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2019 Tax Reforms: Hidden Impact And Opportunities

Speakers:
Stephen Christiano, Eric Collins & Mark Allsopp – Frank Hirth
James Guadiana & Abe Mastbaum – Barton LLP

STEPHEN CHRISTIANO, ASSOCIATE DIRECTOR

Steve joined Frank Hirth LLC in 2011 as part of the Business Tax Group dealing with various partnerships and corporations. He previously worked at Ernst & Young in the financial services department focusing on US hedge funds and private equity funds.

Steve has experience in US taxation, providing a wide range of partnership and corporation tax compliance and advisory services. Steve also has knowledge of dealing with foreign transactions mainly regarding Fixed, Determinable, Annual, Periodical (FDAP) income and Effectively Connected Income (ECI) related issues. His client portfolio consists of financial services clients, general business clients and some high net worth individual clients.

Steve is a US Enrolled Agent (EA).

ERIC COLLINS, DIRECTOR

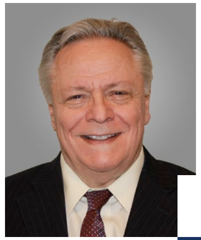
Eric oversees our New York office. His specialist area is the taxation of alternative investments, in particular private equity partnerships with UK and/or US partners, and offering withholding tax advice in the wake of the US Foreign Account Tax Compliance Act (FATCA). Eric has developed extensive knowledge of the US Federal income taxation of international transactions, helping individuals and businesses implement internationally efficient structures.

Eric joined Frank Hirth in 2012, moving to our New York office in 2014 to support our business tax team. He is a member of the Institute of Chartered Accountants in England and Wales (ACA), is a US Enrolled Agent (EA), and co-authored the International Investment Funds and Private Equity (IBFD) tax portfolio: Investment Funds and Private Equity in 2012. Eric also sits on the Tax Technical Team within Frank Hirth whose primary role is to provide technical support to the wider firm.

MARK ALLSOPP, SENIOR TAX MANAGER

Mark is a dual UK and US tax handler who advises a diverse portfolio of clients on both UK and US personal tax issues. He has considerable experience in assisting individuals relocating to the US, navigating them through both the UK and US tax systems. Mark also has vast experience of US expatriation, the IRS Streamlined Foreign and Domestic programmes and has assisted on various tax planning and consultancy projects.

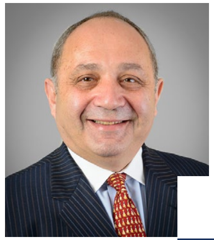
Mark originally joined Frank Hirth in 2007 as a Tax Associate, leaving to take up another position with one of the Big Four from 2011 to 2016, and then returning to Frank Hirth in August 2016. Mark is a member of the Association of Taxation Technicians (ATT) and is US Enrolled Agent (EA).



JAMES GUADIANA, PARTNER

Jim Guadiana focuses his practice on the tax aspects of domestic and international transactions and investments. He serves as advisor to public and privately-held multinational companies and investment firms with regard to their operations and investments in the United States.

Recently, Jim served as U.S. tax counsel to one of the world's largest companies in its pre-IPO reorganization and IPO, advising it on complex U.S. tax and executive compensation matters. He has served as tax advisor for U.S. real estate development projects, providing both pre- and post-formation tax planning, and structuring investment vehicles to optimize after-tax returns for foreign investors.



ABE MASTBAUM, TAX & CAPITAL MARKETS COUNSEL

Abe Mastbaum has been with Barton since 2006. His practice focuses on tax and capital markets issues, securities laws and regulatory enforcement matters. Prior to joining Barton, Abe was a partner and chief operating, financial and compliance at NYC based money manager American Securities, LP. Abe began his career as a CPA at national firm Oppenheimer, Appel, Dixon & Co where he earned his CPA license and MS in taxation before joining The First Boston Corporation as a capital markets specialist and derivatives securities structurer.

CONTENTS

INVESTING IN US REAL ESTATE POST US TAX CUTS AND JOBS ACT OF 2017

- Investing via C-Corporations:
  - US Corporation Tax Rate reduced from 35% to 21%.
  - Alternative Minimum Tax repealed.
  - Net operating losses (NOLs) limits deduction to 80% of the taxpayer’s taxable income for losses generated after December 31st, 2017. Can only carryforward NOLs and repeals two-year carryback rule.

