THE RUNDOWN

OBERON SECURITIES

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CONTENT

Basic Tax Implications of The Tax Cuts and Jobs Act (TCJA)

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The Tax Cuts and Jobs Act (TCJA) was signed into law by President Trump in December of 2017 and includes changes that affect virtually all types of taxpayers. Many of these changes affect small businesses. However, the items outlined below are emphasized because they were devised specifically with such entities in mind.

Even though we're always hearing rumblings that the tax code will be simplified it rarely, if ever, happens. However, the TCJA provisions outlined below do take a major step in that area. These provisions will also make accounting tasks simpler which could inevitably lead to a reduction in compliance costs.

In general, businesses that average less than $25,000,000 in annual gross receipts can potentially benefit from the new provisions. Businesses that produce or resell merchandise such as manufacturers, distributors, and retailers stand to benefit the most. Service based industries can benefit as well, but to a lesser extent.

This discussion focuses on four items specifically related to small businesses that were affected by the provisions of the TCJA. They are as follows:

1. Changing the method of accounting to the overall cash method,
2. Accounting for inventories,
3. Inventory capitalization under Internal Revenue Code Section ("Section") 263A, and
4. Accounting for certain long-term construction contracts

Accounting Methods and Accounting for Inventories

There are two overall accounting methods that are most commonly used by business taxpayers: The accrual method and the cash method. The cash method is easier, more flexible with regard to timing of income and deductions and less burdensome from an administrative standpoint than the accrual method. Before the TCJA, C corporations and partnerships with one or more C corporation partners were precluded from using the cash method of accounting if their average annual gross receipts for the preceding three tax years were $5 million or more.

For taxpayers that produced, purchased, or sold merchandise (for most taxpayers this would be inventory) there were different hurdles with regard to the use of the cash method. Before the TCJA, these type of taxpayers had to use the accrual method with regard to purchases and sales of inventory if their average annual gross receipts for the preceding three tax years exceeded $1 million. For certain industries, the three year threshold was $10 million, assuming they were not a taxpayer affected by the $5 million threshold mentioned above.

In addition, taxpayers that sold merchandise had to account for inventories if they met the $1 million and $10 million thresholds above. If a taxpayer fell below these thresholds they were able to classify inventory as non-incidental materials and supplies. The latter requires capitalization upon purchase and the item is expensed as it is consumed. Accounting for inventories requires calculating cost of goods sold and valuing inventory which is a much more arduous accounting task.

As you can see from the above, the rules before the TCJA varied greatly between type of taxpayer and industry. In addition, the thresholds were fairly low and were not uniform. However, the TCJA has simplified the accounting method and accounting for inventories areas. Effective for tax years beginning after December 31, 2017, the $1 million, $5 million, and $10 million thresholds have been replaced by a uniform $25 million threshold. Under the TCJA, tax shelters still cannot use the cash method.

As was the case before the enactment of the TCJA, qualified personal service corporations such as law, accounting and consulting firms, among others, can generally use the cash method of accounting regardless of the amount of receipts they have had in prior years. The same applies to S corporations and partnerships with no C corporation partner, if they do not generate income from the purchase, production, or sale of merchandise.

Changing to an overall cash method of accounting can provide significant tax savings in the year of the change. However, there must be some due diligence performed to determine whether it would provide a tax benefit.

Generally, under the cash method, a company records income in the year it is received or considered received and expenses are deducted in the year they are paid. The accrual method is a little more complicated. Under the accrual method, if a company sells a customer a good or performs a service in 2017, but does not receive payment for that good or service until 2018, income, in most instances, is recorded in 2017 even though payment is not received until 2018. In this case, a taxpayer would report a receivable for the amount due at the end of 2017.

Similarly, if the same taxpayer receives a good or service in 2017, but does not pay for it until 2018, the company generally can deduct an expense for those goods and services in 2017. The accrual method taxpayer would report a payable or an accrued expense at the end of 2017 for these expenditures. Cash-basis taxpayers normally do not record receivables or payables/accruals on their books, with certain exceptions.

If a taxpayer can now use the cash method of accounting due to the increased average annual gross receipts threshold and receivables exceed its tax deductible payables/accruals, it may be beneficial to change its accounting method from accrual to cash for the 2018 tax year..

Example

For the 2017 tax year, a clothing retailer had average annual gross receipts of $12 million. For book purposes (GAAP) the taxpayer uses the accrual method. In 2018, the average annual receipts for the previous three tax years were $12.5 million. The taxpayer is considering switching from the accrual method to the cash method for tax purposes for the 2018 tax year since the opportunity is now available to them. The taxpayer's accounts receivable and accounts payable/accrued expenses as of their year-ends (12/31/17 and 12/31/18) are below.

