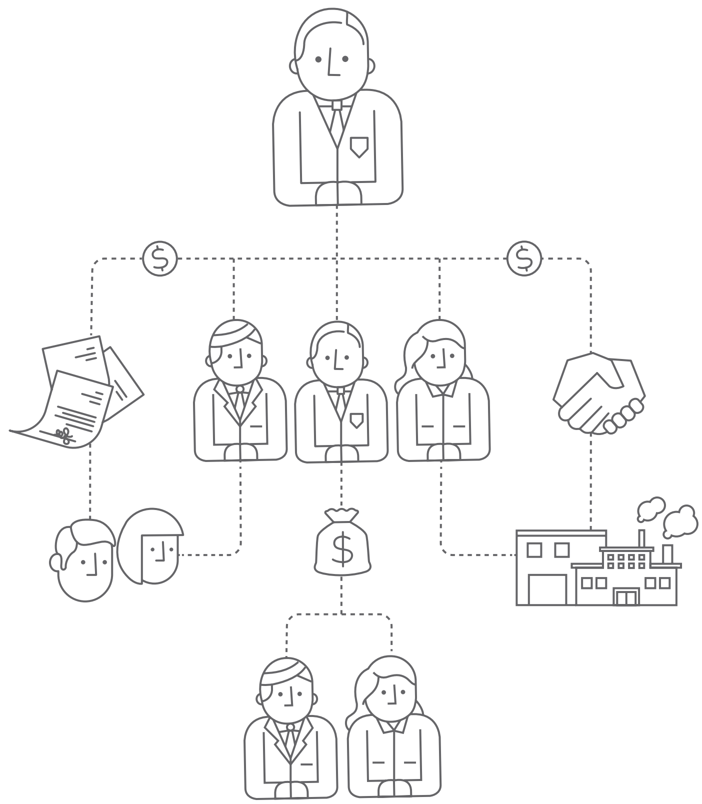
Passive loss and net investment income tax planning

Taxpayers who are individuals, closely held C corporations or personal service corporations are generally restricted in their ability to deduct losses from passive activities. These are losses from rental activities and other business activities in which the taxpayer is not actively involved. However, taxpayers who can demonstrate the necessary level of participation in these activities may be able to deduct these losses and generate significant current income tax savings.

The keys to doing so are: (1) understanding how much participation is necessary, and (2) ensuring that the participation can be substantiated. In most cases, a taxpayer must devote at least 500 hours to an activity in order to avoid the limitations on passive losses. But in some cases, a taxpayer may only need to participate for 101 hours in an activity in order to deduct such losses. Thus, taking action now to increase one's participation can, in some instances, provide a valuable tax deduction.

In situations where the business activity generates a net profit, participation is also relevant when trying to minimize exposure to the 3.8 percent net investment income tax under section 1411. Owners of pass-through entities usually can avoid the tax on their distributive share of income if they participate in the business for more than 100 hours during the year.

Finding ways for owners to meaningfully participate in the business can have the added benefit of significantly reducing their exposure to this tax.



Reconsidering entity choice

Most pass-through businesses consider their entity structure only once, at the time of formation. However, the TCJA has taken the traditional rules and turned them upside down. The 2017 tax changes may lead many partnerships, LLCs and S corporations to reconsider their choice of entity. Under the new law, corporate tax rates have been slashed from 35 percent to 21 percent, while pass-through businesses, such as S corporations and partnerships, may now qualify for a new pass-through deduction that would effectively cut their tax rates from 39.6 percent to 29.6 percent.

With the changes, important issues to consider when re-evaluating entity choice include:

- Why should I remain an S corporation, effectively paying a 29.6 or 37 percent tax rate, if I can get a 21 percent tax rate as a C corporation?
- Can my partnership convert to C corporation status and enjoy the lower corporate tax rate?
- Are there issues beyond the annual tax savings I should be considering?

- Are there self-employment tax implications? What about changes to how the owners are currently compensated?
- What role do state and international considerations play in this decision?
- What is the future exit strategy?

IRS compliance campaign affecting S corporations

The IRS Large Business and International (LB&I) division has identified and selected specific issues on which to focus its compliance efforts through a campaign approach. One of those campaigns focuses on S corporation shareholders who may have claimed losses in excess of their basis in the entity and shareholders' obligation to track (and report) their stock and debt basis when reporting flow-through losses from the S corporation.

S corporation shareholders can take action in anticipation of this campaign, both to ensure that they have adequate records to support their basis calculations and to potentially generate basis before year-end in order to utilize previously suspended losses.