- Investing via Partnerships:
  - Pass-through deduction 199A – adds a 20% deduction at the individual level which brings effective tax rate down to 29.6%.
  - Limits deduction amount based on W2 wages and depreciable assets for individual taxpayers exceeding certain taxable income thresholds.
  - “Operating” real estate businesses are eligible.

- Expensing via Section 179 and 168(k):
  - Expensing via Section 179 increases to $1MM and modifies the definition of qualified real property to include qualified improvement property and improvements to roofs, HVAC, fire protection, alarm and security systems.
  - Expansion of Bonus Depreciation to allow taxpayers to claim 100% bonus depreciation on qualified property; starts to phase out after 2022.

INTRODUCTION TO QUALIFIED OPPORTUNITY ZONES

- The Tax Cuts and Jobs Acts of 2017 (“TCJA”) introduced the qualified opportunity zone program under new Internal Revenue Code (IRC) Sections 1400Z-1 and 1400Z-2 to promote economic development in financially distressed areas within the U.S.

- A “qualified opportunity zone” (QOZ) is defined as a “population census tract that is a low-income community” designated by the State in which it is located.

- The Governors of the respective States designated the QOZ census tracts which were certified by the Secretary of the Treasury.

- See map https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx to determine where QOZs are located.

- There are approximately 8,700 designated QOZs in the United States.

- A state designation as a qualified opportunity zone shall remain in effect for the period beginning on the date of the designation and ending at the close of the 10th calendar year i.e. December 2028.

INTRODUCTION TO QUALIFIED OPPORTUNITY ZONES

Taxpayer generates a realized capital gain taxable in the U.S.

Taxpayer reinvests cash up to the amount of the realized capital gain into a Qualified Opportunity Fund (QOF) within 180 days of realization

1. Tax temporarily deferred on the initial capital gain invested in the QOF
2. Up to 10-15% of the initial capital gain can potentially be excluded from U.S. Federal Income Tax depending on the holding period of the QOF investment
3. Any appreciation in the QOF investment is excluded from U.S. Federal Income Tax if the QOF investment is held for at least 10 years

INTRODUCTION TO QUALIFIED OPPORTUNITY ZONES

- Step 1 – Realize capital gain subject to U.S. Federal Income Tax with an unrelated party
- Step 2 – Reinvest Capital Gain within 180 days from the date sold or exchanged into a QOF
- Three Significant U.S Tax Benefits
    1. In the year of recognition the initial capital gain*** realized is **deferred**; initial basis in QOF is $0
    2. If the QOF investment is held for 5 years, taxpayer gets a **10% step up** in basis; if for 7 years the taxpayer gets a **15% step up** in basis; this effectively **excludes** either 10% or 15% of the initial capital gain from U.S. tax dependent upon the holding period
    3. If the QOF investment is held for at least 10 years, taxpayer gets a **step up in basis to the fair market value** of the sale therefore **eliminating** any capital gain on the appreciation of the QOF investment when sold
- ***U.S. Federal Income Tax must be paid on the initial capital gain reinvested on the earlier of the date the taxpayer disposes of its QOF investment, or **December 31, 2026**
    - **To gain full benefits of the program a taxpayer that invests in a QOF in 2019 and holds its investment for at least 10 years will be able to obtain maximum deferral, obtain the 15% exclusion and receive a basis step up to FMV on the disposal of the QOF interest**

INTRODUCTION TO QUALIFIED OPPORTUNITY ZONES

On March 1st, 2019, Frank H., a Non-U.S. taxpayer, sold a long-term U.S. real estate investment which generated a $1MM capital gain. The capital gains are reportable and taxable on Frank's 2019 U.S. Non-Resident (1040NR) tax return. Frank has until August 27th, 2019 to reinvest the $1MM capital gain into a QOF. He decides to invest the full $1MM into a QOF on July 1st, 2019. He disposes of his QOF interest on July 1st, 2030 for $10MM.

