Tax Changes Likely to Fuel More M&A

M&A multiples are at an all-time high thanks to the low-interest rate environment that we have been enjoying. As long as banks continue to lend, deals will continue to happen. Wall Street and most of Main Street have embraced the tax changes as favorable. Individuals living in high tax states are dreading the $10,000 limit on state, and local tax deductions and many are considering a move. States are pushing back and trying to create incentives for their residents not to move. The most creative approach was set forth by California to try and make the state income tax payment a charitable deduction. The IRS is likely to frown upon such legislation and find ways to disallow the deduction.

The heart of the tax cuts was centered on dropping the maximum federal corporate income tax rate from 35 to a flat 21 percent. In addition, many pass-through businesses which are not professional service businesses will now enjoy a 29.6 percent maximum federal income tax rate. Those in a professional service business earning high income are stuck with a 37 percent maximum federal income tax rate and are limited on their state and local tax deductions.

Businesses that acquired new or used tangible assets after September 27, 2017, will enjoy 100 percent bonus depreciation benefits in the year of purchase. This change will impact future purchase price negotiations between buyers and sellers and will impact buyer side gross-up payments.

To pay for these tax incentives, U.S. taxpayers who own more than 10 percent of a foreign corporation are required to pay a federal tax on offshore earnings as of December 31, 2017. This tax is payable over eight years and is at a reduced rate of 15.5 percent on accumulated earnings and profits held in cash equivalents and 8 percent on remaining foreign earnings and profits. This should incentivize U.S. owners to repatriate cash into the U.S. and fuel more U.S. investment. Other changes in the international tax arena include a minimum tax on low taxed foreign profits. Additionally, in situations where partnerships that operate a U.S. business have foreign owners, there is now a mandatory withholding on the foreign partner's gain in a sale transaction.

As of the date of this article, California has not adopted any of these tax changes, and it is likely that most of the changes will not be adopted. These changes coupled with the favorable tax rules afforded to qualified small businesses under IRC Section 1202 are a big incentive for business owners to re-evaluate their entity structures to make sure they are taking advantage of available tax benefits.

No, Mr. Trump, we will not be able to fit the tax information for most of our clients on a postcard.

Andy Torosyan, Tax Partner

Andy has over 20 years of experience providing strategic tax advice to clients on transactional and tax compliance services across numerous industry sectors including manufacturing, distribution, online-retail, commerce and software, real estate, and investment funds. As the leader of HCVT's Mergers & Acquisitions Tax practice, Andy addresses the tax structuring and reporting issues associated with complex transactions. He focuses on the analysis of the tax efficiencies of proposed deal structures and conducts comprehensive tax due diligence. Andy's M & A experience includes both buy-side and sell-side strategic advisory services. Contact Andy at 626-243-5125 or andyt@hcvt.com. Learn more about HCVT at *www.hcvt.com.*

Tax Cuts and Jobs Act

Significant Changes to Estate & Gift Taxes

President Donald Trump signed the Tax Cuts and Jobs Act (TCJA) into law in late December 2017 bringing many changes in both the income tax and estate/gift tax areas.

Estate/Gift Tax

The TCJA increased the lifetime estate, gift and generation skipping transfer tax exemption to estimated to be $11,180,000 for 2018 per person (an increase from the originally announced amount of $5,600,000 under prior law). The exemption will be adjusted for inflation through 2025 and will return to the inflation-adjusted amount under prior law effective January 1, 2026, without further legislation.

This increase provides an opportunity for additional planning over the next eight years to effectively transfer your wealth to the beneficiaries of your choice. Here are a few planning ideas that could be considered:

- Outright gifts to children and/or grandchildren directly or via trusts.
- Sales to defective grantor trusts.
- Use of grantor retained annuity trusts (GRATs).

We also recommend that current estate planning documents be reviewed as there may be unintended consequences as a result of the new legislation and increased exemption amounts due to formula clauses.

While not part of the TCJA legislation, another important item to note is the increase in the annual gift exclusion amount to $15,000 per recipient for 2018. This allows for gifts of present interests up to $15,000 before gift tax applies. Payments for medical and educational expenses that are paid directly to the medical provider for services or educational institution for tuition are not subject to gift tax and is unlimited.

Income Tax

The TCJA did bring some good news with the drop in the tax rates that apply to fiduciary income tax returns. The TCJA also brought changes to deductions for income tax purposes. Here are a few items that may have the biggest impact on your income taxes:

- State income and property taxes on property owned by the fiduciary can be deducted up to $10,000 (under previous law, deductions were unlimited).
- Qualified business deduction – 20% deduction for business income from pass-through entities, including S corporations, partnerships/LLCs (publicly traded partnerships are included), rental real estate and Schedule C activity. This deduction is subject to exclusions and phase-outs so additional analysis should be done with your tax preparer (previous law did not provide for this deduction).
- Certain other expenses such as investment management fees will be disallowed starting in 2018. Upon further clarification, additional expenses could also be disallowed.
- Depending on the trust document, the income taxable to the beneficiaries may be affected based on the changes to the allowable deductions under TCJA.

Stacy Yamanishi, Tax Partner

Stacy is a tax partner and is a member of HCVT's Trust and Estate Tax practice. Stacy focuses on providing tax consultation to help her clients' achieve their estate planning, gifting and charitable giving goals. She specializes in estate tax compliance and sub-trust allocations. Stacy has extensive experience working multi-generational trust ownership and planning. Stacy works with high net worth individuals and their related entities, partnerships, and trusts. She has experience working with closely-held businesses which result in her ability to address the needs of the business and business owner in an integrated manner to help her clients' achieve tax savings. Contact Stacy at 562-216-1812 or stacy.yamanishi@hcvt.com. Learn more about HCVT at *www.hcvt.com.*

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