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# Tax reform: Deep dive on the application to E&C

2017 Engineering and Construction Conference

# Federal Tax Reform Overview

## Evaluation of Proposed Tax Rates and Ongoing Proposals

### Corporate Tax Rate Reform

**Proposed Rate Considerations**

**35%** Current Tax Rate

**25%** Camp II Proposal

**20%** House GOP Proposal

**15%** Trump Administration Proposal

### Individual Tax Rate Reform

**Proposed Top Rate Considerations**

**39.6%** Current Tax Rate

**25%** Camp II Proposal

**33%** House GOP Proposal

**35%** Trump Administration Proposal

**Considerations that may lower tax base**

- Repeal Corporate AMT
- Full Expensing of Capital Investments
- Retain R&D Credit
- Retain LIFO

**Considerations that may increase tax base**

- Interest Expense Limitation
- Repeal Most Business Tax Expenditures (Trump Administration)
- Repeal IRC §199

# Tax Reform Outlook
## Proposals Impacting E&C

| | Trump Administration Proposal | House GOP Tax Reform Blueprint | H.R. 1 (2014 Camp Plan) | **E&C Business Considerations** |
|---|---|---|---|---|
| **Top Individual Rate** | 35% | 33% | 25% (plus 10% tax on Modified AGI) | • **Impact on Expat hypo calculations** |
| **Corporate Rate** | 15% | 20% | 25% | • **Earnings per-share**<br>• **Effective Tax Rate**<br>• **Accelerate Deductions**<br>• **Revenue Recognition**<br>• **Methods Planning** |
| **Pass-thru Rate** | 15%, but unclear to which entities and income it applies/other restrictions | 25% | Taxed at individual rates | • **Joint Ventures** |
| **AMT** | Repeal | Repeal | Repeal | |
| **Net Operating Losses** | No proposal | Eliminate NOL carryback but permit indefinite carryforward with amount increased by an interest factor. Deduction limited to 90% of taxable income. | Eliminate NOL carryback. Limit current deduction to 90% of taxable income. | • **Carryback of NOLs** |

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# Tax Reform Outlook

## Proposals Impacting E&C

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| | Trump Administration Proposal | House GOP Tax Reform Blueprint | H.R. 1 (2014 Camp Plan) | **E&C Business Considerations** |
|---|---|---|---|---|
| **Capital Cost Recovery / Depreciation** | Not addressed | Full expensing in year one of all assets, tangible and intangible, other than land | Phase in repeal of MACRS; 40-year life for residential and non-residential real property | • **Capital expenditures on heavy equipment** |
| **Interest Expense** | Not addressed | No deduction for interest expense in excess of interest income. Excess deduction carries forward indefinitely. | Modified section 163(j) and implements thin cap rules. Section 163(j) interest deduction limit for adjusted taxable income reduced from 50% to 40% | • **Financing capital expenditure**<br>• **Capital Structure** |
| **Research Credit** | Retain research credit, but repeal most other business tax expenditures | Retain credit; Ways and Means Committee will “evaluate options” to make it “more effective and efficient” | Research credit (alternative simplified credit) would be permanent | • **Continue evaluating qualified projects** |
| **Section 199 Deduction** | Repeal most business tax expenditures except for the research credit | Repeal | Repeal of IRC §199 phased out over two years (6% in year one, 3% in year two) | • **Continue evaluating qualified projects** |

# Tax Reform Outlook
## Proposals Impacting E&C

Engineering & Construction

| | Trump Administration Proposal | House GOP Tax Reform Blueprint | H.R. 1 (2014 Camp Plan) | E&C Business Considerations |
|---|---|---|---|---|
| **Border - Adjusted Tax Base** | No proposal | Tax imposed on imports, but not exports (similar concept to other countries' credit-invoice VATs) | No proposal | • **Procurement Strategy**<br>• **Evaluate cross border services, transfer pricing, and service centers** |
| **International Regime** | Territorial tax system (no further details provided by Administration) | Territorial via 100% dividend exemption with elimination of most subpart F rules. Foreign personal holding company rules retained. | U.S. corporate shareholders entitled to a 95% dividends received deduction for foreign source dividends received from 10%+ owned foreign corporation. 15% and 12% minimum worldwide effective rate on foreign base company intangible and sales income, respectively. | • **Ownership, funding model**<br>• **Control of IP**<br>• **Utilization of existing FTCs** |
| **Deemed Repatriation** | Rate not specified | Difference in rates for cash (8.75%) and noncash assets (3.5%). Amount is payable over 8 years at taxpayer's election. | Difference in rates for cash (8.75%) and noncash assets (3.5%). Payable over 8 years; no interest charge; FTCs and NOLs may offset tax. | • **Mandatory one time tax liability**<br>• **Permanently reinvested earnings assertions** |

