TCJA – Top Ten Tax Law Changes for Small Businesses

DARBY RICH, CPA - TAX MANAGER

MYRA BAKKE, CPA - TAX SHAREHOLDER

Douglas WILSON and Company, PC

#1 Corporate Tax Rates

- New **Corporate Flat Tax Rate of 21%** replaces old graduated brackets of 15%, 25%, 34%, and 35%.
- Corporate Alternative Minimum Tax Eliminated.
- This flat rate also applies to *Personal Service Corporations.*
- Dividend received deductions are reduced to 65% & 50% (previously 80% & 70% under previous law).

#2 Qualified Business Income Deduction

- Section 199 allows a deduction on **personal tax return** of up to 20% of <u>Qualified Business Income</u> from Partnerships, S-corporations, Sole Proprietors, Estates and Trusts. The deduction reduces taxable income and applies to Business Income, Real Estate Investment Trust Dividends, and Publicly Traded Partnership Income.

- <u>Qualified Business Income (QBI) –</u>net amount of qualified items of income, gain, deduction, and loss connected to a qualified U.S. trade or business. QBI does not include investment related items (dividends, interest, short/long-term capital gains and losses, and annuities).
  - ***Deduction does not apply to corporations & is not a deduction on MT return***

QBID Continued ….

- Limitations …

  Income Thresholds - $315,000 (MFJ) & $157,500 (All other taxpayers)

  - All taxpayers whose taxable income exceeds these threshold amounts are also subject to

    W-2 Wages/Qualified Property limits

  This limitation is the greater of :

  - **50%** of the W-2 wages paid with respect to the qualified business, **or**
  - **25%** of the W-2 wages plus 2.5% of the unadjusted property basis immediately after the acquisition of all QP

QBID Limitations Continued ....

- Specified Service Businesses (SSB's) –Health, Law, Accounting, Consulting, Athletics, Financial & Brokerage services, Performing Arts
  - SSB's QBID is reduced at taxable income thresholds of $315,000 and $157,500
  - SSB's do not qualify for the QBI deduction when their taxable income exceeds $415,000 (MFJ) and $207,500 (all other taxpayers)

Initial QBI for a qualified business is the **lesser** of:

1. 20% of the taxpayer's QBI with respect to each qualified business, **or**
2. The **greater** of:
   - **50%** of the W-2 wages paid with respect to the qualified business, **or**
   - **25%** of the W-2 wages plus 2.5% of the unadjusted property basis immediately after the acquisition of all Qualified Property

**Many QBI deduction flowcharts available on the web*

#3 Depreciation

- **<u>Bonus Depreciation</u>** – The new law increases bonus depreciation to **100%** for property acquired **September 27, 2017 – Dec. 31, 2022**. Bonus depreciation is also allowed for **both new & used property** .

- **<u>Section 179 -</u>** The new law increases the maximum amount a taxpayer may expense to **$1,000,000**. The phase-out threshold for the cost of qualifying property placed in service for the tax year is $2,500,000 (*limited to business income*).

- Roofs, heating, ventilation & air-conditioning property, alarm & security systems now quality for section 179 expensing.

- **Farm Equipment & Machinery** recovery period for new property is reduced to a 5 year depreciable life (previously 7 years). Farm Property (3, 5, 7, and 10 year) can now also be depreciated under the 200% declining balance method (previously 150%).

Depreciation Cont…

- **<u>Passenger/Luxury Auto (IRC Section 280F)</u> –** (*Prior to September 27, 2017, luxury vehicle was defined as a vehicles costing more than $18,600 and under 6,000 pounds*).
  - Annual depreciation limits increase to $10,000 in Year 1, $16,000 in Year 2, $9,600 in Year 3, & $5,760 for the 4th and later years (based on business %). Bonus depreciation allowable max deduction is $18,000.

- **SUV's, & Trucks** exempt from passenger auto limits have a Section 179 maximum deduction of $25,000.

