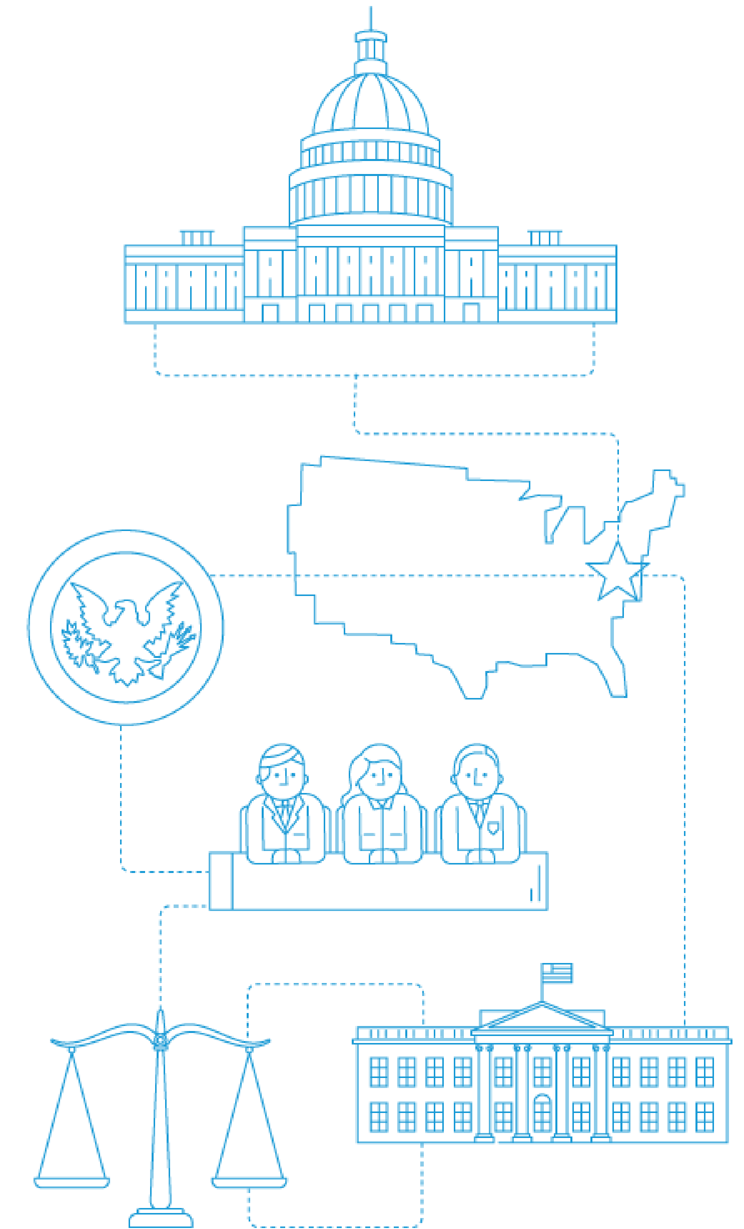
KEY TAX REFORM PROVISIONS
PASS-THROUGH ENTITIES

- The Tax Cuts and Jobs Act (TCJA) allows owners of pass-through entities and sole proprietorships to claim a deduction equal to 20 percent of the 'qualified business income' earned by the business.
  - Generally only applies to businesses that pay substantial wages to employees and/or invest in tangible depreciable business assets.
  - Excludes businesses in certain 'specified service' fields such as health, law and accounting, and businesses where the principal asset is the reputation or skill of one or more of its employees or owners.
  - Wage and service business limitations do not apply for taxpayers with joint taxable income below $315,000 or $157,500 for singles.
- The new rules are the same for 'active' and 'passive' investors and contain no changes to the rules governing net investment income taxes or self-employment taxes.
- General implications
  - A 21 percent corporate tax rate, a top 20 percent individual tax on qualified dividends and capital gains, and the potential to defer or avoid capital gain taxes may cause some partnerships, limited liability companies (LLCs) and S corporations to consider becoming C corporations. However, it is unlikely to be beneficial for professional firms to do so.
  - Reductions to the top individual tax rate on qualified pass-through business income may cut the other way, but may require planning to optimize the pass-through tax benefits.



TAX REFORM RESOURCE CENTER

How might new tax rules affect your business and tax planning?
The TCJA includes sweeping changes to tax law. This resource center features our latest insights and programming, so that you understand what to expect and the potential impact to your tax planning process.

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TAX REFORM: PASS-THROUGH CONSIDERATIONS

2018 planning

FEDERAL

- Pass-through entities will need to undertake an analysis in order to determine how to optimize any benefit provided by the pass-through deduction.
- Compensatory income – i.e., wages paid to S corporation shareholders and guaranteed payments paid to partners – does not factor into the deduction calculation. Pass-through entities will want to factor this into their analysis and compensation planning strategy in 2018 and beyond.
- Most pass-through entities should evaluate their status as such and consider the benefits and detriments of potentially converting to a C corporation.
- Longstanding rules governing the implications of accumulating excessive earnings inside a corporation and of using a corporation to hold significant investment-type assets may become important planning considerations.
- Self-employment and net investment income taxes should also be considered.
- Pass-through entities may consider analyzing the possibility (and practicality) of separating the individual trades or businesses in order to segregate trades or businesses that may qualify for the deduction from those that will not.

INTERNATIONAL

- Pass-through entities may wish to consider interposing a U.S. C corporation to invest in a foreign business. This could result in little to no U.S. tax on foreign earnings to the C corporation and a 20 percent dividend tax for the pass-through owners in the future when dividends are paid. It could also allow a U.S. corporation to act as a treasury center using untaxed or lightly taxed foreign earnings. Also, earnings taxed under special rules relating to global intangible low-taxed income (GILTI) would be taxed at a lower rate than individual rates. Technology companies with foreign operations may have significant GILTI income and could benefit from the use of a U.S. C corporation to hold shares of a foreign operating company.
- The general elimination of U.S. corporate tax on foreign earnings may open up new opportunities for U.S. individuals to invest overseas through U.S. C corporations.

OTHER

- Pass-through entities that make distributions to their owners to pay taxes will need to consider the implications of the deduction on those distributions.
    - The deduction is available to active and passive investors.
    - Trusts and estate also enjoy the benefit of the deduction.
    - However, depending on the owners' individual tax characteristics, some owners' deductions may be limited based on the type of business or the W-2 wages paid while others' deductions may not.
- State and local tax burdens should be a focus when considering pass-through entity structuring and planning, as some states may not conform to the TCJA changes.

2017 planning

FEDERAL

- Taxpayers still have opportunities to position themselves to maximize the benefit of key TCJA provisions. For example, certain accounting method changes to either accelerate deductions into 2017 or defer income into 2018 can be filed with a taxpayer's 2017 tax return. Taxpayers should also consider the timing of certain bonus payments to maximize deductions in 2017.
- A principal challenge will be to stay well-informed as to how key provisions might affect your particular situation and to consider whether opportunities may still arise on the 2017 tax return to maximize potential benefits.

INTERNATIONAL

- Pass-through entities that own an interest in any specified foreign corporation should consider an earnings and profits (E&P) analysis to determine the amount of deferred income inclusion; E&P calculations required for this purpose differ from normal rules.

OTHER

- Companies that pay nonresident withholding and/or file composite tax returns for their owners should think carefully about the information provided to owners to ensure that the pass-through owner deducts the appropriate amount on the 2017 tax return.

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