# Rate Reduction Planning – Permanent Cash Savings

**Tax Reform Proposals Include a Reduction in Corporate Rates Between 10 – 20%**

## Accounting Method Planning Implemented Prior to Rate Reform May Result in Permanent Rate Reduction for Taxpayers

| Current Gross DTA | Cash Tax Reduction if Deduct in 2017 at 35% Rate | Cash Tax Reduction if Deduct in 2018 at 25% Rate | Permanent Benefit of Accelerating Deduction into 2017 |
|---|---|---|---|
| $100,000,000 | $35,000,000 | $25,000,000 | $10,000,000 |

Generally, a taxpayer changing its method of accounting for an item of income or expense only shifts the recognition of such items between deferred and current tax expense. The change would typically produce cash tax savings but rarely creates a permanent tax benefit.

In taxable years bordering a change in federal corporate tax rates, however, taxpayers can capitalize on a permanent tax savings opportunity by decreasing current tax expense as much as possible in years where a decrease in rates is anticipated.

**Tax Reform has provided Companies with an opportunity to use accounting method changes that may result in cash tax savings as well as permanent rate savings.**

### Federal Tax Planning Considerations

**Fixed Assets / Deductions (Non IRC §460)**

- Repair analysis
- Bonus depreciation
- Ready and available/lag
- IRC §174 costs
- IRC §179D
- Prepaid Expenditures
- Accruals and reserves review
- Prepay Bonus Pool

**Fixed Assets / Deductions (IRC §460)**

- Capitalize repair expenses
- ADS election w/ Bonus Depr.
- Ready and available/lag
- IRC §174 costs w/ §59(e) election
- IRC §179D
- Contract review
- 10% method under IRC §460(b)(5)

**Revenue Recognition**

- Unbilled revenue
- Deferred revenue
- Disputed revenue
- Defer advanced payments
- Retention
- Award Fees
- Holdbacks

**Permanent Attribute Planning**

- IRC §199 enhancement
- Lobbying reviews
- Meals and entertainment
- Tax basis reviews (federal and state)
- Federal Credits and Excise Taxes

# International

# International Tax Reform – Scope of US International Taxation

| | Current Law | Trump Administration Proposal[1] | House GOP Blueprint | Camp Bill |
|---|---|---|---|---|
| **US Co's US Sales / Service Income** | Taxable | Taxable | Taxable | Taxable |
| **US Co's Foreign Sales / Services Income** | Taxable | Exempt? | Exempt | Generally 60% Taxable |
| **Payment to non-US Taxpayer for Cost of Goods Sold (COGS)** | Deductible | Deductible? | NOT Deductible | Deductible |
| **Dividends Received** | Taxable | Exempt? | Exemption[2] | 95% DRD[3] |
| **Foreign Sub's**<br>**Foreign Base Company Sales / Services** | Taxable[4] | Exempt? | Exempt | Taxable at 50% of general tax rate[4] |
| **Foreign Sub's**<br>**Foreign Personal Holding Company Income** | Taxable[4] | Exempt? | Taxable | Taxable[4] |
| **Foreign Sub's**<br>**Other Foreign Income** | Deferral[5] | Exempt? | Exempt | Generally 60% taxable (to extent exceeds 10% of basis in tangible assets)[4] |

[1] Trump Administration proposes "territorial tax system" without further detail