- Initial Basis in QOF on July 1st, 2019 = $0; capital gain realized in 2019 = $0 (by taxpayer election)
- Basis Step Up on July 1st, 2024 = $100,000 (10%)
- Additional Basis Step up on July 1st, 2026 = $50,000 (additional 5%)
- Capital Gain Taxable on December 31, 2026 = $850,000 ($1MM-$150K) X 20% = $170,000 (assuming Federal long term capital gains rates haven't changed; add 3.8% for a US Citizen, resident, or GreenCard Holder assuming the NIIT is chargeable)
- As of December 31, 2026, Frank H has successfully avoided $30,000 of U.S. Tax due on the initial capital gain and deferred payment of the remaining $170,000 for more than six years.
- July 1st, 2030 = $9MM of additional appreciation of the QOF investment is not subject to U.S. tax as the basis is stepped up to $10MM FMV as of the date of the sale (by taxpayer election)
- As of July 1st, 2030, Frank H has successfully excluded $1.8MM of additional U.S. tax due on the appreciation of the QOF investment for a **total U.S. tax savings of $1,830,000.**

INTRODUCTION TO QUALIFIED OPPORTUNITY ZONES

- Section 1400Z-2(d)(1) - The term "qualified opportunity fund" means any investment vehicle which is organized as a U.S. corporation or a U.S. partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured—
  - (A) on the last day of the first 6-month period of the taxable year of the fund, and
  - (B) on the last day of the taxable year of the fund.
- Section 1400Z-2(d)(2) - The term "qualified opportunity zone property" (QOZP) means property which is
  - (i) qualified opportunity zone stock,
  - (ii) qualified opportunity zone partnership interest, or
  - (iii) qualified opportunity zone business property.

INTRODUCTION TO QUALIFIED OPPORTUNITY ZONES

Manager/GP

US & Non-US Investors

QOF
(Corp or Pship)

90% of Total Assets are in QOZP or operate a QOZBP directly

Qualified Opportunity Zone Property = QOZ Stock or QOZ Partnership Interest

70% of Tangible Assets is QOZBP

Two-Tier or Single-Tier Structure

Qualified Opportunity Zone Business Property

90% of Tangible Assets is QOZBP

INTRODUCTION TO SECTION 163(J) LIMITATIONS

- "Old" 163(j) – Allowed business interest as a deduction in the tax year in which the interest was paid or accrued, subject to limitation rules; i.e. related party interest, debt to equity ratio etc
    - Was only applicable to C-Corporations

- "New" 163(j) – Limits net interest expense deduction to 30% of the business's adjusted taxable income
    - All entities are subject including partnerships
    - Net interest expense is defined as the excess of business interest expense over business interest income
    - Only applies to business interest and not to investment interest
    - Through 2021 adjusted taxable income includes add backs for depreciation, amortization, interest expense, and taxes
    - Post 2021 removes add back for depreciation and amortization
    - Applies to Controlled Foreign Corporations (CFCs)

INTRODUCTION TO SECTION 163(J) LIMITATIONS

- Exceptions
    - Taxpayers with average annual gross receipts of $25MM or less for the three prior tax years
    - Real Property Trade or Businesses can elect not to be subject to the limitation
        - Election is irrevocable.
        - An electing RPTB must depreciate its nonresidential real property, residential rental property, and qualified improvement property using the alternative depreciation system (30 yr & 40 yr SL)
        - A trade or business described in Section 469(c)(7)(C) includes any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

CHANGES TO THE CONTROLLED FOREIGN CORPORATION (CFC) REGIME

- **U.S. Shareholder Definition***:* Extends Section 951(b) definition of US Shareholder to include US Persons that own 10% or more of the voting power **or** value of a foreign corporation
- **CFC Stock Attribution Rules** – Repeals Section 958(b)(4), so downward attribution may apply to treat stock owned by a foreign person as constructively owned by US Persons owned by that foreign person
- **30-day CFC Rule** – Repeals the requirement that a corporation must be a CFC for an uninterrupted period of 30 days during the tax year for Subpart F to apply
- **FMV method of interest expense apportionment** – Prohibits US-affiliated groups from apportioning interest expense on the basis of the FMV of assets thereby requiring use of adjusted tax basis of assets
- **Foreign Branch Basket** – Created under Section 904(d) for “foreign branch income” that is not included as passive category income
- Repeals Section 902 credit and amends Section 960 credit for a US Corporation that has a Subpart F inclusion as paying only the CFC’s foreign income taxes “properly attributable” to such item of income