	12/31/17	**12/31/18**
Book income	$500,000	$550,000
Accounts receivable	$400,000	$450,000
Accounts payable/ accrued expenses	$300,000	$360,000

For purposes of this example, it is assumed that all accrued expenses are tax deductible. In addition, there are no other book to tax differences.

To determine if changing to the cash method for tax purposes may be beneficial for the 2018 tax year, the above taxpayer would compare its receivables to its accounts payable/accruals at the end of the 2018 tax year. Since the receivables are more than the accounts payable/accrued expenses, the taxpayer may want to consider changing to the cash method. By changing, it would enjoy a deferral of taxes on $90,000 of income in the above example.

Uniform Capitalization

In general, the Uniform Capitalization rules under IRC Section 263A, require applicable taxpayers to perform complex calculations to allocate certain general and administrative costs to inventory. The effect of this provision is to defer the deduction of such costs until the inventory is sold.

Before the TCJA, manufacturers and resellers with average annual gross receipts for the previous three tax years of $10 million or more were required to calculate and report a Section 263A adjustment. Effective for tax years beginning after December 31, 2017 as per the TCJA, taxpayers are not required to report the adjustment if their average annual receipts for the preceding three tax years does not exceed $25 million.

Raising the threshold to $25 million means less small business taxpayers will be subject to the administrative burden of the IRC Section 263A calculation and the recognition of additional income required by the adjustment.

Accounting for long-term contracts

For tax years beginning before January 1, 2018, a contractor with average annual gross receipts of $10 million or less was not required to use the percentage of completion method to account for construction contracts that are to be completed within two years of commencement. The TCJA increased this threshold to $25 million for long-term construction contracts entered into after 12-31-17. The construction project must relate to the construction of real property. Certain home construction projects as well as other types of residential construction contracts also qualify.

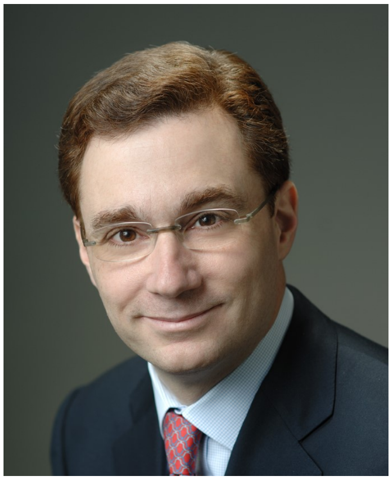
This change gives more taxpayers the opportunity to use the completed-contract method. The major difference between this method and the percentage-of-completion method is that under the former, a taxpayer would only recognize taxable income from the project upon completion. The latter would require income to be recognized earlier. As a result, the completed-contract method allows for a one-year deferral of taxable income on a portion of the contract. In addition, the completed contract method is less difficult to calculate than the percentage-of-completion method.

Form 3115 required for the Above Accounting Method Changes

The IRS has issued guidance in the form of Revenue Procedure ("Rev. Proc.") 2018-40 on how to effectuate the above four accounting method changes. As per the guidance, the accounting method changes are automatic, meaning prior IRS approval is not required and there is no amount required to be paid to the IRS to make the change. In addition, one Form 3115 can be filed for any combination of the first three changes mentioned above as long as the Revenue Procedure is followed. However, it appears that if a change in accounting for long-term contracts is to be made, a separate Form 3115 must be filed for that change. The form(s) must be completed and filed with a taxpayer's return by the extended due of such return for the tax year the change is adopted. A copy of the form is also required to be filed separately.

The above changes should be a welcome addition to small business owners. After completing Form 3115 to effectuate the above changes, many small businesses will see their year-by-year reporting become less complicated and less costly. In addition, there can be significant tax benefits which should make small business owners very happy.

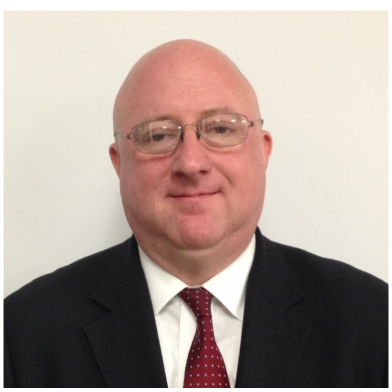
New Team Members



Corey Luskin, Managing Director

Corey brings 25 years of experience in investment banking and corporate development to Oberon. Corey has extensive experience leading mergers, acquisitions, divestitures and financing transactions, primarily for information services, digital media, marketing services, financial technology and financial services companies.

Prior to joining Oberon, Corey was a Managing Director at England & Company LLC, an investment banking boutique based in Washington, D.C. Before that, he worked at major firms including Dresdner Kleinwort Wasserstein (formerly Wasserstein Perella) and Smith Barney, as well as boutique advisory firms Landmark Ventures and the Garros Group, where he was a member of the founding team. In addition to his advisory experience, Corey served as Senior Vice President for Corporate Development at BISYS Group, Inc., a leading financial services technology and outsourcing firm later acquired by Citigroup; and as Vice President of Corporate Development for Innodata, Inc. Corey earned his M.B.A. in Finance from the Wharton School at the University of Pennsylvania and his B.A. in Economics with high honors from the University of Michigan. He is a CFA charterholder.

