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TAX LAW IMPACTS FOR BUSINESS OWNERS (Tax Topic #5)

Tax Reform and What it Means for Your Business

The Tax Cuts and Jobs Act contained many changes to the tax code that impacts businesses. Tax benefits include a reduction in the corporate tax rate, increase in the bonus depreciation allowance, an increase in the §179 expensing amount and the repeal of the corporate alternative minimum tax. Owners of S corporations, partnerships, LLCs, sole proprietorships and farms are allowed a deduction of 20% of qualified business income (QBI), subject to a number of limitations. Please note that unless otherwise indicated, the provisions discussed are in effect Jan. 1, 2018 and sunset Dec. 31, 2025 at which time tax law reverts back to 2017 rules. A highlight of the changes follows:

Corporate taxes. Beginning in 2018, the new tax law introduces a flat C corporate tax rate of 21%. This replaces the previous graduated tax rates of 15% to 35%. Corporate alternative minimum tax was repealed.

Bonus depreciation. The new tax reform law temporarily increases the 50% bonus depreciation allowance to 100% for qualifying property placed in service after Sep. 27, 2017, and before Jan. 1, 2023. A phaseout of the deduction begins Jan. 1, 2023. The new law also removes the requirement that the original use of qualified property must begin with the taxpayer. For the first time, bonus depreciation will be allowed on the purchase of used property.

Section 179 expensing. The new tax reform law increases the §179 expensing amount to $1 million and the investment limitation to $2.5 million. Additional real property, such as a roof on a non-residential property, can qualify for a §179 expensing deduction.

Pass-through businesses (see additional discussion at *Tax Topic #6*). The new tax reform law allows noncorporate taxpayers to deduct up to 20% of domestic qualified business income (QBI) from an S corporation, partnership, LLC, sole proprietorship or farm. In some situations, net rental income can qualify for some or all of the 20% QBI deduction. Limitations apply based on wages paid or if the qualified business income is from a specified service business (like consulting, law, accounting, medical, financial services, etc.) Neither limitation applies if the taxpayer’s taxable income on his or her Form 1040 is less than $157,500 for a single person ($315,000 for a married filing joint couple.)

Listed property. The new tax reform law increases the depreciation for passenger automobiles placed in service after Dec. 31, 2017. The maximum amount of allowable depreciation is $10,000 for the year in which the vehicle is placed in service; $16,000 for the second year; $9,600 for the third year; and $5,760 for the fourth and later years. The new law removes computers and peripheral equipment from the definition of listed property. Therefore, laptop computers, for example, are not subject to the strict substantiation requirements that apply to other listed property.

Tax deferred exchanges. The tax deferred exchange rules in §1031 will only apply to real property. Personal property, such as autos, machines, tractors, equipment, etc. may no longer qualify under the tax deferred exchange rules.

Deductions and credits. There are several significant changes to business deductions and credits:

- The entertainment deduction has been repealed. The cost of tickets to concerts, football games or the ballet are no longer deductible. We now suggest tracking meals versus entertainment expenses in separate account categories.
- The §199 domestic production activities deduction is eliminated.
- The new tax reform law retains the research and development credit, but will require five-year amortization of research and development expenditures.
- The new tax reform law creates a temporary credit for employers paying employees who are on family and medical leave.
- For businesses with gross receipts in excess of $25 million, the new tax law caps the deduction for net interest expenses at 30% of adjusted taxable income.

Stock options. The new tax law allows qualified employees of private companies to defer tax on the exercise of options for up to five years. CEOs, CFOs, highly compensated employees and 1% owners are not eligible for the deferral.

Net operating losses (NOL's). The new tax law limits the net operating loss deduction to 80% percent of taxable income for losses arising in tax years beginning after Dec. 31, 2017. The carryback for NOL's is eliminated, except for qualifying farm losses. NOL carryforwards will be indefinite, subject to the percentage limitation.

These are just a few of the changes included in the new tax reform law. Your 2018 business taxes will be affected.

State impact. California and several other states do not automatically conform to the Federal tax changes.

- California does not offer bonus depreciation. Assets will be depreciated based on the usual conventions and will result in ongoing adjustments between Federal and California reporting as the different methodologies are applied.
- Section 179 expensing for California remains capped at $25,000 for all business assets placed in service per year.
- There is no 20% QBI deduction for the calculation of California taxable income.

Questions we can help to answer.

- Is there anything I can do now that will make my taxes less under the new tax reform law?
- Are my withholding and estimated tax payments correct considering the new tax reform law? (See additional discussion at ***Tax Topic #3***.)
- Will I qualify for the new 20% QBI deduction? (See additional discussion at ***Tax Topic #6.***)
- Is this the year to buy additional equipment or a new vehicle for my business?

Please do reach out if you have questions regarding your particular business and its tax planning needs.