“[W]ithout taxes, there would be no government; without government, there would be anarchy; and in anarchy, there would be no income.” –Martin A. Chirelstein & Lawrence A. Zelenak

I. Topics
   A. Tax Treatment of EMBA Tuition
   B. An Executive’s Tax Companion: An Overview of the Corporate Tax Forest for the C-Suite Crowd
   C. Possible Tax Reform on the Horizon
   D. Base Erosion and Profit Shifting (BEPS)/Tax Havens (if time)

II. Tax Treatment of EMBA Tuition
   A. General rules for education as business expenses:
      1. The cost of education is deductible as a business expense if the education:
         a) Is required by law (or your employer) to maintain employment, or
         b) Maintains or improves current job skills

      2. The cost of education is not deductible as a business expense if the education:
         a) Is necessary to meet minimum job requirements, or
         b) Qualifies taxpayer for new trade or business
            (i) Hard to determine
               (a) Kopaigora v. Comm’r (EMBA did not qualify taxpayer for a new trade or business; EMBA expenses deductible)
               (b) Creigh v. Comm’r (EMBA did qualify taxpayer for a new trade or business; EMBA expenses nondeductible)
B. Unreimbursed allowable costs for *employees* are deductible as miscellaneous itemized deductions
   1. Taxpayer must itemize
   2. Only expenses in excess of 2% of Adjusted Gross Income (AGI) are deductible
   3. Warning on Alternative Minimum Tax
   4. *Deduction would be eliminated in the current tax reform bill*

C. Allowable costs for a self-employed person are fully deductible on Sch. C (Income from Sole-Proprietorships)

D. A Note on Employer Reimbursed Expenses
   1. If the education expenses qualify as business expenses, the reimbursement is excluded from the employee’s income as a working condition fringe benefit
   2. If the education expenses do NOT qualify as business expenses, the employee may still exclude up to $5,250 (per year) of reimbursed expenses from a qualified employer reimbursement plan
      a) *Exclusion would be eliminated in the current tax reform bill*

E. Nonbusiness education benefits: Complex and changing—see IRS Publication 970, *Tax Benefits for Education* on the IRS website (irs.gov)
F. Examples:

1. Waylon Smithers is an executive at Springfield Nuclear Power Plant (SNPP). To enhance his skills, and get more respect from his boss, SNPP CEO Mr. Burns, Smithers enrolls in the Executive MBA program at Springfield University. He pays, out of his own pocket, the $30,000 in tuition, fees, and books. He has AGI of $100,000.

2. Same as #1, except that Smithers is a self-employed management consultant and enrolls in the EMBA program to sharpen his skills and sell more business.

3. Same as #1 except that SNPP reimburses Smithers for the $30,000 in educational costs.

4. Homer Simpson is a low level employee at SNPP. He would like to get promoted to “safety inspector” but federal law requires safety inspectors to have completed certain courses in nuclear physics. Homer enrolls in certain physics courses at Springfield University to increase his chances of promotion. He pays $12,250 in tuition. His AGI is $60,000.

5. Same as #4, except that SNPP reimburses Homer $5,250 of his tuition costs.

6. Same #4, except that SNPP reimburses Homer the full $12,250 of his tuition costs. Homer is in the 15% tax bracket.
III. An Executive’s Tax Companion: An Overview of the Corporate Tax Forest for the C-Suite Crowd

“The devil is in the details (as is Santa Claus)”—Richard Pomp

A. Opening Scenarios:
   1. Mundane issues at the “start-up” company: The case of the derelict ski-lift attendants

   2. The established business adapts to new realities: Aggressive tax planning meets overeager marketing plans

B. The Tax Function’s Tax Compliance Role
   1. U.S.
   2. State and local
      a) Income
      b) Sales/Use
      c) Property
   3. Foreign (see below)
   4. Audits by taxing authorities across all jurisdictions
      a) Large corps in the U.S. are under constant audit
      b) General statute of limitation is 3 years
         (i) But this is extended during audits
         (ii) A corporation might have “open years” going back 10-15 years!
C. Overview of U.S. Taxation of International Income

1. U.S. corporations are taxed in the U.S. on their worldwide income (residence based taxation)
   a) To avoid “double taxation,” U.S. corporations doing business overseas get a credit against their U.S. income tax = the lesser of:
      (i) Foreign income taxes paid on the foreign-source income or
      (ii) U.S. taxes paid on the foreign-source income
   (a) Called a “direct” foreign tax credit

