Corporate Tax Update

ACCOUNTING METHOD CHANGES UNDER TAX CUTS AND JOBS ACT OF 2017

Presented By:

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Tax Cuts and Jobs Act Changes for Companies with Gross Receipts <$25 Million

- Expanded availability of the cash method of accounting
- Reduced requirements to account for inventory
- Decrease in applicability of §263A (UNICAP)
- Increase in long-term contract accounting threshold

Cash Method of Accounting

- Report income when received
- Deduct expenses when paid
- Some exceptions
- Simplest form of accounting and easiest to manipulate (control) timing of taxable income

Expanded Use of Cash Method of Accounting

- Increased thresholds of:
  - $1 million (mfg) and $10 million of gross receipts with inventory
  - $5 million average annual gross receipts for corporations or partnerships with corporations as a partner
- New threshold under §448(b)(3):
  - $25 million in average annual gross receipts over the prior 3 taxable years
- Aggregation rules do apply for:
  - Controlled groups
  - Trades or business under common control

FAQ

If I switch to the cash method does that mean I can write off my inventory when purchased?

No!

Accounting for Inventories

- Can treat inventory as non-incidental materials and supplies (deductible when consumed), or
- A method that conforms to the taxpayer's method of accounting reflected in their financial statements or books and records
- May ease administrative burden of tracking inventory and cost of goods sold

Application of §263A (UNICAP)

- Creates an exemption from §263A for taxpayers that met §448(b)(3) or $25 million average annual gross receipts
- Increased from $10 million for reseller and retailers
- Procedures are now also eligible for the exemption
- Would provide one-less book to tax difference needed to be calculated

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Long-term Contract Accounting

- §460(e) expands exception for certain construction contracts
- Will not have to use percentage of completion method if gross receipts test of $25 million is met and the anticipated completion date is less than two years from commencement
- Increases previous threshold of $10 million
- Other methods available include cash, accrual and completed contract methods
- This will apply on a cut-off basis and only apply to contracts entered into after December 31, 2017

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Target Beneficiaries

- All companies with gross receipts less than $25 million – high receivable & low payable/accrued expense businesses – accrual to cash
- Corporations or partnerships with corporations as a partner – accrual to cash
- Manufacturers & Producers – 263A & inventories
- Resellers between $10 million and $25 million of gross receipts – 263A
- Contractors between $10 million and $25 million of gross receipts

Accrual to cash example

• Accounts Receivable	$1,000,000
• Prepaid Expenses	$50,000
• Accounts Payable	($200,000)
• Accrued Expenses	($75,000)

• Net 481a adjustment	$775,000

Inventory example

- Inventory consists of the following:

Raw Materials	$1,000,000
Capitalized O/H	$125,000
Capitalized Labor	$200,000
Supplies used in Production	$25,000

Book Inventory	$1,350,000
Additional 263a Costs	$75,000

Tax Inventory	$1,425,000
Net 481a adjustment	$400,000

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How and why to file for a change?

- File Form 3115 to change any of the preceding accounting methods
- Due date is same as federal income tax return (including extensions)
- REV PROC 2018-40 provides automatic consent to any taxpayer filing Form 3115 for the proceeding changes
- Any pending applications can be converted to the automatic consent procedures
- Provides availability to administer cash planning opportunities if cash method is elected
- Could provide an additional temporary write-off in current year
- Four-year adjustment if company has to change back

FAQ

- Must I also use the cash method for my financial statements presented to the banks?
  - NO!
    - The general rule does require taxpayers to use the same methods of accounting for taxes as they do for their internal books and records
    - However, under the regulations, there is latitude to use different statement and tax reporting, as long as the internal books and records include reconciliations between the two

FAQ

- If I switch to cash method now, what happens when my company's average annual gross receipts exceed $25M?
  - Another accounting method change is filed and the income is recaptured over 4 years!!!
  - Using our prior example:
    - $775,000 tax deduction in 2018
    - If we fail the Avg. Gross receipts test for 2019
    - Company would have $193,750 of taxable income each year for the next 4 years
    - NPV of the deferral, even in this scenario, is over $31,000 at an assumed 30% tax and 6% discount rate

BENEFITS & OPPORTUNITIES

NEW OPPORTUNITY ZONE TAX INCENTIVE

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What is an Opportunity Zone?

