



plante moran | Audit. Tax. Consulting.  
Wealth Management.

# The Tax Cuts and Jobs Act and *Wayfair*: Their impacts on private equity

January 23, 2020



# Today's presenters



**Brett Bissonnette**

Senior Manager, National Tax Office  
brett.bissonnette@plantemoran.com



**Tony Israels**

Senior Manager, State & Local Tax  
tony.israels@plantemoran.com



**Jeremy Sikkema**

Senior Manager, Tax Transaction  
Advisory Services  
jeremy.sikkema@plantemoran.com



**Nevra Kreger**

Partner, Private Equity  
nevra.kreger@plantemoran.com



# Administration

## Have questions?



- Feel free to submit them at any time in the Q&A feature at the bottom of the GoToWebinar tool bar.



- Today's webinar will be recorded and added to Plante Moran's website in a few days for on-demand viewing.



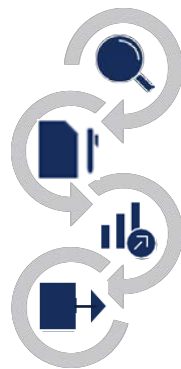
- This presentation will be emailed to all registrants a few days following the webinar.



# Plante Moran's private equity practice

Founded in 1924, Plante Moran is among the nation's largest certified public accounting and business advisory firms. With more than 3,100 professionals in 25 offices, we provide a wide range of services to over 20,000 clients. We have multiple affiliated entities that provide value-added services to our clients, including our investment bank, P&M Corporate Finance (PMCF).

Our private equity practice delivers financial, tax, strategy, operations, and technology expertise throughout the private equity life cycle.



**Assess** — *Strategically evaluate targets*

**Close** — *Efficiently close transactions*

**Grow** — *Define priorities and create value*

**Exit** — *Minimize surprises and reduce risk*

**525+**  
private equity  
clients

**1,000+**  
portfolio  
company clients

**380+**  
private equity  
industry experts

**350+**  
deals annually



# Overview of today's discussion

- Economic nexus: State and local tax
- *Wayfair's* impact on other tax types
- Legislation recap
- Bonus depreciation
- Business interest expense limitation
- Carried interest
- Qualified business income deductions
- Opportunity zones
- Entity choice



# Economic nexus: State and local tax



## Polling question 1:

Do you believe that your portfolio companies have properly addressed economic nexus and *Wayfair*?

- Yes.
- No, but we're currently evaluating.
- No, but we know that we have exposure.
- No, we haven't started our analysis.



# Recent developments: Economic nexus

*South Dakota v. Wayfair, Inc.*, U.S. S.Ct., Dkt. No 17-494 (decided June 21, 2018)

- South Dakota statute at issue provided:
  - A remote seller has nexus if its annual in-state gross revenue exceeds \$100,000, or if the seller has 200 or more separate transactions into the state in the preceding or current calendar year.
  - Physical presence is not required
  - Injunction upon filing of declaratory judgment
  - No retroactivity (applies to sales made on or after May 1, 2016)
  - Expeditious hearing — straight to SD Supreme Court





# Recent developments: Economic nexus

## U.S. Supreme Court decision

- On June 21, 2018, the Court ruled in a 5-4 decision in favor of South Dakota.
- Court comments favorably on the fact that South Dakota's law:
  - Provides a safe harbor threshold, so small businesses are protected.
  - Is not retroactive.
  - Provides simplification through Streamlined Sales Tax Agreement.
  - Single, state-level tax.
  - Uniform definitions of products and services.
- The nexus arguments used to be about what constitutes physical presence.
- Going forward, the arguments will be over what constitutes "substantial nexus."



# Recent developments: Economic nexus

## Impact

- All but two states with a statewide sales tax (Florida and Missouri) have enacted economic nexus provisions as of Oct. 1, 2019.
- 25 states adopted South Dakota's thresholds
  - \$100,000 in sales **OR** 200 transactions
  - Many dropping the transaction threshold

Arkansas	Connecticut	Hawaii	Illinois	Indiana
Kentucky	Maine	Maryland	Michigan	Minnesota
Nebraska	Nevada	New Jersey	North Carolina	Ohio
Rhode Island	South Dakota	Utah	Vermont	Virginia
Washington	Washington D.C.	West Virginia	Wisconsin	Wyoming



# Recent developments: Economic nexus

## Impact

- 8 states have higher sales thresholds
  - \$200,000 — Arizona (to lower to \$150,000 for 2020 and \$100,000 for 2021 and thereafter)
  - \$250,000 in sales — Alabama, Georgia, Mississippi
  - Georgia to lower to 100,000 on Jan. 1, 2020.
  - \$500,000 in sales — California, Massachusetts, New York, Tennessee, Texas
  - California DOR tried to implement threshold of \$100,000. Compared to population, this would be the equivalent of South Dakota's threshold being \$2,250.
  - Massachusetts dropping threshold to \$100,000 on Oct. 1, 2019.
  - New York has lower transaction threshold of 100
  - 16 states have no transaction threshold (only sales)
  - 3 states (Connecticut, Massachusetts, and New York) have an “and” requirement.
    - Transaction **and** sales threshold must both be met for a filing requirement.

