Indian Country & Tax Reform

What Happened, What's Next and What Can We Do?
Holland & Knight Native American Law Group

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Kathleen Nilles | Holland & Knight
Nicole Elliott | Holland & Knight
Ken Parsons | Holland & Knight
Kayla Gebeck | Holland & Knight

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Webinar Agenda

» What happened?
» What is in the bill and what does this mean for Indian Country?
» What is next?
» What can tribes do?

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Today's Presenters

Kathleen Nilles
Tax Partner
Washington, D.C. | 202.457.1815
Kathleen.Nilles@hklaw.com

Nicole Elliott
Tax Partner
Washington, D.C. | 202.469.5144
Nicole.Elliott@hklaw.com

Ken Parsons
Senior Tax Counsel
Washington, D.C. | 202.469.5231
Ken.Parsons@hklaw.com

Kayla Gebeck
Public Affairs Advisor
Washington, D.C. | 202.469.5372
Kayla.Gebeck@hklaw.com

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Big Picture

- First comprehensive tax reform legislation in more than 30 years
- Fulfills a campaign promise by President Trump and incorporates Republican Congressional tax plans that have been formulated over several years
- Passed by a vote of 227-203 in the House and 51-48 in the Senate
- Signed into law on December 22, 2017 (date of enactment)
- Most provisions became effective January 1, 2018 (or taxable years beginning after December 31, 2017)
  - Some provisions are retroactive and many are temporary

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Individual Provisions

- Lowers individual tax rates to 10, 12, 22, 24, 32, 35 and 37 percent
- Increases the standard deduction from $6,500 and $13,000 under current law to $12,000 and $24,000
- Caps the state and local tax (SALT) deduction at $10,000, limits mortgage interest deduction and eliminates certain other individual deductions
- Eliminates Obamacare's individual mandate penalty
- Expands the Child Tax Credit from $1,000 to $2,000

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Business Provisions

- Lowers the corporate tax rate from 35 to 21 percent
- Creates pass-through deduction (Qualified Business Income)
- Limits deduction of business interest
- Allows immediate expensing for capital equipment
- Modifies and limits Net Operating Losses

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Status of Tribal Governments Under Tax Reform

- » No changes (good or bad) specifically targeted at tribes
  - Tribal Governmental tax immunity preserved
- » But tribes and tribal enterprises will not enjoy the same competitive edge they previously had over taxable businesses
  - Corporate tax rate reduced
  - Tax deduction for certain pass-through businesses owned by individuals
- » The cost of capital for tribal governments will be significantly higher (compared to that for state/local governments and investor-owned businesses)

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Choice of Entity Comparison

- » C Corporation with $100,000 of taxable income that distributes the remaining taxable income as a dividend:
  - Corporate tax on $100,000 earnings is $21,000 (21%)
  - Tax on dividend of $79,000 is $18,802 (20% + 3.8% net investment income tax)
  - Effective tax rate is 39.8%
- » Single-member LLC with $100,000 of taxable income and an owner in the highest marginal tax bracket (37%):
  - No entity level tax
  - Tax on $100,000 is $29,600 ($100,000 - $80,000 x 37%)
  - Effective tax rate is 29.6%

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Choice of Entity Comparison

» Tribally owned business with $100,000 of income, all of which is taxable to members at the highest marginal tax bracket when distributed:
- No tax at the tribal level
- Tax on $100,000 is $37,000
- Effective tax rate is 37%

» Which entity is preferable for tribes? Key components of the analysis include:
- What the entity plans to do with the profits
  - Retain vs. distribute
- The nature of the business entity
  - Is it generating income that would be taxable or non-taxable to members when distributed?

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Key Tax Provisions – Tribal Members

» Tribal health care, tribal general welfare exclusion, and deferred compensation

» SALT deduction cap and other limitations

» Kiddie Tax “simplification”

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Key Tribal Exclusions Maintained

- Section 139D - Exclusion for Tribal Health Care
- Section 139E - Exclusion for Tribal General Welfare Benefits
- Exclusion for deferred compensation (Moreover, no provisions that would prevent deferral of tribal per capita under plans that follow nonqualified deferred compensation rules and rabbi trust safe harbor.)