- An economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. (*source: IRS)*
- 8,700+ census tracts have been designated covering parts of every state, the District of Columbia and 5 U.S. territories
  - This represents more than 10% of U.S. census tracts
- Must meet basic low-income criteria, however
  - Adjacent census tracts are also designated, regardless of income threshold
- The IRS produced a final list of Opportunity Zones organized by state
  - State websites allow Opportunity Zone search by address

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How do Opportunity Zones work?

- Taxpayers receive benefits like capital gains tax deferral and some forgiveness for investing in **Qualified Opportunity Funds**

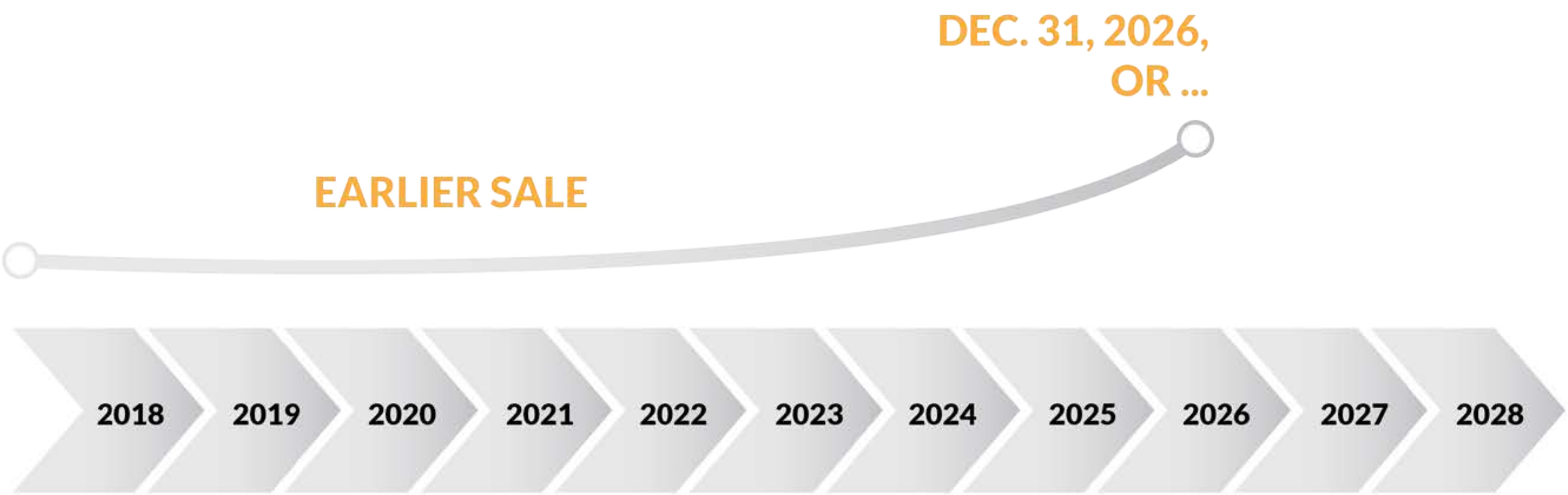
- Qualified Opportunity Funds take these dollars and invest in **Qualified Opportunity Zone Property**

Opportunity Zone Tax Incentives

- Defer tax for gains invested in a Qualified Opportunity Fund
- Partial forgiveness of capital gains (up to 10%) when QOF investment held for 5 years
- Additional 5% gain forgiveness for QOF held 7+ years
- Total gain forgiveness for any appreciation if investment is held 10 years

Deferral period

The capital gains tax deferral period ends either at the date of earlier sale or December 31, 2026, whichever is earlier