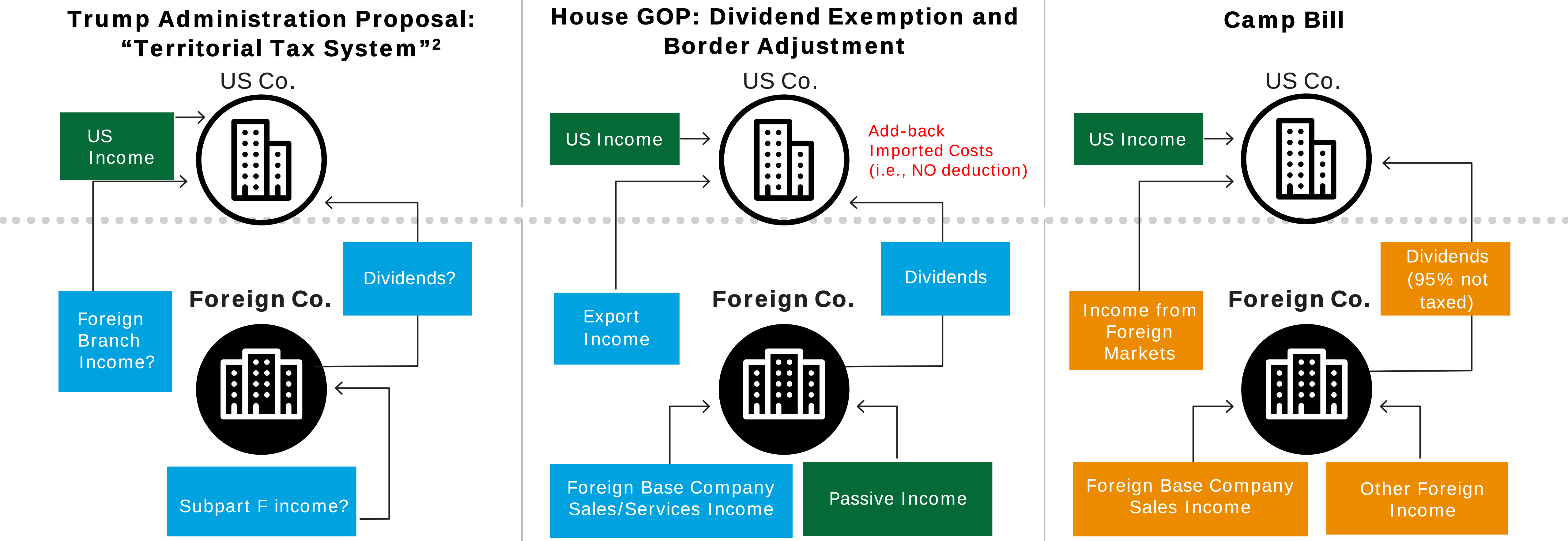
[2] Proposed 100% Participation Exemption

[3] Proposed 95% Participation Exemption for 10%-owned Subsidiaries

[4] Deemed Inclusion to US Co.

[5] Subject to US Tax upon Future Distribution to US Co

# International Tax Reform – Scope of US International Taxation




- Included in US Co's Taxable Income
- Income NOT (or potentially not) subject to US Tax
- Partly taxed, partly not taxed

NOTE 1: Trump Administration, House GOP and Camp plans all propose a one-time Transition Tax on previously deferred earnings of Controlled Foreign Corporations. Rates vary from 10% (President Trump) and split rates under House GOP and Camp (3.5% and 8.75%)

NOTE 2: The mechanics of the Trump Administrations territorial tax regime are currently unknown and therefore additional information is needed to determine the extent to which certain income is subject to United States taxation.

# Multistate Considerations

# Multistate Tax Considerations

## General Corporate Reform Provisions

- Corporate background and profile
  - Impact of federal tax reform will vary by industry, geography and type of tax
- Decrease in federal income tax rate
  - State impact of federal accounting method changes
    - For example, a federal accounting method change may impact the Texas Margin Tax (e.g., the repair regulations)
- State tax attribute analysis (NOLs and credits, release of valuation allowances/tax accounting impact, etc.)
  - Overlooked state tax attributes in prior years may become valuable with onset of accounting method changes, repatriation and federal/state tax reform differences
- Review of territorial impact/BEPS/385 implications, if applicable
  - Filing methodologies and elections
  - Understand what planning steps have been taken to address BEPS and 385 concerns and how tax reform will impact those plans
  - State tax impact may remain despite federal changes to interest deduction (e.g., Massachusetts)
- Full expensing of business investment
  - State Conformity
    - Reasonable expectation that state conformity to federal tax reform will vary widely, potentially increasing federal and state tax differences
    - Technology solutions may be necessary/recommended to more accurately and efficiently track variances
  - State Credits and Incentives opportunities
- Elimination of deductions/credits and state interest expense
  - State conformity

# Multistate Tax Considerations

## Repatriation Provisions

**Federal Tax Policy of deemed repatriation intended to lead to actual repatriation of foreign accrued profits**
(and reinvestment in the U.S. economy)

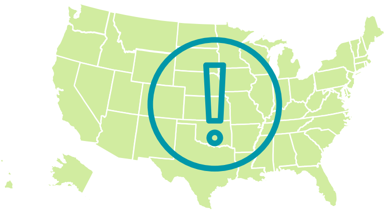
**Characterization of Income at the Federal Level – Repatriation**

- Evaluate unitary groups and differences between federal and state filing groups (e.g., which entity considered to receive deemed repatriated funds)
- Deemed Dividend
  - Dividend, Line 1 gross receipts, miscellaneous, etc…?
  - State DRD, apportionable vs. allocable, distortion?
- Recipient of income at the federal level
  - Impact and considerations for states with different filing groups
  - Potential intercompany elimination for deemed distribution (e.g., WW filings, tax havens, 80/20 companies)

