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2017 Tax Cuts Act: What it Means for Businesses

The Tax Cuts and Jobs Act was signed by President Trump on December 22. The Act makes sweeping changes to the U.S. tax code and impacts virtually every taxpayer. For businesses, tax benefits include a reduction in the corporate tax rate, increase in the bonus depreciation allowance, an enhancement to the Code Sec. 179 expense and repeal of the alternative minimum tax. Owners of partnerships, S corporations, and sole proprietorships are allowed a temporary deduction as a percentage of qualified income of pass-through entities, subject to a number of limitations and qualifications. On the other hand, numerous business tax preferences are eliminated. Note that items listed are the more common items, and is not all-inclusive.

Corporate Taxes

A reduced 21-percent corporate tax rate is permanent beginning in 2018. Also, the 80-percent and 70-percent dividends received deductions under current law are reduced to 65-percent and 50-percent, respectively. The Tax Cuts and Jobs Act also repeals the alternative minimum tax on corporations.

Bonus Depreciation

The bonus depreciation rate has fluctuated wildly over the last 15 years, from as low as zero percent to as high as 100 percent. It is often seen as a means to incentivize business growth and job creation. The Tax Cuts and Jobs Act temporarily increases the 50-percent "bonus depreciation" allowance to 100 percent. It also removes the requirement that the original use of qualified property must commence with the taxpayer, thus allowing bonus depreciation on the purchase of used property.

Section 179 Expensing

The Tax Cuts and Jobs Act sets the Code Sec. 179 dollar limitation at $1 million and the investment limitation at $2.5 million. Although the differences between bonus depreciation and Code Sec. 179 expensing would now be narrowed if both offer 100-percent write-offs for new or used property, some advantages and disadvantages for each will remain. For example, Code Sec. 179 property is subject to recapture if business use of the property during a tax year falls to 50 percent or less; but Code Sec. 179 allows a taxpayer to elect to expense only particular qualifying assets within any asset class.

Qualified Improvement Property

In the past, the cost recovery periods for most nonresidential real property was 39 years. Qualified improvement property placed in service after Dec. 31, 2017, is generally depreciable over 15 years using the straight-line method and half-year convention. Qualified Improvement Property can also generally be expensed using Section 179 discussed above.

Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property if the improvement was placed in service after the date the building was first placed in service. Qualified improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

Luxury Automobiles

The luxury automobile depreciation limits have been increased. Under prior law, the first year depreciation deduction was limited to $3,160. Under the new law, for 2018 the depreciation deduction for the year placed in service has increased to $10,000. The deduction is then $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years.

Other Deductions and Credits

Numerous business tax preferences have been eliminated or modified. These include items such as:

- The Code Sec. 199 domestic production activities deduction was eliminated.
- Changes to the rules for the rehabilitation credit.
- The Act leaves the research and development credit in place, but requires five-year amortization of research and development expenditures.
- Creates a temporary credit for employers paying employees who are on family and medical leave.

Changes to Meals & Entertainment deduction

Beginning in 2018, no deduction is allowed generally for entertainment, amusement, or recreation; membership dues for a club organized for business, pleasure, recreation, or other social purposes; or a facility used in connection with any of the above.

The business meals deduction of 50% has been expanded to include in-house cafeteria arrangements.

Action step - <u>You should set up a separate expense account for tracking entertainment expenses and make sure your meals accounts don't include the title of "entertainment" (since the traditional account title is Meals & Entertainment).</u>

Employer Deductions for Fringe Benefit Expenses Limited

Deductions for employee transportation fringe benefits (e.g. parking and mass transit) are disallowed. The employee receiving those company paid benefits is not taxed on the benefits, the company paying those benefits can no longer deduct them. Note, this rule is not applicable to situations where the employer pays these benefits on behalf of the employee (through payroll withholdings).

Additionally, if you have employees who are paying for transportation benefits personally through a pre-tax company cafeteria plan, this pre-tax amount is not allowed as a deduction to the company.

Action step - ***<u>You should set up a separate expense account for tracking company payments of these amounts. An appropriate account title might be “Employee Parking – Non-Deductible”.</u>***

Interest Deductions

In an attempt to "level the playing field" between businesses that capitalize through equity and those that borrow, the Tax Cuts and Jobs Act generally caps the deduction for net interest expenses at 30 percent of adjusted taxable income, among other criteria. Exceptions exist for small businesses, including an exemption for businesses with average gross receipts of $25 million or less.

Pass-Through Businesses

Currently, up to the end of 2017, owners of partnerships, S corporations, and sole proprietorships – as "pass-through" entities – pay tax at the individual rates, with the highest rate at 39.6 percent. The Tax Cuts and Jobs Act allows a temporary deduction in an amount equal to 20 percent of qualified income of pass-through entities, subject to a number of limitations and qualifications.

The Tax Cuts and Jobs Act contains rules that will prevent pass-through owners—particularly service providers such as accountants, doctors, lawyers, etc.—from converting their compensation income taxed at higher rates into profits taxed at the lower rate.

The pass-through business deduction is reported on the owner’s income tax returns. More detailed information in available in the separate document related to the “Pass-Through Business Deductions”.

Net Operating Losses

The Tax Cuts and Jobs Act modifies current rules for net operating losses (NOLs). Generally, NOLs will be limited to 80 percent of taxable income for losses arising in tax years beginning after December 31, 2017. It also denies the carryback for NOLs in most cases while providing for an indefinite carryforward, subject to the percentage limitation.

Like-Kind Exchange Treatment Limited

After December 31, 2017, the rule allowing the deferral of gain on like-kind exchanges is modified to allow for like-kind exchanges only with respect to real property that is not held primarily for sale (there is a limited transition rule).

In Closing

These are just highlights of the changes and impact of the Tax Cuts and Jobs Act. There is much more to discuss than can be covered in this letter. We can help you with the immediate and long-term impact of the Tax Cuts and Jobs Act on your situation. Please call our office for guidance on all of the provisions that directly affect you. If contacting us during tax season, we may need to set up a meeting after tax season.