2. But: most U.S. corporations conduct business overseas via foreign subsidiaries
   a) Foreign subs generally only pay U.S. tax on their U.S. source income (likely to be zero)
   b) Most income earned overseas by the foreign subs is not taxed in the U.S. until paid as dividends to the U.S. parent (certain exceptions apply) —called REPATRIATION
      (i) Allows corporations to time the receipt of dividends and the payment of U.S. tax
      (ii) Results in deferral of U.S. tax on foreign-source income
      (iii) When the foreign sub pays the dividend to the U.S. parent, any foreign taxes paid over the years on the earnings associated with the dividends become creditable in the U.S.
   (a) Called the “indirect” foreign tax credit
   (b) Multinational corps keep detailed records of foreign sub earnings and foreign taxes paid
(c) Since most foreign tax rates are lower than the U.S. rate, a significant U.S. tax liability can occur when earnings are repatriated.

D. Tax Planning

1. Classic Tax Planning
   a) Defer Income/Accelerate Deductions
   b) E.g., take advantage of Bonus Depreciation, Accelerated Depreciation, etc.
   c) Affects the timing rather than amount of tax paid
   d) Important because of effect on cash flow
   e) Temporary differences between book and taxable income do not affect reported GAAP tax expense
      (i) E.g.: the use of accelerated depreciation defers tax (and improves cash flow on a present-value basis)
         (a) Current tax expense is reduced, but
         (b) Deferred tax expense is increased by an equal amount
            (i) Reflects that fact that the favorable book/tax difference will eventually reverse

2. Effective Tax Rate Planning
   a) “Permanent” Reductions in Tax
   b) Important because of effect on cash flow AND reported GAAP earnings
c) Note: aggressive tax planning will not result in a reduction in GAAP tax expense re: GAAP (FIN 48) demands that no tax benefit can be recorded on the books unless there is a “more likely than not” chance of the position being sustained

d) “Permanent” differences between book and tax expense affect reported GAAP tax expense
   (i) E.g., earning tax-exempt income
   (ii) E.g., earnings of foreign subs that are taxed at a rate less than 35% reduce GAAP tax expense (and increase bottom line earnings) if indefinitely reinvested overseas
      (a) Problem: Upon repatriation, U.S. tax becomes due AND GAAP tax expense must be increased to accrue that tax
         (i) The tax cost in cash and the GAAP hit to earnings combine to effectively LOCK THE FUNDS OUTSIDE OF THE U.S.
         (ii) Over $2.6 trillion may be “parked” overseas because of this issue

e) Effective tax rate planning can have a powerful effect on GAAP earnings
   (i) Every additional dollar a company earns in revenue or saves in expenses only drops 65 cents to the bottom line
   (ii) Every additional dollar of GAAP-reported tax expense drops a full dollar to the bottom line
      (a) Some companies rely on the tax function to “make the numbers”
f) Example #1: In 2016, XYZ Corp has
   (i) Pre-tax book earnings of $50 million
       (a) $20 million from the U.S.
       (b) $30 million from foreign subs
           (i) $4.5 million in foreign taxes
               has been paid on this income
   (ii) No permanent differences except for its foreign income

   (iii) Income tax expense on the GAAP financial statements =

   (iv) Effective tax rate =
g) Example #2: In 2016, XYZ Corp has
   (i) Pre-tax book earnings of $50 million
       (a) $30 million from the U.S.
       (b) $20 million from foreignsubs
           (i) $3 million in foreign taxes has been paid on this income
   (ii) No permanent differences except for its foreign income

   (iii) Income tax expense on the GAAP financial statements =

   (iv) Effective tax rate =
h) Example #3:

(i) As of 12/31/16, XYZ Corp has $100 million in foreign subsidiary earnings indefinitely invested overseas
   (a) $15 million of foreign taxes have been paid in this income
   (b) This means the company has $85 million of cash overseas

(ii) In 2017, XYZ has a cash flow problem and needs to repatriate all of these earnings—so the foreign subs pay dividends to the U.S. parent of $85 million

(iii) In 2017, XYZ has $22 million of pre-tax book income (all U.S.)

(iv) U.S. tax on the repatriated $85 million:
   (a) The amount reported as dividend income = 

(v) Total 2017 GAAP Tax Expense

(vi) Effective Tax Rate
i) From United Technologies, Inc. 2016 Annual Report:

Income Statement (Partial)