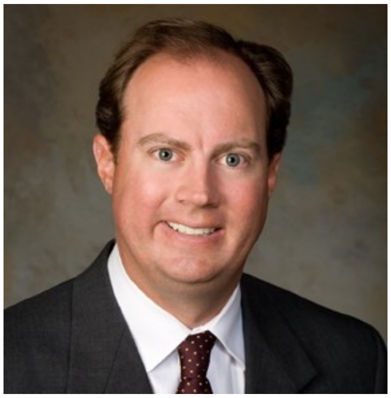


David Karlin, Managing Director

David brings to Oberon over 20 years of experience in financial services with a focus on small and middle market investment banking. David has extensive experience in M&A, public and private capital raising across a broad range of structures, strategic advisory, and assisting companies with investor relations and market positioning.

Prior to joining Oberon, David was at Matrix Advisors, a New York-based merchant bank and strategic advisory firm assisting small and lower middle-market companies with capital markets, business development and M&A. In addition, from 2014 to December 2016, David was chairman of National Stock Exchange Holdings and a Director of the National Stock Exchange until its sale to NYSE/ICE. In 1996, David began working at boutique firms dedicated to serving the needs of small and middle market companies. In this capacity, he worked with a broad range of institutional investors, including mutual funds, hedge funds, private equity funds and venture funds, advising them on a range of open market and investment banking transactions. David began his career at Lehman Brothers as an advisor in the firm's Private Client Group and later held a similar position at Gruntal & Co. In this role, he advised high net worth individual investors in the analysis, construction, and management of their investment portfolios. David earned his B.S. in Economics from the University of North Carolina at Chapel Hill.

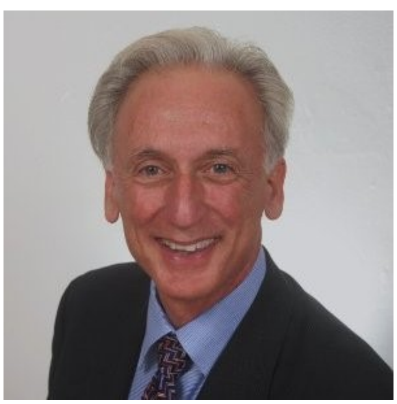
New Team Members



Geoff Coar, Managing Director

Geoff Coar is a Managing Director of Business Development, bringing to Oberon over 20 years of experience in commercial banking advising public and private companies on senior debt structures and capital market strategies.

Prior to joining Oberon and his current role as Senior Managing Director of Opus Bank, Geoff held roles as Senior Vice President with US Bank, Citibank and Wachovia where he focused on advising Southern California middle-market companies on lines of credit, term debt and acquisition financing, asset-based lending, commercial real estate financing, international trade and treasury management solutions. Geoff began his career with Wells Fargo Commercial Banking serving as an analyst, relationship manager and business development. Geoff earned his B.S. from the University of South Carolina.



Allan Grafman, Managing Director

Allan is a Managing Director of Business Development, bringing over 25 years of experience sourcing funding for clients. He is CEO of All Media Ventures, and he has been active as a private equity operating partner, CEO of a venture capital portfolio company, and board director of 8 companies, public and private. In the media and technology sectors, his focus has been monetizing intellectual property for consumer-facing and B2B companies in licensing, entertainment, and technology.

Prior to joining Oberon, Allan served in the following roles:

- Operating Partner, Mercury Capital, a private equity firm
- President, Archie Comics, an entertainment and licensing company
- CEO, Modelwire, a media software enterprise
- EVP & CFO, Hallmark Entertainment, a content producer and distributor
- VP and MD, Tribune Company, a worldwide media firm
- VP and GM, Capital Cities/ABC/Disney, a cable television enterprise
- Announcer and Salesman, KSHE Radio, a leading radio broadcaster

In addition to his board directorships, Allan is frequently published in thought leadership journals including “Directors and Boards” and “National Association of Corporate Directors.” Allan earned his M.B.A. in Finance, as part of Beta Gamma Sigma Honors, at Columbia University; his MIA in Economics as a Fellow at Columbia University; and his B.A., as part of Phi Beta Kappa, at Indiana University.

Recent Transactions

Real House, SimpleOrder, Apptricity, Digirad

June 2018

Real House Inc.

Term Loan

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July 2018

SimpleOrder Ltd.

Has Been Acquired by

OBERON SECURITIES

August 2018

Apptricity Corporation

Credit Facility

OBERON SECURITIES

Announced September 2018

Digirad Corporation

$26,000,000

Has Announced the Acquisition of

OBERON SECURITIES

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