New loss limitations

The 2017 tax law includes a new restriction that limits an owner's ability to deduct active business losses against nonbusiness income. Previously, active losses could be offset against all income, with no limitation on their deductibility. Under the new law, "excess business loss" deductions are limited to income plus a threshold amount of $250,000 ($500,000 for married filing joint). Any losses that are limited under this new provision are carried-over and become NOLs in subsequent years. This generally results in a one-year delay in claiming losses limited as a result of the new rule. However, the new tax law also limits the utilization of NOLs to 80 percent of taxable income in any given year. Accordingly, NOLs generated as a result of this new active business loss limitation will be likewise subject to additional restrictions for NOLs.

Taxpayers should review their active business income and losses to evaluate whether any losses would be fully offset against active business income or whether they may be subject to this new limitation.

Planning for the new partnership audit rules

All entities organized as partnerships for federal tax purposes will be affected by the new partnership audit rules enacted in late 2015 and effective for partnership tax years beginning on or after Jan. 1, 2018, which, among other items, raises the specter of an entity-level tax on any audit adjustments.

Partnerships will need to designate a partnership representative whose powers to bind the partnership go well beyond the tax matters partner of current law. As a result, these new audit rules will create significant new business conflicts among current partners, as well as former partners and managers.

Since enactment, additional regulatory guidance, as well as technical corrections to the statute itself, have become effective. Most critically, both the regulations and technical corrections clarify that the "push-out" mechanism, by which partnerships can place the burden of examination-related tax adjustments on their partners—the partners in the year being examined—by issuing them statements showing their share of any adjustments, will be operable through tiered partnership structures.

Although audits may not begin to take place until 2020, potential conflicts and risks could exist right now when transactions are undertaken involving tax positions that may be subject to audit under the new regime. Therefore, we recommend that partnerships act immediately to ensure that appropriate governance and operating provisions are in place in the partnership's governing documents to adequately protect the interests of current partners, former partnership and management.

Self-employment tax considerations for partners

Several tax court decisions, in conjunction with other forms of guidance including long-standing and controversial proposed regulations, have created an unclear picture as to the treatment of members of limited liability companies (LLCs) or limited liability partnerships (LLPs) under the self-employment tax rules.

The IRS has taken aggressive positions on this, and recent decisions indicate that in certain cases, LLCs may want to consider modifying their governance rules, substantiating the fact that certain portions of income are exclusively a return of capital (and not compensation for personal services), or adopting a limited partnership structure. These changes may provide greater confidence regarding the application of the self-employment tax to members of LLCs or LLPs.

Partners as employees

Partnerships or LLCs may find treating partners as employees provides several benefits, including state tax benefits and overall simplification of reporting wages via Form W-2 instead of Schedule K-1. There have been several developments in the law, both favorable and unfavorable, regarding the extent to which this practice may be permissible. This includes unfavorable regulations not allowing employee treatment under structures in which the partners of a tax partnership are employees of a single-member LLC owned by the tax partnership.

A partnership or LLC considering taking or maintaining a position that some of its direct or indirect partners are direct or indirect employees may want to consider adopting a tiered structure so that employees are partners in a holding company rather than the tax partnership that is their actual employer. Additionally, partnerships or LLCs considering taking this position will also want to analyze the impact such a decision may have on their partners' ability to utilize the new pass-through deduction afforded by section 199A. Specifically, W-2 wages paid to direct or indirect partners will not be considered qualified business income and, thus, are not eligible for the new deduction. However, the wages may be considered W-2 wages for purposes of the wage limitation, possibly increasing the overall deduction available, had the partners previously been limited as a result of insufficient W-2 wages.

Planning in this area can generally produce the desired result with minimal hurdles.

New carried interest legislation

The TCJA added a new section to the tax code impacting the treatment of so-called carried interests, defined generally as partnership interests received in exchange for services in certain specified businesses in the investment and real estate industries. This provision acts to change the holding period for determining if a sale of a capital asset results in short-term or long-term gain from one year to three years, to the extent that gain is received through a carried interest.

Many exceptions and nuances apply to this new recharacterization rule. We recommend that taxpayers expecting a large carried interest realization event consider the applicability of this new provision and discuss potential mitigation strategies with their tax advisors.

State and local tax considerations

Nexus review

Nexus is most often addressed in the context of analyzing what a company does and determining where the company could arguably have established sufficient contacts to be required to file state income and franchise tax returns. However, the question of where a company has to file only scratches the surface of the importance of nexus.