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Sales:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product sales</td>
<td>$40,735</td>
<td>$39,801</td>
<td>$41,545</td>
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<tr>
<td>Service sales</td>
<td>16,509</td>
<td>16,287</td>
<td>16,355</td>
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<tr>
<td><strong>Total</strong></td>
<td>57,244</td>
<td>56,088</td>
<td>57,900</td>
</tr>
<tr>
<td><strong>Costs and Expenses:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of products sold</td>
<td>30,325</td>
<td>29,771</td>
<td>30,367</td>
</tr>
<tr>
<td>Cost of services sold</td>
<td>11,135</td>
<td>10,660</td>
<td>10,531</td>
</tr>
<tr>
<td>Research and development</td>
<td>2,337</td>
<td>2,279</td>
<td>2,475</td>
</tr>
<tr>
<td>Selling, general and administrative</td>
<td>6,060</td>
<td>5,886</td>
<td>6,172</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>49,857</td>
<td>48,596</td>
<td>49,545</td>
</tr>
<tr>
<td>Other income (expense), net</td>
<td>785</td>
<td>(211)</td>
<td>1,238</td>
</tr>
<tr>
<td>Operating profit</td>
<td>8,172</td>
<td>7,291</td>
<td>9,593</td>
</tr>
<tr>
<td>Interest expense, net</td>
<td>1,039</td>
<td>824</td>
<td>881</td>
</tr>
<tr>
<td>Income from continuing operations before income taxes</td>
<td>7,133</td>
<td>6,467</td>
<td>8,712</td>
</tr>
<tr>
<td><strong>Income tax expense</strong></td>
<td>1,697</td>
<td>2,111</td>
<td>2,244</td>
</tr>
<tr>
<td><strong>Net income from continuing operations</strong></td>
<td>5,436</td>
<td>4,356</td>
<td>6,468</td>
</tr>
</tbody>
</table>

Excerpts from the Tax Footnote Disclosure:

Reconciliation of Effective Income Tax Rate. Differences between effective income tax rates and the statutory U.S. federal income tax rate are as follows:

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statutory U.S. federal income tax rate</td>
<td>35.0%</td>
<td>35.0%</td>
<td>35.0%</td>
</tr>
<tr>
<td>Tax on international activities</td>
<td>(8.1)%</td>
<td>(2.0)%</td>
<td>(3.3)%</td>
</tr>
<tr>
<td>Tax audit settlements</td>
<td>(2.9)%</td>
<td>—</td>
<td>(4.3)%</td>
</tr>
<tr>
<td>Other</td>
<td>(0.2)%</td>
<td>(0.4)%</td>
<td>(1.6)%</td>
</tr>
<tr>
<td><strong>Effective income tax rate</strong></td>
<td>23.8%</td>
<td>32.6%</td>
<td>25.8%</td>
</tr>
</tbody>
</table>

With few exceptions, U.S. income taxes have not been provided on undistributed earnings of UTC’s international subsidiaries. These earnings relate to ongoing operations and were approximately $31 billion as of December 31, 2016. It is not practicable to estimate the amount of tax that might be payable. We intend to reinvest these earnings permanently outside the U.S. or to repatriate the earnings only when it is tax effective to do so.
E. C-Suite Concerns & Advice

1. Get informed about the tax risks the company faces
   a) The IRS is viewing tax risk management as a C-suite and board-level corporate governance task
   b) Have the tax department brief you on the risks and their approach to tax planning

2. Appreciate the need for the treasury function to work with the tax function in managing cash flow

3. Understand that the mix of earnings (U.S. vs. foreign; high-tax foreign vs. low-tax foreign) will impact GAAP tax expense and the bottom line

4. Be proactive:
   a) Give the tax function a seat at the table as deals are being negotiated; business decisions are made
      (i) Tax concerns should not drive strategy, but the tax function can better manage the tax risk of strategies before implementation
   b) Give the tax function a seat at the table in internal matters (e.g., systems upgrades)
      (i) Tax requires data at a more granular level than other corporate functions
IV. Possible Tax Reform on the Horizon

“[T]he tax code is like daytime television—almost anything done to it would improve it.” —George F. Will

A. No major tax reform since 1986

B. House Ways and Means Committee Chair Brady released the 429-page “Tax Cuts and Jobs Act of 2017” on Nov. 2, 2017 [The bill is being “marked-up” the week of Nov. 6]

1. The Senate Finance Committee is expected to unveil its tax reform bill in the next few days

“Of course the truth is that the congresspersons are too busy raising campaign money to read the laws they pass. The laws are written by staff tax nerds who can put pretty much any wording they want in there. I bet that if you actually read the entire vastness of the U.S. Tax Code, you'd find at least one sex scene ("'Yes, yes, YES!' moaned Vanessa as Lance, his taut body moist with moisture, again and again depreciated her adjusted gross rate of annualized fiscal debenture").” —Dave Barry