Alabama	Arizona	California	Colorado
Idaho	Iowa	Kansas	Massachusetts*
Mississippi	New Mexico	North Dakota	Oklahoma
Pennsylvania	South Carolina	Tennessee	Texas

\*As of 10/1/2019



# Recent developments: Economic nexus

## Challenges

- Periods to measure thresholds may differ
- Most say “current or preceding calendar year”
- Others:
  - Preceding 12 months: (Connecticut, Massachusetts, Michigan, Minnesota, Mississippi, Tennessee, Vermont, Washington D.C.)
  - Previous calendar year: (New Mexico, Rhode Island)
  - Current calendar year: (Oklahoma, Washington)
  - Measure past 12 months on July 1, begin collecting on October 1: (Texas)
  - Determined on a quarterly basis for previous 12 months: (Illinois)
  - Some simply say “Annual Sales” (Alabama, Virginia)
- Different starting dates to collect tax
  - Arizona, Kansas, Tennessee, and Texas begin Oct. 1, 2019
  - All other state enforcement dates have passed
- Still have different statutory construction
  - Most states are gross revenue
  - Tennessee — sales for resale don’t count towards threshold, but other exempt sales do count



# Recent developments: Economic nexus

## Considerations

- Nexus can still be created by:
  - In-state employees
  - In-state property
  - Sporadic employee visits
  - Independent contractors in the state acting on taxpayer's behalf
  - Attending trade shows
  - Making deliveries in company vehicles
  - Click-through nexus
- State taxes on interstate commerce will be sustained if they apply to an activity with “substantial nexus” with the state.



# Recent developments: Economic nexus

## Changes (Already?!)

- Many states have already enacted changes after a knee-jerk reaction to imposing economic nexus:
  - California
    - DOR originally issued guidance for \$100,000 threshold. Legislature increased it to \$500,000 on April 30, 2019 — one month after the provision went into effect.
  - Georgia
    - Original thresholds of \$250,000 to be lowered to \$100,000 Jan. 1, 2020
  - Massachusetts
    - On Oct. 1, 2019, the State is changing threshold from \$500,000 AND 100 transactions to \$100,000 (dropping transaction threshold)
  - New York
    - Originally had a threshold of \$300,000 raised to \$500,000 on June 28, 2019
  - Colorado, North Dakota
    - Dropped transaction threshold
  - Oklahoma, Pennsylvania
    - Originally had threshold of only \$10,000, but raised it to \$100,000 (OK as of Nov. 1, 2019)



# Recent developments: Economic nexus

## Extreme examples

- Kansas (Notice 19-04)
  - “Kansas imposes its sales and use tax collection requirements to the fullest extent permitted by law.”
  - Kansas DOR announced it is imposing economic nexus effective Oct. 1, 2019, with no sales or transaction threshold.
  - One sale, no matter how big, into the state creates a filing requirement.
- New York
  - New York is taking the position it had economic nexus in its laws since 1989 and *Wayfair* simply made it enforceable.
  - Therefore as soon as *Wayfair* was decided, its law was enforceable.
  - New York hasn’t imposed this retroactively (no state has attempted retroactivity), but its claim leaves the door open.



# Recent developments: Economic nexus

## Extreme examples (cont.)

- New Hampshire
  - New Hampshire doesn't impose a sales tax, but it passed legislation saying none of its in-state businesses are subject to out-of-state remote seller sales tax.
  - Contrast this to Kansas, who says all out-of-state sellers with one sale into the state have to collect and file sales tax.
  - Legal battles sure to follow





# Recent developments: Economic nexus

## More guidance needed regarding:

- Timing of registration and collection
- What's a "transaction"
- Clarity on scope of sales to which the threshold is applied
- Sales to the government and other exempt entities



# *Wayfair's* impact on other tax types



# Recent developments – Economic nexus

## What about cities?

- Alaska
  - The State doesn't collect sales tax but certain municipalities do. Recently, Nome passed an ordinance imposing sales tax on remote sellers with \$100,000 in sales and 100 transactions.
  - Other cities expressed an interest in doing the same, but only if there was uniformity and a central filing system.
- Colorado
  - Home-rule jurisdictions impose, administer, collect, and audit their own sales tax.
  - No response to *Wayfair*, yet
- Louisiana
  - Jefferson Parish in a legal fight with Walmart.com over marketplace facilitator collection.