#4 Net Operating Losses

- The two-year Federal NOL carryback is repealed **except for losses** incurred in the **trade of business of farming** for tax years ending in 2018.
- Federal NOL's may be carried forward indefinitely (until used up).
- For losses arising in tax years beginning in 2018, the Federal NOL deduction is limited to 80% of taxable income in the year the NOL is carried to. (*Estimates may still need made even if you have an NOL*)
- **MT NOL** for tax years beginning after Dec 31, 2017 will still have the option to carryback three preceding tax periods with a carryover of ten tax periods following the loss. The NOL carryback may not exceed $500,000.

#5 Like Kind Exchanges

- Like Kind Exchange treatment is only available for real property after December 31,2017.

- Like Kind Exchanges are no longer allowed for depreciable tangible personal Section 1231 property (non-real estate machinery & equipment).

- Effective 01/01/18, gain/loss will be reported by taxpayers trading in depreciated property (machinery & equipment) when purchasing replacement in the year of the trade.

#6 Reduced Meal & Entertainment Expenses

- **Entertainment Expenses** (golf, sporting events, night clubs, hunting, vacations, etc.) are no longer deductible. Prior to 2018, only 50% of these types of expenses were deductible if related to the active conduct of business.

- Meals provided for employees at the convenience of the employer are only 50% deductible , prior to 2018 they were 100% deductible if a de minimus fringe benefit.

- There is no longer a deduction for transportation, parking, and commuting benefits for employees.

- Business Meals with clients/customers/partners/officers/directors are still 50% deductible.

- Meals while traveling on business and employee meals for a required business meeting are also still 50% deductible.

#7 Interest Expense & Loss Limitations

- **<u>Business Interest Expense -</u>** is now limited to 30% of "adjusted taxable income" for tax years beginning after December 31, 2017.
  - **Exceptions:** Taxpayers with average annual gross receipts of $25 million or less for three previous tax years are exempt from the interest deduction limitation.

- **<u>Excess Business Losses –</u>** The TCJA established loss thresholds for non corporate taxpayers of $250,000 for single taxpayers & $500,000 for Married Filing Joint (aggregate for all businesses).

#8 Accounting Method Changes

- TCJA provides increased availability of the <u>cash method of accounting</u>.

  - New Gross Receipts test of $25 Million for **Small Business** determination effective for tax years after Dec 31, 2017.

  - Taxpayers meeting this test can use the cash method of accounting and **are not required** to keep inventories, apply uniform capitalization rules, or use the percentage of completion method for small construction contracts.

  - The test is satisfied for a tax year if average annual gross receipts for the 3 prior tax years do not exceed $25 Million.
    - *Taxpayers making the change to the overall cash method, a change in use of inventories, or a change to capitalize costs under Section 263-A can file a single Form 3115 with these automatic changes at no charge.*

#9 Tax Credits

- **<u>*NEW* Employer Credit for Family & Medical Leave-</u>** In Tax years beginning after December 31, 2017 and before January 1, 2020 eligible employers can claim a **new general business credit** for wages paid to employees on leave. This credit provides a tax benefit for employers providing paid leave to their employees under the Family & Medical Leave Act (FMLA).
  - *Credit is equal to 12.5% of wages paid if payment is 50% of wages normally paid to employee. Payroll Expense is reduced by the credit.*

- **<u>Opportunity Zone Incentive–</u>** The TCJA allows taxpayers who sell real property at a gain to roll over the gain into a qualified opportunity zone fund (QOZF). The tax is then deferred or eliminated if the taxpayer holds the investment for at least 5 years.
- *List of all U.S counties that qualify to establish QOZF can be found at **www.irs.gov/irs-drop/n-18-48.pdf***

#10 Other Changes & Notes

- Domestic Production Activities Deduction (DPAD) deduction under IRC section 199 is eliminated for tax years beginning after December 31, 2017.

- DE Minimus Safe Harbor Capitalization election – yearly election made on tax return to expense tangible personal property (materials, supplies, and other assets) whose individual cost does not exceed $2,500. Have a written capitalization policy in place stating that you comply with Section 1.263(a)-1(f) DE Minimis Safe Harbor election and are in compliance with IRC code sections 167 & 168.

Thanks so much for the opportunity and best of luck in 2019!