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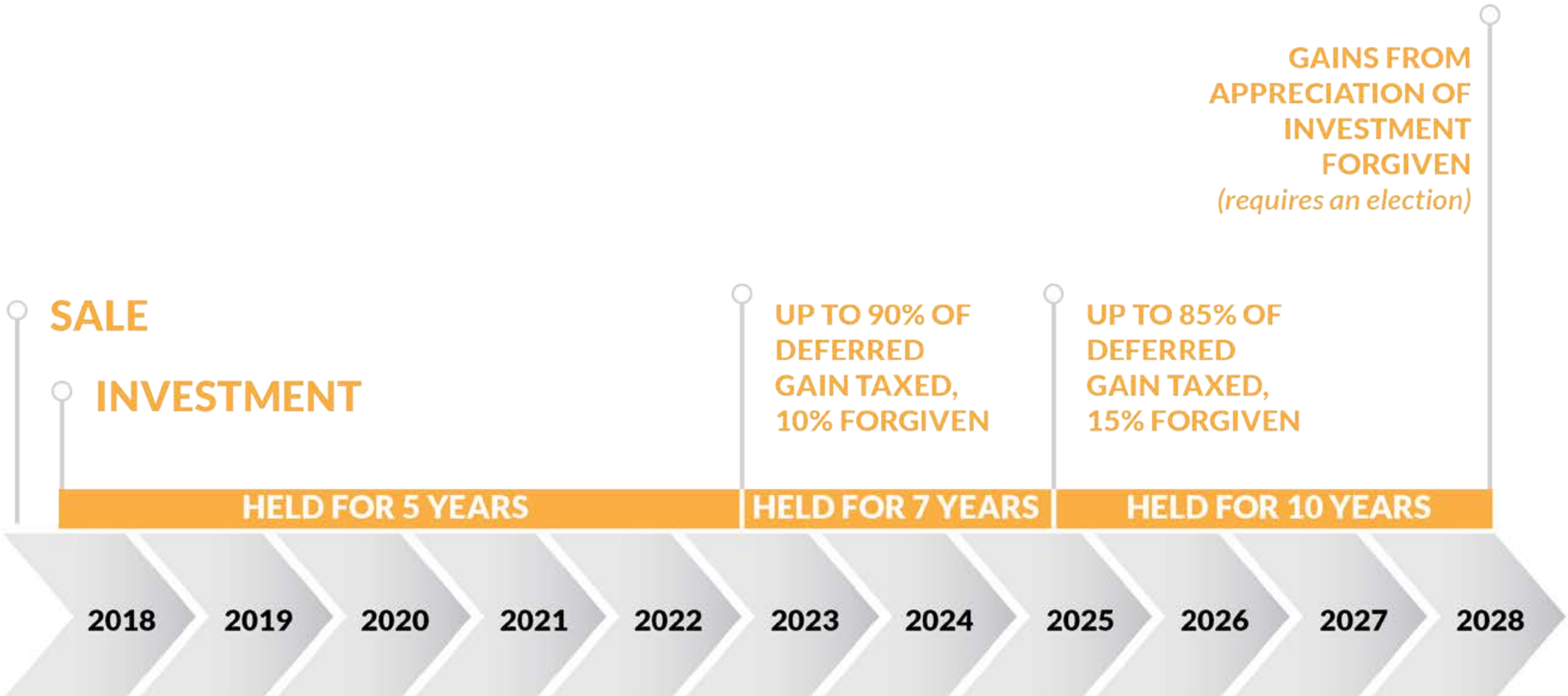
Gains Forgiveness Overview



Qualified Opportunity Fund: Purpose & Process

- An investment vehicle set up as either a partnership or corporation for investing in eligible property or businesses that are located in a Qualified Opportunity Zone. (*source: IRS)*
- Qualified Opportunity Fund must be certified:
  - Eligible taxpayers can self-certify
  - No IRS action or approval required
  - Taxpayer must complete form and attach to federal income tax return for taxable year
  - The tax return must be timely filed (extensions permitted) for self-certification to take effect