# Impact on other taxes

## What we can expect

- States will likely challenge nexus requirements for other taxes
  - Income taxes
    - CA, CO, CT, MI, NYS and TN have had thresholds based on property, payroll and/or sales sourced to their state.
    - PL 87-272 still applies to protect clients from paying tax based on net income.
    - PL 86-272 doesn't apply to minimum taxes (e.g., CA) or to other types of taxes
  - Net worth tax
    - TN has thresholds based on property, payroll, and sales.
  - Gross receipts tax
    - OH, TN, and WA have thresholds based on property, payroll, and/or sales.
    - OR has recently passed legislation imposing a gross receipts tax.
    - Expect other states may follow suite to by-pass PL 86-272.



# Impact on other taxes

## Movement already

- Hawaii
  - Proposed applying its economic nexus standard of \$100,000 for sales tax to income tax.
- Texas
  - Proposing applying its economic nexus standard of \$500,000 for sales tax applies to franchise tax.
- Washington
  - Announced as of Jan. 1, 2020, it's nexus standard of \$100,000 for sales tax now applies to all business and occupation (gross receipts) tax.



## Life after *Wayfair*

- Changed rules for sales tax
- Need nexus study to review any potential historic issues
- Analyze sales by state and compare to each state's statutes
- Monitor state bulletins and communications on *Wayfair's* impact according to them
- How to comply with new rules and filings:
  - Consider what needs to be done to collect and remit going forward
  - New software
  - Third party or internal person



# Legislation recap



# Legislation recap

- TCJA
  - Enacted Dec. 22, 2017
  - Many provisions expire on Dec. 31, 2025 (we're almost 25% there!)
- Technical corrections to TCJA — necessary but unlikely
  - Qualified improvement property
  - New NOL carryforward and carryback modifications effective date
- Guidance
  - Regulations: Proposed and final
  - Revenue Procedures
  - Revenue Rulings
  - Notices
  - Forms and instructions
  - Future — court cases following audits





# Bonus depreciation



# Background

- Bonus depreciation extended and increased to 100% for qualified property placed in service (PIS) before Jan. 1, 2023
  - Percentage reduced by 20% each year PIS until Dec. 31, 2026
- Qualified property
  - MACRS property with a recovery period of 20 years or less
  - Certain computer software
- Excluded property
  - Required to be depreciated under the alternative depreciation system
  - Qualified improvement property (QIP) PIS after Dec. 31, 2017



# Background (cont.)

- Qualified property: Use
  - Original use began with taxpayer
  - Previously used by party other than taxpayer or predecessor if meets requirements:
    - Taxpayer hasn't acquired property from related person within meaning of Section 267 or 707(b)
    - Member of controlled group hasn't acquired property from another member of same controlled group



# Section 179

## TCJA changes to IRC Section 179

- The TCJA increased the maximum amount a taxpayer could expense under Section 179 from \$500,000 to \$1M. The phaseout threshold amount increased from \$2 to \$2.5M.
- Amounts are indexed for inflation beginning after 2018.



# Eligible dates & percentages: Post-TCJA

If placed in service on or after:	And before:	Pre-TCJA applicable bonus percentage:	Post-TCJA applicable bonus percentage:
09/27/2017	01/01/2018	50%	100%
01/01/2018	01/01/2019	40%	100%
01/01/2019	01/01/2020	30%	100%
01/01/2020	01/01/2021		100%
01/01/2021	01/01/2022		100%
01/01/2022	01/01/2023		100%
01/01/2023	01/01/2024		80%
01/01/2024	01/01/2025		60%
01/01/2025	01/01/2026		40%
01/01/2026	01/01/2027		20%



# Business interest expense limitation: Sec. 163(j)



## Polling question 2:

Have you noticed any of your companies having interest expense limited?

- Yes, we are fine with it
- Yes, we are looking for alternative funding structures
- No, we don't have any interest expense
- No, we have enough taxable income



# Basics of limitation and calculation

## Business interest expense deductions are limited to:

- Business interest income
- Plus, 30% of adjusted taxable income (ATI)
- Plus, floor plan financing interest

## Adjusted taxable income is equal to taxable income:

- + Net operating losses (NOLs), qualified business income deduction, and capital loss carryovers/carrybacks
- + Business interest expense (except floor plan financing)
- – Business interest income
- + SG&A Depreciation, amortization, and depletion deductions (no longer added back after 2021)
- +/- Nonbusiness income, gain, deduction, or loss
- +/- “Other adjustments as provided by the Secretary”





# Partnerships

- Limitation calculated at the partnership level
  - Excess business interest expense and excess taxable income allocated to partners on Schedule K-1s
- Excess business interest expense reduces the partners' bases in their partnership interest
- Burden of record maintenance and complex schedule K-1 reporting



# Multitiered entities

- Limitation can apply at each layer up a chain — must apply all tests at each level.
- Elections out of 163(j) can only be made if the entity directly operates an excepted trade or business.
- Complex interest tracing rules can apply if business interest exists in holding companies.



