

TAX CUTS AND JOBS ACT FOR BUSINESSES

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Introduction

On December 20, 2017, Congress passed the Tax Cut and Jobs Act which was signed by President Trump on December 22, 2017. The tax cuts are permanent for businesses but temporary for individuals expiring in 2025 and returning to where they were in 2017.

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TCJA and Policy Goals of Tax Reform

Policy Goals	<p>Increase US competitiveness</p> <ul style="list-style-type: none"> ▶ 21% corporate tax rate, AMT repeal ▶ 100% exemption for foreign-source portion of dividends
	<p>Economic growth and job creation</p> <ul style="list-style-type: none"> ▶ Lower individual and corporate tax rates ▶ New 20% deduction for domestic “qualified business income” from a partnership, S corporation, or a sole proprietorship received by US corporations from 10%-owned foreign corporations ▶ New “Opportunity Zones” to spur investment in economically distressed communities
	<p>Encourage US investment</p> <ul style="list-style-type: none"> ▶ 100% expensing of investments in certain qualified property
	<p>Change Obama-era health care policies</p> <ul style="list-style-type: none"> ▶ ACA “shared responsibility payment” reduced to \$0

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BUSINESS TAX PROVISIONS SUMMARIZED

- **Corporate income tax reform**
 - Corporate income tax rate reduction
 - Reduction of corporate dividends received deduction to reflect reduced corporate tax rate
 - Corporate (but not individual) AMT repeal
- **General business tax reform**
 - Immediate expensing for certain capital expenditures
 - Interest expense limitation
 - Net operating loss limitations
 - Like-kind-exchange reform
 - Repeal of domestic production activities deduction
 - Meals & entertainment expense limitation increase
- **Pass-through entity specific tax reform**
 - 20% Deduction for qualifying business income
 - Business loss limitation

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Reduction of Corporate Tax Rates

The Tax Cuts Act reduced the corporate tax rate to a flat 21% rate.

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Charitable Deduction is Denied for Contributions to a College or University in Exchange for Athletic Event Seating Rights

Under pre-Tax Cuts Act, if a taxpayer made a payment to or for the benefit of a college that would have been allowable as a charitable deduction but for the fact that the taxpayer received the right to buy tickets for seating at an athletic event in the institution's athletic stadium, 80% of the payment was treated as a charitable contribution.

Under new Tax Cut Act, no charitable deduction is allowed for a payment to a college or university in exchange for which the contributor receives the right to purchase tickets or seating at an athletic event.

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Moving Expense Deduction Eliminated, Except for Certain Armed Forces Members

The Tax Cut Act suspends the moving expense deduction for years after 2017 and before 2026

- Except for members of the Armed Forces on active duty

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Alternative Minimum Tax on Corporations is Repealed

Elimination of the corporate AMT makes it possible for some businesses to lower their effective tax rates below 21% with various deductions, the benefit of which would otherwise have been reduced or eliminated if the AMT applied.

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Reduction in Corporate Dividends Received Deduction

- Reduces the 70% dividends received deduction to 50%.
- Reduces the 80% dividends received deduction to 65%.

The effective tax rate on 50% dividends is $50\% \times 21\% = 10.5\%$

The effective tax rate on 65% dividends is $35\% \times 21\% = 7.35\%$

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Domestic Production Activity Deduction (DPAD) is Repealed

Code Sec 199 was passed in 2004 for the benefit of companies who manufactured goods inside the United States or produced oil & gas and in its place the government came up with the Section 199A deduction.

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Up to 20% Deduction for Qualified Business Income

Code Sec. 199A was added by the Tax Cuts and Jobs Act. This created a new deduction for all noncorporate taxpayers. The deductible amount for a **qualified trade or business** is the lesser of:

- 20% of the **qualified business income** earned in a qualified trade or business, subject to certain limitations or
- The greater of (1) 50% of the W-2 **wages** relating to the qualified trade or business or (2) the sum of 25% of the W-2 wages relating to the qualified trade or business plus 2.5% of the unadjusted basis immediately after acquisition of all **qualified property**.