C. Some highlights (a sampler)

1. Individual rate brackets would change

<table>
<thead>
<tr>
<th>Current Brackets</th>
<th>Current Rates</th>
<th>Tax Cuts and Jobs Act</th>
<th>Tax Cuts and Jobs Act Brackets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single $0 to $9,325</td>
<td>10%</td>
<td>Zero</td>
<td>$0 to $12,000 Single</td>
</tr>
<tr>
<td>Married $0 to $18,650</td>
<td>15%</td>
<td>12%</td>
<td>$0 to $24,000 Married</td>
</tr>
<tr>
<td>HOH $0 to $13,350</td>
<td>25%</td>
<td>25%</td>
<td>$45,000 to $200,000 Single</td>
</tr>
<tr>
<td>single $37,900 to $91,900</td>
<td>25%</td>
<td>25%</td>
<td>$45,000 to $200,000 Married</td>
</tr>
<tr>
<td>Married $37,900 to $133,200</td>
<td>25%</td>
<td>25%</td>
<td>$90,000 to $260,000 HOH</td>
</tr>
<tr>
<td>Single $91,900 to $191,650</td>
<td>28%</td>
<td>28%</td>
<td>$67,500 to $230,000 HOH</td>
</tr>
<tr>
<td>Married $191,650 to $416,700</td>
<td>33%</td>
<td>SEE NOTE ABOVE ON HOW AMERICANS IN THIS BRACKET WILL RECEIVE A TAX CUT</td>
<td>$200,000 to $500,000 Single</td>
</tr>
<tr>
<td>Married $233,350 to $416,700</td>
<td>33%</td>
<td>SEE NOTE ABOVE ON HOW AMERICANS IN THIS BRACKET WILL RECEIVE A TAX CUT</td>
<td>$200,000 to $500,000 Married</td>
</tr>
<tr>
<td>HOH $233,350 to $416,700</td>
<td>33%</td>
<td>SEE NOTE ABOVE ON HOW AMERICANS IN THIS BRACKET WILL RECEIVE A TAX CUT</td>
<td>$200,000 to $500,000 HOH</td>
</tr>
<tr>
<td>Single $416,700 to $444,450</td>
<td>39.6%</td>
<td>39.6%</td>
<td>Over $500,000 Single</td>
</tr>
<tr>
<td>Married Over $444,450</td>
<td>39.6%</td>
<td>39.6%</td>
<td>Over $1,000,000 Married</td>
</tr>
<tr>
<td>HOH Over $444,450</td>
<td>39.6%</td>
<td>39.6%</td>
<td>Over $500,000 HOH</td>
</tr>
</tbody>
</table>
2. The personal exemption would be eliminated and the standard deduction would be increased

<table>
<thead>
<tr>
<th>Current Tax Code</th>
<th>The Tax Cuts and Jobs Act</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Basic Standard Deduction:</strong></td>
<td><strong>Larger Standard Deduction:</strong></td>
</tr>
<tr>
<td>$6,350 for single individuals</td>
<td>$12,000 for single individuals</td>
</tr>
<tr>
<td>$12,700 for married couples</td>
<td>$18,000 for heads of household</td>
</tr>
<tr>
<td>$9,350 for heads of household</td>
<td>$24,000 for married couples</td>
</tr>
<tr>
<td><strong>Additional Standard Deduction:</strong></td>
<td><strong>(Inflation-Adjusted)</strong></td>
</tr>
<tr>
<td>$1,250 for Individuals who are elderly</td>
<td></td>
</tr>
<tr>
<td>or blind</td>
<td></td>
</tr>
<tr>
<td><strong>Personal Exemption(s):</strong></td>
<td></td>
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<tr>
<td>$4,050 each for taxpayer, spouse, and</td>
<td></td>
</tr>
<tr>
<td>dependent</td>
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</tbody>
</table>

*These amounts will be adjusted annually for inflation*

3. Other personal tax changes
   a) Mortgage interest deduction would be retained
      (i) Max loan amount would be reduced from $1 million to $500,000
      (ii) Interest would only deductible on a principal residence
      (iii) Interest on “home equity” debt would only deductible if used to improve the home
   
   b) Charitable contribution deduction would be retained
      (i) No deductions would be allowed for college athletic event seating rights (vs. an 80% deduction allowed under current law)
      (ii) Charitable mileage rate (currently 14 cents per mile) would be indexed to inflation

   c) Deduction for property taxes would be retained, but with a $10,000 annual limit

   d) Most other itemized deductions (e.g., medical, state and local income taxes or sales taxes, tax preparation fees) would be eliminated
e) Moving expense deduction would be eliminated

f) Deduction of alimony paid (and taxation of alimony received) would be eliminated effective for post-2017 divorces

g) Exclusion of gain on sale of principal residence ($250,000 single; $500,000 married filing joint) would be changed:
   (i) Home would need to be owned and used as a principal residence for five out of the last eight years (instead of two out of the last five years under current law)
   (ii) The exclusion would be allowed only once every five years (instead of only once every two years under current law)
   (iii) The exclusion would phase out for taxpayers with adjusted gross income over $500,000 ($250,000 single)