# How to handle self-charged interest?

- Neither the statute nor proposed regulations include a rule
- Treasury “intends” to issue some type of a rule
- Preamble to proposed regulations suggest potential solution:
  - “ ... the IRS intend to adopt certain rules to re-characterize ... the business interest expense ... arising from a self-charged lending transaction that may be allocable to the owner, to prevent such business interest ... expense from entering or affecting the section 163(j) limitation calculations for both the lender and the borrower ... ”



# Transaction planning

- Excess business interest expense is now a tax attribute limited by Section 382 limitation post-acquisition of C and S corporations
- Freeing up ordinary deductions through asset sale



# When are regulations coming?

- Was expected in “late summer/early fall” but not issued by Jan. 1, 2020
- Issues we’re waiting for:
  - “Depreciation” and COGS
  - Self-charged interest
  - Tiered



# Carried interest



# Holding periods/gain treatment for applicable partnership interest (API) and specified assets

	Specified assets held less than or equal to 3 years	Specified assets held greater than 3 years
API held less than or equal to 3 years	Gain attributable to specified assets and/or sale of API is short-term capital gain	Gain attributable to specified assets and/or sale of API is short-term capital gain
API held greater than 3 years	Gain attributable to specified assets is short-term capital gain  Gain on sale of API is long-term capital gain	Gain attributable to specified assets and/or sale of API is long-term capital gain



# Planning opportunities

- Asset sales to create 1231 gain
- Which asset to look at?
- Carry waivers
- Distribution of stock/interests to carry holder
- Rolling acquisitions
- Additional contributions





# Qualified business income deductions (QBID)



# Basics

- Generally, a deduction for individuals and trusts of up to 20% of ordinary income from a qualified U.S. business.
- QBI excludes:
  - Income not effectively connected with a U.S. trade/business.
  - Wage income, guaranteed payments, capital gains, and dividends (except REIT dividends).
- Deduction is subject to several limitations
  - Wage limitation
  - Asset limitation
  - Phaseout for specified service businesses
  - Net taxable income limitation

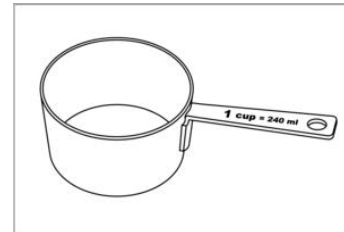


# Remember the QBID “recipe”

Like every good meal, the maximized QBID deduction results from a proper mixing of the ingredients.

- The perfect QBID “recipe” can be used as shorthand when a detailed calculation is not prepared:

5 parts - income *and either*  
2 parts - wages *or*  
1 part - wages *and*  
20 parts - UBIA



- This applies to the determination at the trade or business level, only, and assumes that overall taxable income is more than \$321,400 in 2019; otherwise, income is the only factor.

