HARDWOOD FEDERATION

1111 Nineteenth Street, NW, Suite 800, Washington, D.C. 20036
Phone: 202-463-2452 • Fax: 202-463-4702
www.hardwoodfederation.com

Hardwood Federation Update

By Dana Lee Cole
Hardwood Federation Executive Director

Tax Reform…It Did Happen! In the waning days of 2017, the **Tax Cuts and Jobs Act** - legislation comprehensively revising the Internal Revenue Code - passed Congress and was signed by the President. The 600 page bill addresses a wide range of disparate issues. Below, we have attempted to describe the relevant provisions, and their potential effect, on our sector.

A word of caution—Because each company will be impacted in different ways, based on your unique circumstances, Hardwood Federation (HF) strongly urges you to consult with your tax planners and accountants as this new law moves into the implementation phase.

- **S Corporations and Pass Throughs**: The Tax Cuts and Jobs Act creates a 20 percent deduction for the non-wage portion of pass-through income, coupled with a lowering of the top individual rate to 37 percent. This blended approach creates an effective tax rate for these entities of 29.6 percent. While this rate is higher than what was promised when leadership and the Administration offered their tax reform blue print back in September, it is certainly an improvement over the current treatment of these tax structures. **One caveat**—service industries are not eligible for the deduction, but that restriction should not affect our hardwood manufacturing facilities.

  The 20 percent deduction is limited to the greater of 50 percent of a business' W-2 wages, or 25 percent of a business' W-2 wages, plus 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property held in the qualified business for taxpayers with income over $315,000 (married) or $157,500 (individuals). The limitation is phased in over the next $100,000 (married) of taxable income and $50,000(individuals).

- **Estate Tax**: The final bill maintains the estate, gift, and generation-skipping transfer taxes (currently at a 40-percent tax rate). For estates of decedents dying and gifts made after 2017, the new law doubles the exemption for all three taxes from $5,600,000 to $11,200,000 per person. The gift and estate tax exemptions would remain unified, so any use of the gift tax exemption during one's lifetime would decrease the estate tax exemption available at death.

- **Net Operating Losses (NOLs)**: Current law generally permits a taxpayer to carry back an NOL two years and carry forward an NOL 20 years to offset taxable income. Effective for losses generated in tax years following 2017, the new law limits a taxpayer's ability to utilize its NOL deduction to 80 percent of taxable income (determined without regard to the deduction). Additionally, carrybacks of all NOLs arising in tax years after 2017 are eliminated and instead would permit all NOLs in this category to be carried forward indefinitely.

- **Expensing/cost recovery**: The new law allows for 100 percent (up from 50 percent in existing law) expensing for investments in new and used property made after Sept. 27, 2017 and before January 1, 2023. A five-year phase down of full expensing begins in 2023.

- **<u>Sec. 179 Expensing Limits:</u>** This benefit was made more robust by increasing the limit to $1 million, with a phase-out beginning at $20 million in total qualified property placed in service. The provision is expanded to include property used to furnish lodging, and improvements to nonresidential real property including roofs, heating, ventilation and air-conditioning property, fire protection and alarm systems, and security systems.

- **<u>Business Interest Expense:</u>** This <u>new</u> provision targets interest payments which companies have been able to deduct from taxation. Under the new law, the amount of interest expense companies can deduct from their taxes is limited to 30 percent of EBITDA, or earnings before interest, taxes, depreciation and amortization. This runs through 2021, after which the basis will be EBIT, or earnings before interest and taxes. EBIT is a more restrictive test and will likely increase taxes for companies with considerable depreciation or amortization.

- **<u>State and Local Property Tax Deductions</u>**: The new law allows individual taxpayers to deduct for tax years beginning after 2017 up to $10,000 for any combination of state and local income taxes, property taxes, and sales taxes.

- **<u>Corporate Tax Rate</u>:** The final agreement settled on a 21 percent tax rate for C Corporations, a notch higher than the 20 percent rate in both the House and Senate-passed versions. The corporate alternative minimum tax, or AMT, is also repealed. Inclusion of AMT, at a 20 percent rate in the Senate version, threatened to undermine any benefits of a newly lowered 20 percent rate for C Corporations.

Also notable …
Existing tax incentives for standing timber, and reimbursement for reforestation costs, were left alone by tax writers. Forest landowners were concerned that these incentives would be targeted to pay for comprehensive tax reform. This was an area that HF covered during our Fly-In, and we are pleased that Congress recognized the benefits of these incentives to maintain the viability of our nation's working forests

All of the renewable energy tax credits that made it into the House tax reform bill were stripped out in conference. Leadership has vowed to pursue a follow-up package of so-called "tax extenders" to address these credits. One of the proposals in the mix is the <u>Biomass Thermal Utilization or BTU Act</u>, which would provide an investment tax credit for installing residential and commercial biomass heating units that run on chips or pellets. The Hardwood Federation has been advocating for this proposal as a means of addressing our residuals issues.

Going forward …
In terms of follow-up legislative action to address the inevitable anomalies that will arise, given the speed with which this bill was fashioned, we were originally thinking that a so-called “technical corrections” bill or bills would be pursued this year. However, in talking with House and Senate staff, it appears that partisanship may preclude any technical corrections measures from proceeding through Congress.

This leaves the IRS in an interesting spot, where it will have to be creative in interpreting many of the new law’s provisions without more specific direction from Congress. Again, it will be important to consult your accounting professionals regarding how the tax bill provisions impact <u>you</u> and <u>your</u> company, specifically.

As always, we will be providing updates as the ‘nitty gritty’ of implementing the **Tax Cuts and Jobs Act** begins.