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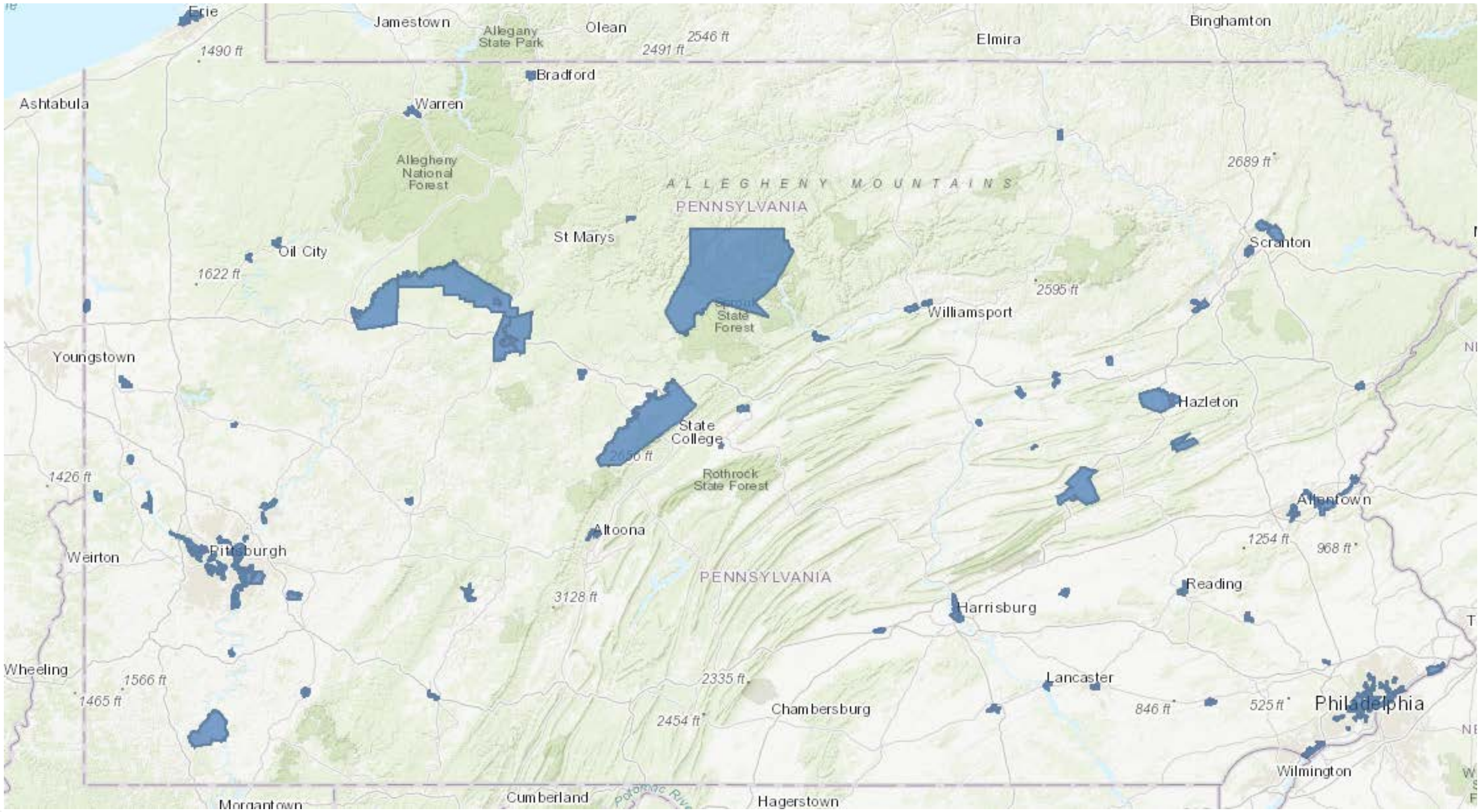
Zone Map – PA