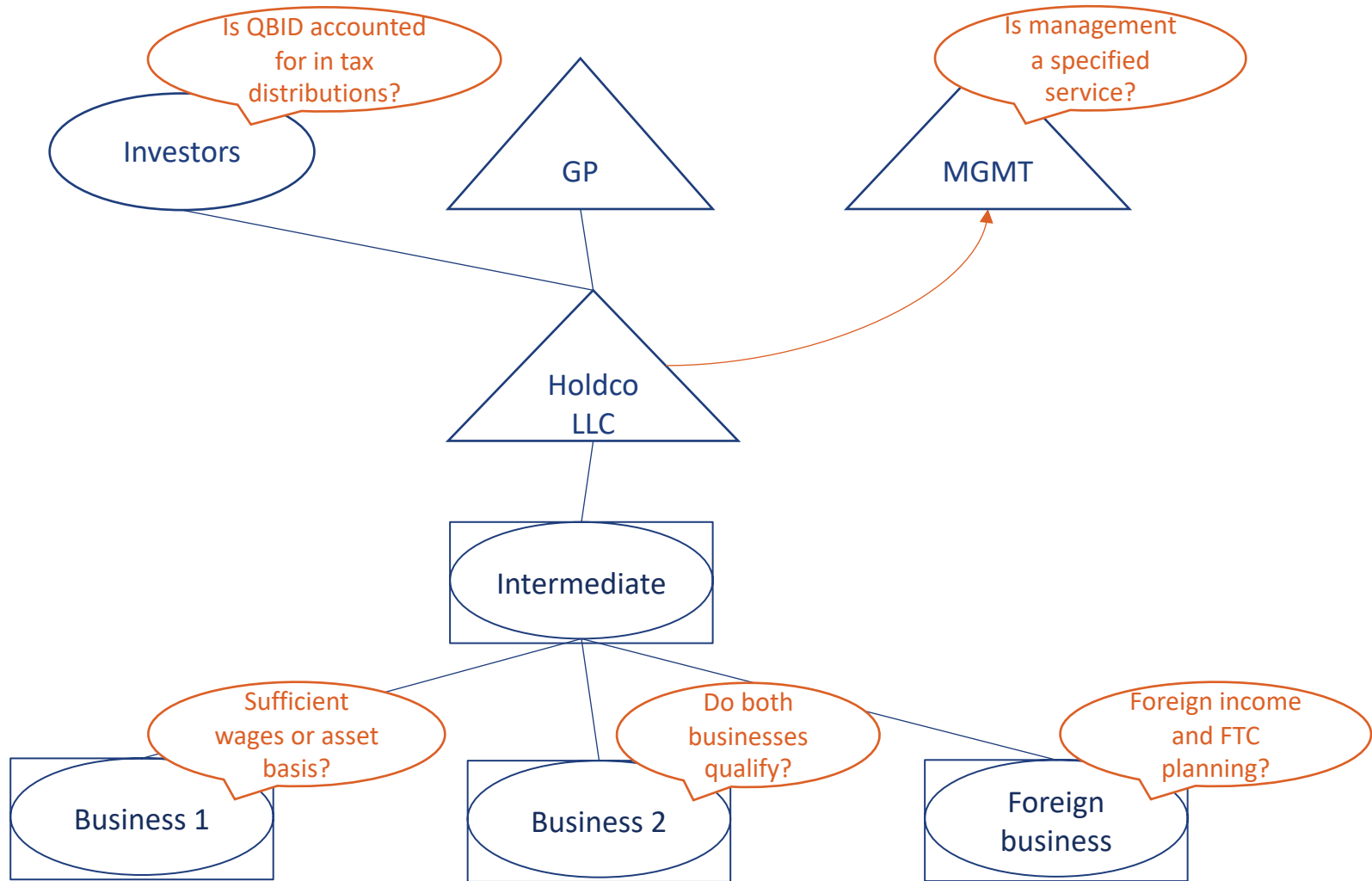


# Specified services

- Performance of services in the fields of:
  - Health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services
- Performance of services that consist of:
  - Investing and investment management
  - Trading or dealing in securities
  - Partnership interests
  - Commodities
- Any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees



# Maximizing the deduction





# What it means to you

- PE fund
  - Provides an investment management services
  - Excluded from definition of QBI
- QBI from tiered entities
  - Underlying investments in partnerships
  - Pass-through income from a qualified trade or business
  - Fund's share of the underlying investment's QBI will be passed through to your investors
- Increased complexity for tax filings
  - Information reporting will be required on all pass-through business returns
  - Additional time and expense should be expected
  - Pass-through K-1s may be delayed in multitiered structures



# Opportunity zones



## Polling question 3:

Are you planning to use an opportunity zone to defer gain on a recent sale?

- Yes
- Maybe, I am looking for an investment
- No
- Unsure, but I would like to see if I can qualify



