

Breaking It Down: Must-Know Tax Reform Highlights

By Dana Lee Cole, Hardwood Federation

Legislation comprehensively revising the Internal Revenue Code passed Congress and was signed by the president in the waning days of 2017.

The below attempts to describe relevant provisions and their potential effect on our sector, each company will be impacted in different ways based on unique circumstances. We urge you to consult with your tax planners as this new law moves into the implementation phase.

S Corporations & Pass-Throughs

The Tax Cuts and Jobs Act creates a 20 percent deduction for the non-wage portion of pass-through income. Senators Daines and Johnson had negotiated a 23 percent deduction during Senate negotiations, but this was ratcheted back to 20 percent, 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 its 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's W-2 wages or 25 percent of a business's 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 a NOL two years and carry forward a 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 Jan. 1, 2023. A five-year phase down of full expensing begins in 2023.

Sec. 179 Expensing Limits

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.

Business Interest Expense

This new 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.

State & Local Property Tax Deductions

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.

Corporate Tax Rate

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 is that existing tax incentives for standing timber and reimbursement for reforestation costs were left alone by tax writers.

All of the renewable energy tax credits in the House version were stripped out in conference. Leadership has vowed to pursue a follow-up package of so-called "tax extenders" to address these credits.

HF believed that a "technical corrections" bill would be pursued this year. However, it appears partisanship may preclude any corrections measures from proceeding.

This leaves the IRS in the spot where it will have to interpret many of the new law's provisions without more direction from Congress. ■



Dana Cole is executive director of the Hardwood Federation. The Federation serves as the united voice of the hardwood industry.

Review Seeks To Help Industry Understand Chinese Market For Logs

After a recent inquiry from a member, RTA Executive Director Jim Gauntt reached out to the Hardwood Federation (HF) on the subject of hardwood saw log exports to China.

"I asked HF Executive Director Dana Lee Cole to help us determine if there was a meaningful way to develop an industry-wide educational message on how to best balance the needs of American sawmills with the needs for some industry members who ship logs to China," Gauntt said.

Cole responded with outreach to hardwood industry executives. This outreach resulted in a call between 23 hardwood association executives to explore the impacts log exports were having on each other's respective members.

As part of the preparation for that call, some data developed by the *Hardwood Market Report* (HMR) was distributed. Figure 1, U.S. Exports of Hardwood Logs, clearly illustrates that the United States is hardly at the peak of export volume. In 2005, for example, U.S. exports were close to 550MMBF, and 2017 was tracking along at the same YTD pace through October.

"The issue isn't as much volume," said

HMR Editor Judd Johnson. "It's that the species mix and quality of the log being exported have changed."

An example of this can be seen in Figure 2, which illustrates China's growing appetite for U.S. Red Oak saw logs.

As has been reported by HMR and others, the issue of saw log exports can be divisive since it impacts loggers and sawmills in different ways in different parts of the United States. Some businesses thrive on a mix of exporting sawn products and logs to the rest of the world, and others, like the RTA member who put out a call for help, are finding it impossible to compete for logs to saw ties from.

"Part of the problem is there isn't a lot of quality data, just a lot of anecdotal information that differs from region to region," Cole said.

That became clear during the call and was one of the reasons that led the American Hardwood Export Council (AHEC) to begin developing hard data on the subject. For example, one executive reported that fewer logs were going from his area because payment issues had surfaced. Another executive reported that the value of the exports was actually now lower because high-quality veneer log demand

was being replaced by lower quality saw logs.

"The need to understand the Chinese market better will help producers learn if this is a long-term secular change that will impact sawmills who cut ties permanently, or if it is a transitory trend that could lead to problems for loggers and mills if the log-demand-spigot is abruptly turned off," Gauntt said.

To help with this, in addition to the research that AHEC is doing, HF has added a portal to its website where anyone can add comments on the impacts of log exports to China or the rest of the world. That web link is <https://www.votervoice.net/THF/Surveys/4330/Respond>

RTA encourages members to share their voice on the subject—good, bad or indifferent—by commenting on the subject in this portal.

As for further action, RTA will continue to participate in calls and meetings on the subject and help quantify the issue and its impacts on members as clearly as possible in the coming year.

If any member would like RTA to post comments to the portal for them please write ties@rta.org and we will pass them along on your behalf. ■

FIGURE 1

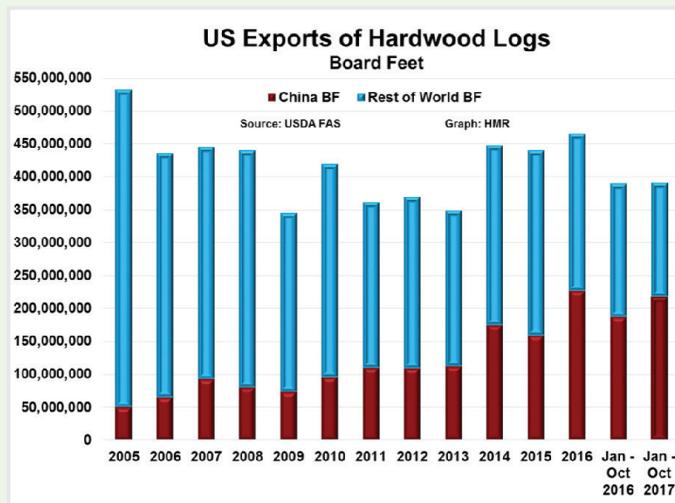


FIGURE 2

