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TAX CUTS & JOBS ACT PLANNING

From a new deduction for qualified business income to a significantly lower corporate tax rate, the Tax Cuts and Jobs Act (TCJA) brings a host of planning opportunities for your business. This article presents some tax planning ideas under the TCJA for you to think about while there's sufficient time left in 2018 to take action.

MAXIMIZE THE QUALIFIED BUSINESS INCOME DEDUCTION

Under the TCJA, business owners may deduct up to 20% of their qualified business income. The deduction is available for qualified business income from both pass-through entities (partnerships, LLCs, and S corporations) and sole proprietorships (including farms). It is, however, subject to various rules and limitations.

Although official guidance is lacking on this new deduction, there are some planning strategies that can be considered now. For example, there are ways to adjust your business's W-2 wages to maximize your qualified business income deduction. Also, it may be helpful to convert your independent contractors to employees, assuming the benefit of the deduction outweighs the increased payroll tax burden. Other planning strategies include restructuring the business, investing in short-lived depreciable assets, and leasing or selling property between businesses.

RETHINK CHOICE OF ENTITY

The TCJA makes major changes to the choice of entity decision. Because C corporations are now taxed at a flat rate of 21% (as opposed to a top rate of 35% under prior law), many business owners wonder whether they should restructure their business operations as a C corporation. Unfortunately, the answer is not simple. For one thing, the top individual tax rate also fell under the TCJA, from 39.6% to 37%. Also, the new qualified business income deduction isn't available for C corporations or their shareholders. There are other factors to consider as well, such as self-employment and state taxes.

It is also important to remember that C corporations are subject to double taxation, meaning that corporate income is taxed once at the entity level and again when it's distributed to shareholders as dividends. This can be avoided if the corporation retains all profits to finance growth, and does not pay profits out as dividends. However, this opens the door to the accumulated earnings tax (or personal holding company tax) if profits accumulate beyond the reasonable needs of the business.

The choice of entity decision is complicated, but we're here to help. We would be happy to analyze your particular circumstances to see if a C corporation is right for you.

ACQUIRE ASSETS

This is a great time to acquire business assets, thanks to the TCJA. Your business may be able to take advantage of very generous Section 179 deduction rules. Under these rules, businesses can elect to write off the entire cost of qualifying property rather than recovering it through depreciation. The maximum amount that can be expensed this year is $1 million (up from $510,000 for 2017). This amount is reduced (but not below zero) by the amount by which the cost of qualifying property exceeds $2.5 million (up from $2.03 million for 2017). Also, the Section 179 deduction is now available for certain tangible personal property used predominantly to furnish lodging and certain improvements to nonresidential real property (roofs, HVAC, and security systems). Note that if your business is already expected to have a tax loss for the year, you cannot claim a Section 179 write-off that would create or increase the overall business tax loss.

Above and beyond the Section 179 deduction, your business also can claim first-year bonus depreciation. The TCJA establishes 100% first-year bonus depreciation for qualified property acquired and placed in service after 9/27/17 and before 1/1/23 (1/1/24 for certain property with longer production periods). Unlike under prior law, this provision applies to new and used property. The bonus percentage will phase down for years 2023 through 2026. Note that 100% bonus depreciation deductions can create or increase a Net Operating Loss (NOL) for your business's 2018 tax year. Under the TCJA, the NOL generally can't be carried back to an earlier tax year, but it can be carried forward indefinitely. Unfortunately, NOLs arising in tax years beginning after 2017 can't reduce taxable income by more than 80%.

Given these generous provisions, your asset acquisition plan is more important than ever. We can help you develop a plan that is right for your business.

ADOPT A MORE FAVORABLE ACCOUNTING METHOD

The cash method of accounting, which allows you to recognize sales when cash is received, is attractive to many small businesses due to its simplicity. For tax years beginning after 2017, the ability to use the cash method is greatly expanded. Any entity (other than a tax shelter) with three-year average annual gross receipts of $25 million or less can use the cash method regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. Likewise, C corporations and partnerships with C corporation partners can use the cash method if they meet the $25 million gross receipts test.

Under pre-TCJA law, if the purchase, production, or sale of merchandise was an income-producing factor, inventories were required to be maintained, and the cash method wasn't allowed unless the taxpayer met a $1 million gross receipts test or a $10 million gross receipts test (which only applied if the taxpayer's principal business activity was an eligible activity). Also, for years beginning before 2018, C corporations and partnerships with a C corporation partner with average annual gross receipts over $5 million couldn't use the cash method.

The $25 million gross receipts test is made on a year-by-year basis, and we can monitor whether your average annual gross receipts fall below the threshold. If they do, we can discuss the pros and cons of changing your accounting method. If a change would be beneficial, we can help you file the appropriate paperwork with the IRS.

DETERMINE ELIGIBILITY FOR THE EMPLOYER-PAID FAMILY AND MEDICAL LEAVE CREDIT

The TCJA establishes a new credit for employer-paid family and medical leave. The credit is for tax years beginning in 2018 and 2019 and is equal to 12.5% of the amount of wages paid to qualifying employees on family and medical leave. However, the employer must pay at least 50% of the wages normally paid to the employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percent by which the payment rate exceeds 50%.

WATCH OUT FOR NEW BUSINESS INTEREST EXPENSE LIMIT

Regardless of its form, every business will be subject to a net interest expense disallowance. Starting in 2018, net interest expense in excess of 30% of your business's adjusted taxable income will be disallowed. However, your business won't be subject to this rule if its average annual gross receipts for the prior three years is $25 million or less. Also, real property trades or businesses can choose to have the rule not apply if they elect the Alternative Depreciation System (ADS) for real property used in their trade or business. Since ADS is a slower way to depreciate property, real property trades or businesses will need to look at the trade-off between currently deducting their business interest expense and deferring depreciation expense.

MONITOR STATE RESPONSE TO TAX REFORM

States react differently to changes to federal tax law. For example, some states automatically conform to federal tax law as soon as legislation is passed. Other states require their legislatures to adopt federal tax law as of a fixed date. This generally occurs on an annual basis. There are some states, however, that pick and choose which federal provisions to adopt. Because of this, your state income tax rules may be drastically different than the federal income tax rules. It is important to monitor your state's response to the TCJA and to help minimize your state income tax bill.

CONCLUSION

This article is to get you thinking about tax planning moves for the rest of the year. This year is unique given the numerous tax law changes brought by the TCJA. Even with uncertainty about some of the TCJA's provisions, there are things you can do now to improve your business's situation. Please don't hesitate to contact us if you want more details or would like to schedule a tax planning session.