On June 21, 2018, the U.S. Supreme Court issued its decision in *South Dakota v. Wayfair*, overturning the long-standing "physical presence" nexus standard established through *Quill v. North Dakota* in 1992. With the Wayfair decision, the Court has opened up the possibility for states to impose sales and use tax collection and remittance responsibilities on remote sellers based solely upon their economic presence in a state. This decision and resulting changes to the sales and use tax nexus landscape will have wide-ranging impacts on most taxpayers in most industries. Over half of the states have provided new laws or guidance in response to *Wayfair* through early fall 2018.

Other nexus issues, such as whether the company has the right to apportion or has to throw back or throw out sales from its sales factor, may have more bearing on the amount of total state income and franchise tax actually paid.

Additionally, it is important to understand whether a company has any opportunities to restructure legal entities or business operations to generate benefits from establishing or cutting off nexus. For example, a company in a loss year with an expectation of generating income in future years may be well advised to establish nexus now in states it has targeted for expansion in order to protect an NOL.

In some cases, this can be as easy as hiring or moving an employee earlier than originally planned; however, regardless of the necessary steps, any nexus-establishing activities must be done by year-end.

State tax reform review

With the passage of the federal tax reform, both business and personal income taxpayers will need to consider how the federal changes will affect state law. Currently, state conformity must be observed on a state-by-state basis. While some states and localities automatically conform to changes to the Internal Revenue Code for income tax purposes (so-called "rolling conformity" states), many others have fixed-date conformity or only conform to specifically enumerated provisions.

Many states and localities have indicated that the method and/or level of federal conformity is likely to change in the wake of major reform. Additionally, the states have responded to federal tax reform by cherry picking selected sections of the code in which to conform—meaning that while a state may conform to the majority of the TCJA, some provisions may be modified on the state level. It is likely that the states will continue to address federal tax reform deep into the 2019 state legislative sessions.

Apportionment review

Before year-end, it is important to extrapolate estimated apportionment data from the first through third quarters of the current year and the fourth quarter of the prior year to identify key positions for which the company will need specific, highly detailed data for its returns.

Additionally, by analyzing this data, the company can determine whether more favorable apportionment can be obtained via restructuring of its legal entity structure or business operations or through requesting to use an alternative apportionment formula.

Attribute maximization

State attribute regimes, such as state net operating loss calculation and usage rules, can vary significantly from federal, and opportunities exist in relation to attributes generated before establishing nexus, becoming a member of a combined or consolidated group and acquiring, merging or liquidating an entity.

If a company has substantial tax attributes trapped in a perennially underperforming or newly acquired entity and has another entity that could fully utilize those attributes, it may be beneficial to merge those entities or, in some cases, to elect or request to file on a combined or consolidated basis.

Current-year deduction maximization

If a company has multiple entities in its structure, it may be beneficial to examine projections of current-year income and deductions to identify isolated current-year loss entities. It may be possible to fully utilize the deductions creating those projected losses through expense allocation, transferring payroll or property, restructuring, or electing or requesting to file on a combined or consolidated basis.

Unitary review

Depending on the circumstances, filing state income tax returns on a mandatory combined basis can provide substantial benefits or detriments to taxpayers. It is important to determine whether the business has the requisite control, integration and flow of value to establish unity and to model state income taxes on a separate and combined basis.

Where sufficient value exists, it may be advisable to take steps to break or create unity. This analysis is particularly important if the company has completed, or is going to complete, a major acquisition or disposition of entities or assets during the tax year.

Shared services consolidation

Many businesses have duplicative functions, such as payroll and billing, within legal entities or business units. By consolidating these functions in a single entity and setting up intercompany charges, it may be possible to create operational savings and tax benefits via nexus isolation and shifting taxable income to states with favorable tax base computations, apportionment rules or rates.

Credits and incentives compliance

Many state tax credit programs and incentive packages have ongoing annual compliance requirements that must be met in order to retain benefits and avoid clawbacks.

It is important for a company benefitting from state credits and incentives to understand its continuing compliance responsibilities, ensure that it meets commitments (such as those associated with new hiring, job retention and investment) by agreed-upon deadlines, and file all required forms and data in a timely manner.

By reviewing active state credit and incentive agreements and applicable statutory and regulatory requirements, as well as taking the right steps now to keep in compliance for this year, a company can avoid having to go through the arduous process of renegotiating deals or the outright loss of prior, current and future benefits.

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