INTRODUCTION TO INTERNATIONAL TAX REFORM

- Transition Tax (Section 965) – Imposes a one-time tax on a 10% US shareholder's pro rata share of the foreign corporation's accumulated post-1986 deferred earnings and profits at a rate of 15.5% of the foreign corporation's aggregate cash position, and 8% on the remainder
  - Effective for the last year of foreign corporations **beginning** before January 1, 2018

- Dividends Received from Foreign Corporations - US Corporations receiving foreign source dividends from its underlying foreign subsidiaries will be 100% exempt from US Corporate tax as long as the US Corporation holds a 10% or more interest in the foreign corporation that is not considered a PFIC or CFC (Section 245A)
  - Effective for distributions made after December 31, 2017

INTRODUCTION TO INTERNATIONAL TAX REFORM

- Foreign-Derived Intangible Income (FDII) – Created new Section 250 which created a category of income of a domestic corporation that is taxed at a 13.125% tax rate through 2025
  - FDII – defined as a US corporation's net income earned through US operations in connection with "export" sales, leases, licenses and services to the extent exceeding a "deemed tangible return"
  - Effective for tax years beginning after December 31st, 2017

- Base Erosion and Anti-Abuse Tax (BEAT) – Section 59A imposes a base erosion minimum tax on corporation's subject to US net income tax that have :
  - Avg annual gross receipts of at least $500MM and,
  - Have related party deductible payments totaling 3% or more of the corporation's total deductions
  - Related party includes a 25% or more owner of the taxpayer or any person related to the 25% shareholder
  - Tax Rate equals additional 5% for 2018 and 10% for 2019 and beyond

GLOBAL INTANGIBLE LOW-TAXED INCOME (GILTI)

- GILTI is a new category of income under Section 951A that is similar to Subpart F that is deemed repatriated in the year earned over a specified deemed return
- GILTI is the income of a CFC which is reduced for ECI or other Subpart F income that exceed 10% of the CFC's Qualified Business Asset Investment (QBAI)
  - QBAI – Depreciable assets that are used in a trade or business under Section 167
    - Does not include amortizable intangible assets under Section 197
- GILTI = Net Tested Income – (Net Deemed Tangible return on 10% x QBAI) – interest expense
  - Effective for tax years of a foreign corporation beginning after December 31, 2017
- Differences between how a US individual is taxed vs a US Corporation
  - US Corporation allowed a deduction equal to 50% of its GILTI inclusion (effective tax rate equals 10.5% on GILTI) and a deemed foreign tax credit up to 80% of foreign income taxes paid by the CFC
  - US Individual Shareholder not allowed the deduction or foreign tax credits available to a US Corporation (Potentially a combined global tax rate on GILTI >50% depending on local country tax rates)
    - Possible planning with a Section 962 election
    - Restructuring with a US Corporation
    - Check the Box
    - Waiting on Section 250 regulations

UK TAX UPDATE HMRC ADJUSTMENTS

- 17/18 Saw the first enaction of the Deemed Dom rules
  - UK ND & R >15/20 years and paid the Remittance basis charge
  - Time to cleanse mixed funds up in April 2019
  - Automatic rebasing of foreign assets to April 2017

- Requirement to correct tax on offshore assets (RTC)
  - HMRC ‘amnesty’ Programme. Enter to avoid potentially larger penalties in the future

- Introduced larger penalties for error/carelessness
  - Up to 200% of tax due
  - Now demand full UK fiscal year information (Reporting K-1s etc).

- Offshore letters being sent to clients
  - ‘Phishing’ by HMRC to obtain taxpayer confirmation of appropriate reporting.

UK TAX UPDATE – UK RESIDENTS/NON-RESIDENTS

- From April 2019, Entrepreneurs relief ownership period now has to be 24 months (previously 12)
- From April 2020, PPR deemed occupation period will only be 9 months, not 18 months
- From April 2020, lettings relief will only apply if the owner shared occupancy with the tenant
- UK Non-Residents, specifically-
  - Consultation paper- NR buyers of UK residential property hit with 1% SDLT
  - What is unclear- how determine residency, what if the person retains residency, how imposed?
  - Consultation in progress (12 weeks from Feb 12th).

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