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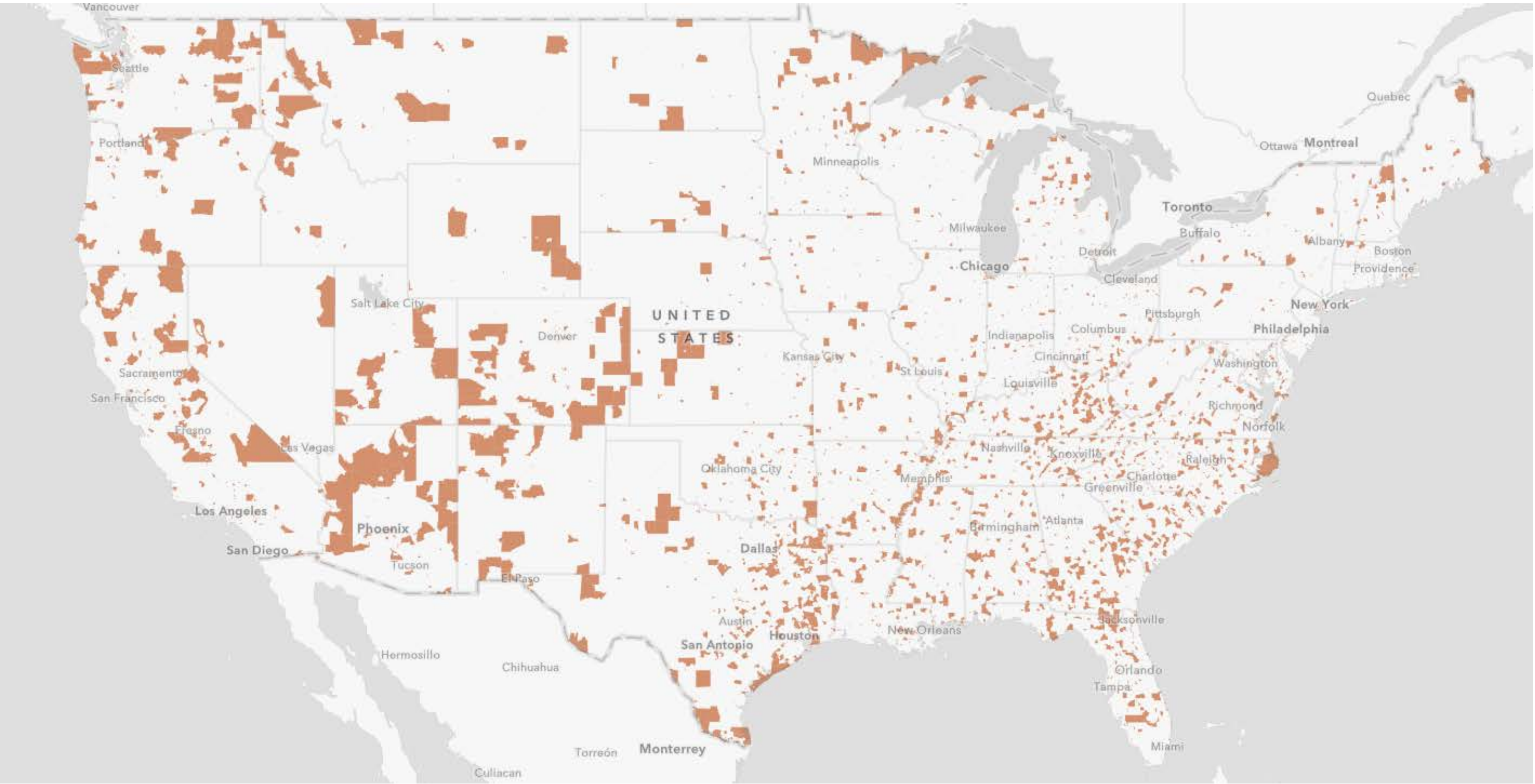
Zone map – Continental US



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