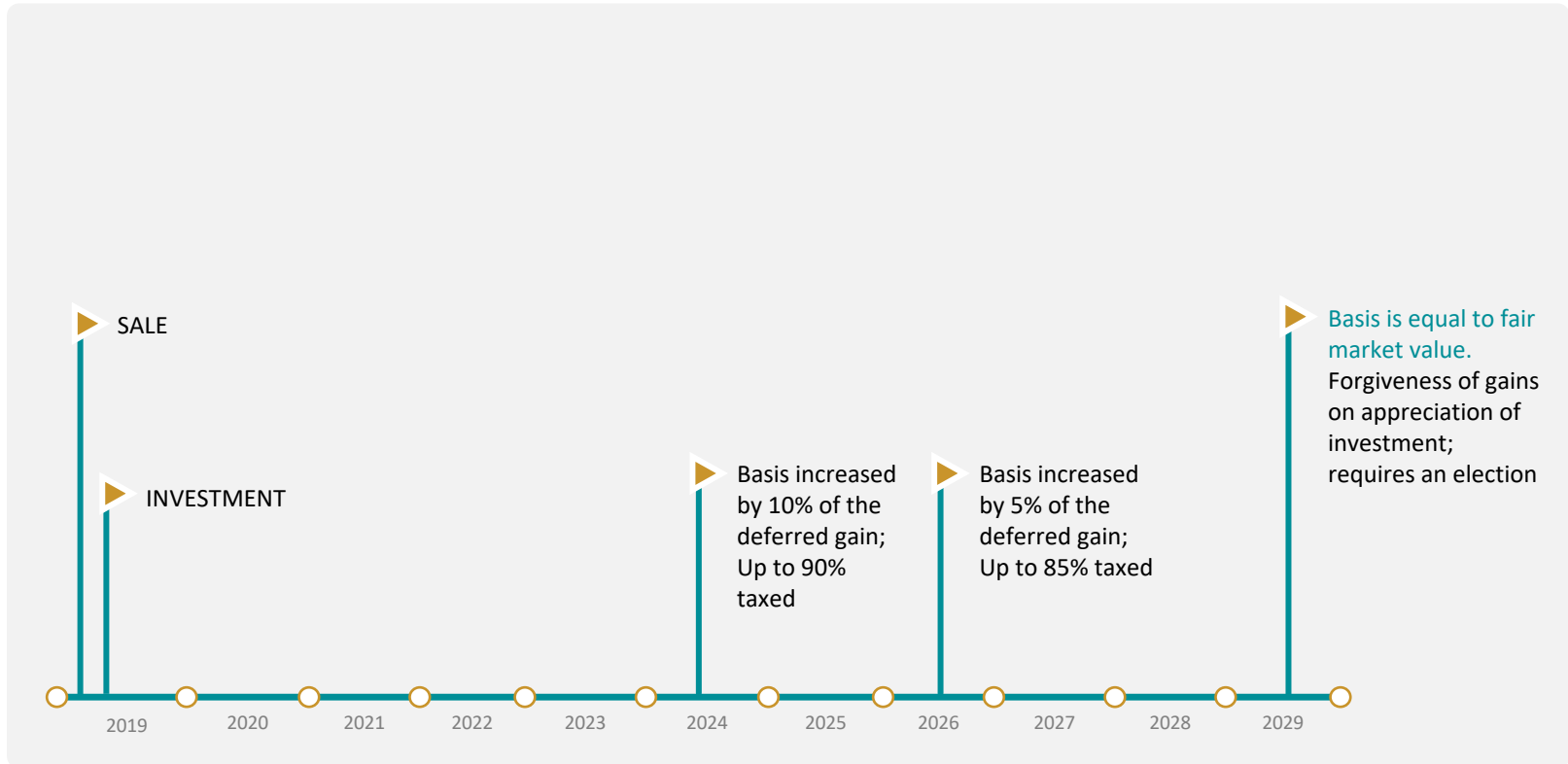


# Opportunity zones

- New community development investment vehicle: qualified opportunity fund
  - Program to incentivize investment in selected low-income census tracts/geographic areas
- Investor benefits:
  - Temporary deferral of invested capital gains
  - Potential 10-15% exclusion on original gain
  - Permanent exclusion on sale of fund investment held for 10+ years