**Actual Repatriation**

- Evaluate most efficient method to repatriate

# Examples of the “urgency” to act now for State taxes



## Immediate Considerations for State Tax Analysis

1. The resolution of state tax audits resulting in payments, may yield a permanent tax rate benefit
   - ✓ Negotiating a resolution can be a time consuming process
2. The analysis and resolution of client’s uncertain tax positions (e.g., proactive filing in states with economic nexus, VDAs, market sourcing, etc.) may yield a permanent tax rate benefit
3. Reporting of federal RAR changes to states where a liability may result

## Other Benefits

1. Expiring statutes of limitations in various states may limit the ability to utilize additional state attributes such as net operating losses, credits/incentives
2. Analyzing the state tax effect of federal changes may provide a company more time to initiate changes to mitigate an unfavorable impact
3. If tax reform allows for the repatriation of funds from overseas under beneficial terms, investment of those funds in certain states could bring potential tax benefits from states’ economic development agencies; given the potential magnitude of funds to be repatriated, companies should proactively explore potential credits and incentives packages so that they are prepared to take necessary action steps in the event of repatriation of funds

# Global Mobility

# Considerations for Global Mobility and Human Resources

**Trump administration and GOP key policy objectives:**

- Reducing both corporate and individual tax rates
- Creating jobs in the US
- US (and global) cross-border policy reform
- Repealing and replacing the Affordable Care Act (ACA)

## Key considerations and planning

### Costs of international assignments

- Changes to individual income tax rates will result in changes to the company costs incurred in relation to tax equalized assignments
- US hypothetical taxes may decrease
- Tax reimbursement costs could increase or decrease depending on the mix of assignees inbound and outbound to the US, and also to high or low-tax countries

### Talent

- Changes in the ability to move employees between countries may require companies to reassess their talent strategy as it relates to talent acquisition, mobility, global footprint, and overall employer brand.
- These changes may include cross-border entry constraints related to immigration and also new taxes/tariffs.
- International travel may become increasingly difficult or costly for business travelers.

### Business travel

- Decrease in corporate tax rates may incentivize companies to identify non-US sourced income to effectively utilize foreign tax credits
- Employers may be able to increase the amount of non-US income by better monitoring where revenue-producing employees work

### Accelerated corporate tax deductions

- Employee benefit plans may present several considerations for accelerating deductions, for example:
- Accelerating the accrual of bonus payments
- Pre-funding of qualified retirement plans
- Pre-funding Voluntary Employees Beneficiary Association Plans (VEBAs)

### Deferral of income by individuals

- Anticipation of lower individual tax rates may motivate employees to defer income to future tax years
- Deferral of income by employees may also delay corporate tax deductions related to that income

### Equity compensation

- ***Share-based income tax accounting.*** Changes to corporate tax rates will magnify issues presented by recent share-based payments guidance (ASU 2016-09)
- ***Tax withholding.*** Rules regarding withholding taxes from share-based awards through net share settling have been relaxed; companies using a sell-to-cover approach may want to revisit the potential impact on EPS and cash flow
- ***Recharge strategy.*** Tax reform may allow for greater tax-free repatriation of cash, allowing companies to revisit whether to repatriate only upon transfer of stock

### Affordable Care Act

- Although efforts to repeal and replace ACA are currently taking place within Congress, ACA remains the law of the land, including the employer mandate that requires employers to offer healthcare coverage to 95% of full-time employees
- Identifying full-time employees based on the tax law and regulations can be complex and employers could face a significant liability if the 95% requirement is not satisfied
- Information reporting requirements (i.e., Forms 1095-B, 1095-C) remain in-place and some aspect of reporting may also be required under new proposals

# Summary and Q&A

# Proactively navigate the journey and better prepare for upcoming tax reform

**Assess baseline situation**
- Initiate dialogue with key executives on change imperative
- Develop a strong understanding of planned initiatives that may be impacted
- Establish baseline state and key applicable considerations

**Validate assumptions**
- Validate key assumptions with stakeholders
- Refine the model and pressure test the assumptions / outputs generated
- Prepare a deliverable outlining the initial design of a readiness plan for consideration

**Define scenarios and associated impact**
- Set up a dynamic model with the key inputs identified
- Model multiple scenarios and quantify impact
- Identify potential corporate rate reduction and E&P/FTC considerations

**Implement action plan**
- Proactively implement changes to align with tax and business strategy
- Manage change throughout the organization

A prepared organization ready to use Tax reform to their advantage

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