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SALT Deduction Cap and other Limitations

- The deduction for state and local taxes (including both income and property taxes) is now capped at $10,000 aggregate for both joint and single filers
- *Note: On-reservation housing is exempt from state property taxes, and per capitas paid to on-reservation residents are exempt from state income taxes*
- Eliminates deductions for personal casualty losses (e.g., loss of home or other property in fire, landslide or earthquake) unless the loss incurred in a federally-declared disaster area
- Also eliminates deduction for most miscellaneous itemized deductions and moving expenses
- Eliminates above-the-line deduction for alimony paid under divorce agreements and modifications to such agreements entered into after 2018

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Kiddie Tax

- “Simplifies” Kiddie Tax by linking it to trust tax rates rather than the parent’s tax rate
- Sharply increases taxes for minor children and those aged 19-23 who are full-time students
- For example, a tribal member receiving a $100,000 lump sum distribution from a minors trust at the age of 18 would owe $35,000 in tax vs. $15,000 if the tax did not apply
  - Effective rate of 35% vs. $15%
- Careful planning can minimize the impact of the Kiddie Tax
  - Delay and/or stagger distributions
  - Earned income

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Economic Development Incentives

- Tax-Exempt Financing
- Treatment of Alaska Native Corporations and Settlement Trusts
- Opportunity Zones
- Indian tax extenders not included in tax reform

Treatment of Alaska Native Settlement Trusts

- Allows an Alaska Native Corporation ("ANC") to assign certain payments to a Settlement Trust without recognizing income
- Permits an ANC to elect annually to deduct contributions made to a Settlement Trust
- Requires Settlement Trusts to take into income amounts deducted by the ANC

Treatment of Alaska Native Settlement Trusts

- Taken together, these provisions offer a significant tax savings to ANCs, Settlement Trusts, and their beneficiaries
- The savings is due in large part to the favorable tax rates on Settlement Trusts vs. ANCs
  - 10% ordinary income and 0% capital gains vs. 21% corporate tax rate
- How to use these benefits? Some examples:
  - Assign payments to Settlement Trust that would have been fully taxable to the ANC
  - Contribute the ANC's appreciated property to the Settlement Trust

Tax-Exempt Financing

- Private Activity Bonds - Retained for State and Local governments, but not expanded to allow tribes to issue
- Advance Refunding of existing governmental bonds - Prohibited for all issuers
- Tribal Bonds - NO FIX (Tribes still required to meet governmental function test, unless tribe secures an allocation of Tribal Economic Development Bond authority and only $500 M more in TEDBs can be allocated.)
- Secondary Impacts of Reduction of Tax Rates—see HK Client Alert

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Opportunity Zones

- Opportunity Zones for low-income communities
  - Nomination process controlled by state governors
  - No tribal set-aside
- Nomination and Designation of Qualified Opportunity Zones
  - Applications be submitted in writing within 90 days of the enactment date
  - Code Section 45D(e) defines a "low-income community" as any census tract if:
    - a) the poverty rate is at least 20 percent, or
    - b) the median family income does not exceed 80 percent of statewide median family income or, if in a metropolitan area, the greater of 80 percent statewide median family income or 80 percent of metropolitan area median family income

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What is Next?

Tax Extenders

- S. 2256, Tax Extender Act of 2017
  - Accelerated depreciation
    - Retroactive to December 31, 2016
    - Effective until December 31, 2018
  - Indian Employment
    - Retroactive to December 31, 2016
    - Effective until December 31, 2018
  - Indian Coal
    - Retroactive to December 31, 2016
    - For a 13-year period

Tribal Specific Legislation

- H.R. 3138, Tribal Tax and Investment Reform Act
- S. 1935, Tribal Tax and Investment Reform Act
- S. 2012, Tribal Economic Assistance Act of 2017

Technical Corrections?

Infrastructure Legislation?

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Continue to Advance Tribal Tax Parity Agenda

- Parity for Tax-Exempt Bonds
  - Tribes are the only governments that are limited to using tax-exempt bond financing for "essential government functions"
- Parity for Indian Adoption Tax Credit
  - Families that adopt special needs children in tribal court are not eligible for tax benefits available to families that adopt special needs children in state court
- Parity for Excise Tax Exemptions
  - Tribal governments do not receive the same excise tax exemptions as state and local governments
- Parity for IHS Health Professionals
  - IHS student loan repayment benefits are not tax-exempt even though the same benefits provided by other public health service providers would be exempt

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Other Tax Reform Items

- Exclude tribal government per capita payments to tribal members ages 19-23 from the Kiddie Tax
- Low-income Housing Tax Credit
  - Fix still needed to ensure tribes have access
- New Markets Tax Credit
  - Expires 2019 and future authorization is unclear
- Retroactively extend/make permanent Indian Tax Extenders
  - Accelerated depreciation (needs modification for consistency with tax reform)
  - Indian employment credit (needs updating)
  - Indian coal production

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