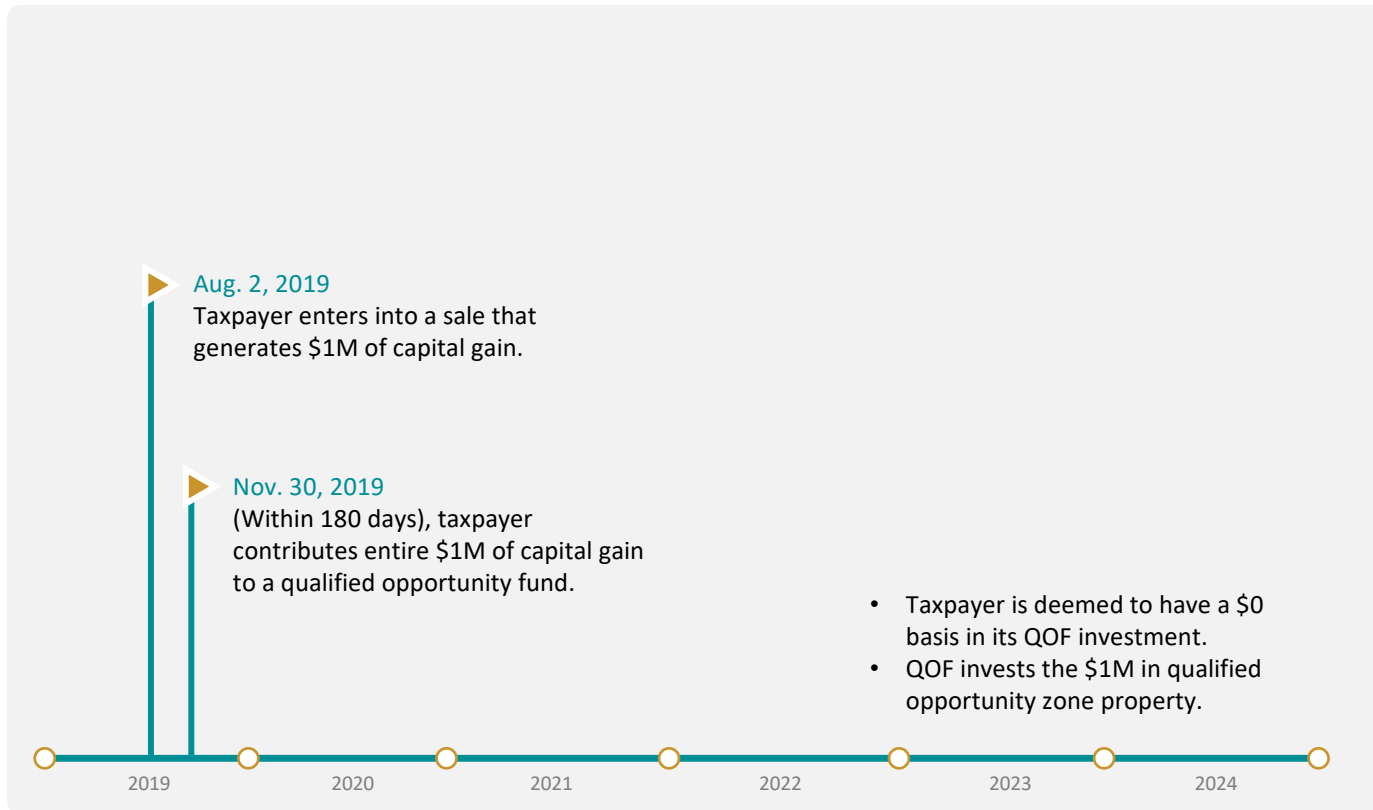


# How it works: Tax deferral and tax exemption



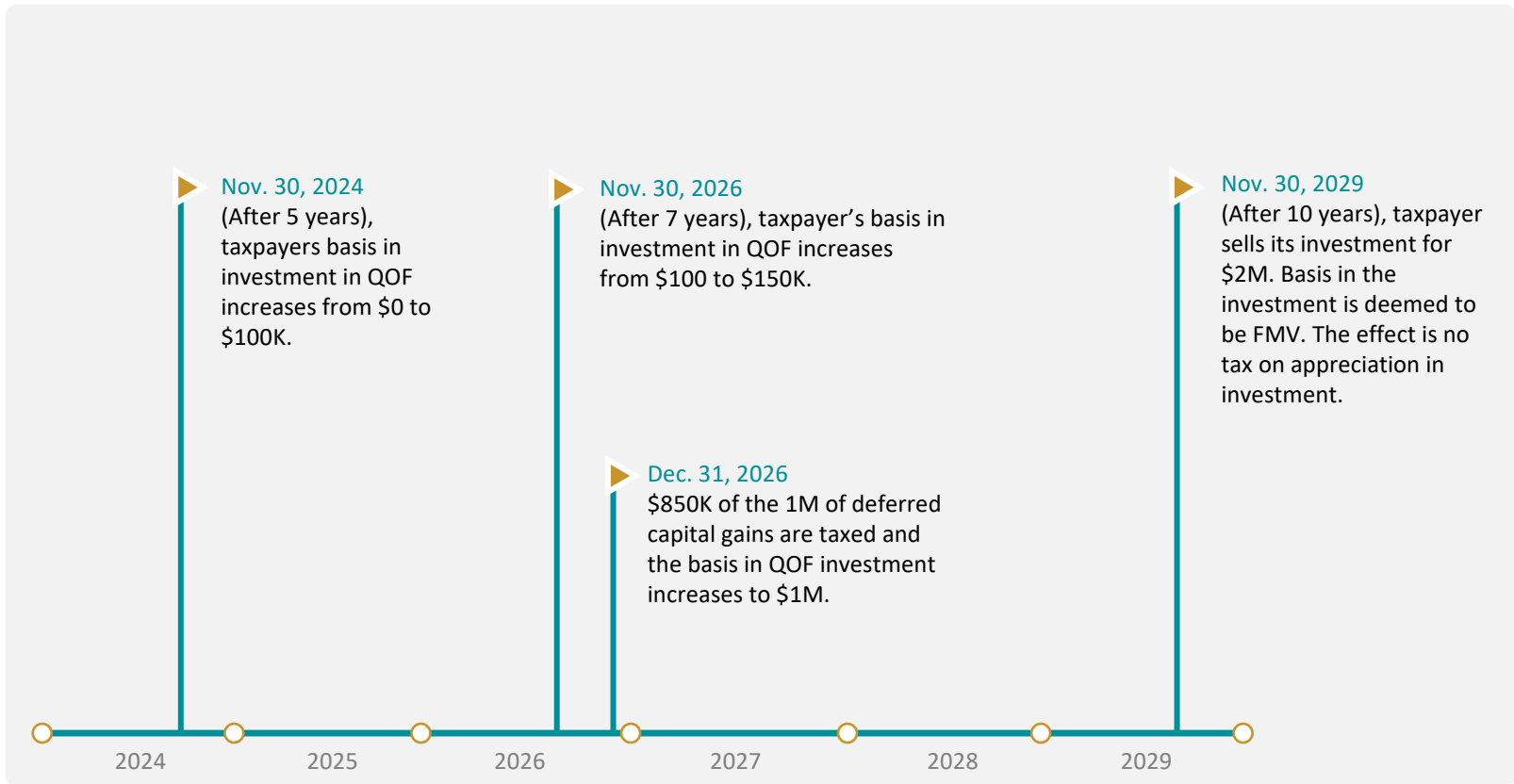


# Sample QOF investment





# Sample QOF investment (cont.)





# Entity choice



# Entity choice

Entity type	C corp – earnings distributed	Partnership/ S corp – no QBID	Partnership/ S corp – full QBID
<u>(Effective tax rates (assuming the highest marginal rates))</u>			
Current tax rate	21.0%	37.0%	29.6%
Tax on distributions	23.8%	0.0%	0.0%
Effective tax rate: Combined	39.8%	37.0%	29.6%
Effective tax rate: Combined —prior law	50.5%	39.6%	39.6%

## Specific changes driving entity choice analyses:

- Changes in effective tax rates
- New limitations on deductions
- International tax considerations
- State and local tax obligations
- Sale/transaction considerations (form and timing)



# Entity choice

- Passthroughs are still usually more tax-efficient when exit transactions are taken into account.
  - Potential benefits from QBID and generally lower exit cost
  - Present value of lower current tax cost in C corporations doesn't usually make up for exit cost
  - C corporations have planning considerations — lower current tax cost if excess business interest expense position, allow for state tax deductions, and do not include complicated K-1 reporting
- New proposed Section 382 regulations likely lower utilization of NOLs and other carryover attributes
- Planning for Section 1202 stock



# Presenters



## Brett Bissonnette, Senior Manager, National Tax Office

Brett has practiced law and public accounting for over 20 years. He primarily uses his past experience in litigation and accounting to provide tax consultation services to Plante Moran's clients. Brett plays an extensive role in connection with various practice areas related to private equity, including due diligence, transaction structuring and reporting, transaction cost analysis, and tax controversy.