4. Gift and Estate Taxes
   a) Lifetime exclusion would double (to $10 million per person plus inflation adjustments)
   b) Estate tax would be repealed after 2023; basis “step-up” at death would be retained
   c) The gift tax would remain, but the tax rate would reduced from 40% to 35%

5. The Alternative Minimum Tax (AMT) would be eliminated
6. Business property with a life of less than 20 years would be immediately deducted when placed in service
   a) Would expire December 31, 2022

7. The corporate income tax rate would be reduced from a top rate of 35% to a flat rate of 20% (personal service corporations would pay a flat rate of 25%)

8. Maximum rate on business income of individuals (including income from pass-through entities)
   a) Passive income would be taxed at a maximum rate of 25%
   b) Active income attributed to capital (generally 30% of income) would be taxed at a maximum rate of 25%; remaining % (attributed to labor) would be taxed at ordinary rates
   c) Income from personal service businesses— accounting, law, consulting, engineering, financial services, or performing arts would be subject to ordinary rates (income attributed to capital would = 0%)

9. Deductions for net interest expense limited would be limited to 30% of a business’s adjusted taxable income
   a) Would apply to all business forms
   b) Would not apply to businesses with average gross receipts of $25 million or less

10. Deferral of gains on like-kind exchanges would be limited to real estate

11. Business entertainment expenses (currently 50% deductible) would no longer be allowed
12. Reform of taxation of foreign income
   a) Dividends received by a U.S. parent corporation from foreign subsidiaries would no longer be subject to U.S. tax

   b) U.S. parent corporations would be subject to U.S. tax on 50% of the “foreign high returns” of its foreign subsidiaries
      (i) “High returns” = excess of the subsidiaries’ aggregate net income over a “routine return” on their aggregate adjusted bases in depreciable tangible property (with some adjustments)
         (a) Routine return = 7% plus the published federal short-term rate
         (ii) Effectively creates an approximate 10% minimum tax on foreign income

   c) One-time transition tax: Accumulated earnings of foreign entities owned by U.S. persons would be deemed repatriated and subject to a one-time tax (payable over 8 years) of
      (i) 12% on earnings held in cash and
      (ii) 5% on earnings held in noncash assets

13. No cuts to 401(k) plan limits were proposed
14. Tax returns would go from this...

...to this:

SIMPLE, FAIR “POSTCARD” TAX FILING

1. Wage and compensation income
2. Subtract contributions to specified savings plans
3. Subtract standard deduction OR
4. Subtract mortgage interest deduction
5. Subtract real property tax deduction
6. Subtract charitable contribution deduction
7. Taxable income
8. Preliminary tax (from table)
9. Add tax on investment income
10. Subtract family and child credits
11. Subtract earned income credit
12. Subtract higher education credit
13. Total tax
14. Subtract taxes withheld
15. Refund due / taxes owed

D. Stay Tuned!
V. Base Erosion and Profit Shifting (BEPS)/Tax Havens

A. The OECD defines BEPS as “tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.”

B. Example:
   1. USCo = U.S. parent corporation, with a 35% tax rate
   2. HoldCo =
      a) Wholly-owned subsidiary of USCo
      b) Incorporated in Havenland, with a 1% tax rate
   3. MfgCo
      a) Wholly-owned subsidiary of HoldCo
      b) Incorporated in Industria, with a 20% tax rate
      c) Earns profits by manufacturing in Industria
   4. USCo sells IP (patents and trademarks) it wants to use outside of the U.S. to HoldCo
   5. HoldCo licenses the IP to MfgCo
   6. MfgCo deducts the royalty payments it makes to HoldCo to use the IP, reducing its tax in Industria
   7. The group has shifted income from a 20% tax rate to a 1% tax rate,¹ and lowered its GAAP income tax expense and GAAP effective tax rate

C. Real World Example: Walmart “has placed at least $76 billion worth of assets in 78 subsidiaries located in 15 tax havens in which it has no retail stores.”²

¹ Because the royalty income is passive, it should be immediately taxed in the U.S. under what are known as the “Subpart F” rules. But the affiliated group can avoid Subpart F by “checking the box” to essentially treat HoldCo and MfgCo as one single entity in the eyes of the U.S. tax law—causing the U.S. to ignore the “intercompany” royalty payment.