## Tony Israels, Senior Manager, State & Local Tax

Tony is a senior manager in Plante Moran's state and local tax practice. He specializes in providing clients with multistate tax consulting services, including implementation of solutions to minimize sales and use taxes, income and franchise taxes, and property taxes. Tony is the SALT lead member in the firm's tax due diligence team. He works with all types of businesses, including large multistate and multinational clients, C corporations, S corporations, and LLCs.



## Jeremy Sikkema, Senior Manager, Tax Transaction Advisory Services

Jeremy is a senior tax manager and leader of Plante Moran's tax transaction advisory services group. He has more than nine years of public accounting experience, specializing in federal and state tax compliance and tax due diligence. He also has considerable experience with state and local taxes and transaction structuring. Many of Jeremy's clients are portfolio companies of private equity groups that are active in mergers and acquisitions.





### Nevra Kreger, Partner, Private Equity

Nevra serves middle-market private equity-owned organizations throughout the life cycle of the platform company's investment. She creates value for her clients by going beyond compliance to provide tangible recommendations that improve their business and minimize risk. Her expertise includes due diligence, opening balance sheet valuation, purchase price allocation matters, stock options, and other equity-based compensation. She specializes in professional and business services firms, but also serves Michigan K-12 clients and performs employee benefit plan audits.



# Q&A



# Thank you for attending!



**Brett Bissonnette**

Senior manager, National Tax Office  
brett.bissonnette@plantemoran.com



**Tony Israels**

Senior manager, State & Local Tax  
tony.israels@plantemoran.com



**Jeremy Sikkema**

Senior manager, Tax Transaction Advisory Services  
jeremy.sikkema@plantemoran.com



**Nevra Kreger**

Partner, Private Equity  
nevra.kreger@plantemoran.com