Why – to help non-corporate taxpayers who don't get the 21% rate on their business income. Effectively makes business income top tax rate of 29.6%

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20% Deduction - continued

Qualified trades and businesses include all trades and businesses except the trade or business of “performing services” as an employee or owner.

Note, these rules apply to qualified trade/business income, not necessarily to the entire business entity.

Generally, rental activities are not qualified. Exception for self-rental.

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20% Deduction - continued

- **Qualified Business Income**

- Income, gain, deductions, and loss from trade/business
 - Does not include
 - Investment items such as capital gains/losses, dividends, interest income
 - Wage income (including partner's guaranteed payments)
 - Annuities
 - Qualified REIT dividends or Qualified PTP income
 - Can include income from a **Specified Services Trade or Business**
 - With an income-focused exception

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20% Deduction - continued

- **Wages** for this calculation includes:

- Taxable wages as shown on Box 1 of the W-2
- Elective deferrals (i.e. 401k, SIMPLE IRA, etc.)
- Compensation deferred under IRC Section 457
- Designated Roth contributions
- Wages does not include payments to statutory employees or wages paid in the form of cash
- IRS Notice provides for 3 different ways to calculate wages

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20% Deduction - continued

Qualified property relating to a qualified trade or business for a tax year is tangible property of a character subject to a Code Sec 167 depreciation allowance that is:

- Held by and available for use in the qualified trade or business at the close of the year
- Which is used at any point during the taxable year in the production of qualified business income and
- The depreciable period for which has not ended before the close of the tax year
- The deduction also may not exceed (1) taxable income for the year over (2) net capital gain plus aggregate qualified cooperative dividends.

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20% Deduction - continued

- **Specified Service Trade or Business:** those involving the performance of services in law, accounting, health, actuarial science, performing arts, consulting, athletics, financial services, investing and investment management, and brokerage services.
- This is also generally defined to include any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners.

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20% Deduction - continued

Specified Service Trade or Business – income exception

- If the individual's taxable income is less than the threshold of \$157,500 (\$315,000 on a joint return) then SSTB qualifies
- If the individual's taxable income is between \$157,500 and \$207,500 (\$315,000 and \$415,000 on a joint return), then the deduction is phased out.
- If the individual's taxable income is above the threshold, there is no deduction.

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20% Deduction - continued

The deduction is applied to partnerships and S corporations at the partner or shareholder level. Thus, each partner or shareholder must take into account his allocable share of each qualified item of income, gain, deduction.

The Sec 199A deduction does not reduce a taxpayer's AGI. The deduction is taken after AGI is determined, but it is not an itemized deduction, rather, the deduction is available to both taxpayers who itemize deductions and those who claim the standard deduction.

The Sec 199A deduction does not affect basis at the partner or shareholder level.

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20% Deduction - continued

Special rules for

- Election to aggregate business activities
- Netting business income with business losses
- Qualified business losses to be carried forward

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Qualified Trade or Business Income (QBI)

Total Revenue	\$ 3,000,000	\$ 6,000,000
Payroll	800,000	1,300,000
All Other Expenses	<u>2,000,000</u>	<u>4,100,000</u>
Net Income	<u>\$ 200,000</u>	<u>\$ 600,000</u>
Pass-through Deduction at 20%	<u>\$ 40,000</u>	<u>\$ 120,000</u>

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Specified Service Trade/Business

Trade/Business Revenue	\$ 500,000	\$ 1,500,000	\$ 600,000
Payroll	100,000	600,000	150,000
All Other Expenses	300,000	500,000	350,000
Qualified Business Income	<u>\$ 100,000</u>	<u>\$ 400,000</u>	<u>\$ 100,000</u>
Pass-through Deduction at 20%	<u>\$ 20,000</u>	<u>\$ 80,000</u>	<u>\$ 20,000</u>

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Taxable Income Limitation

	<u>Single</u>	<u>Single</u>	<u>Joint</u>
Qualified Business Income	\$ 100,000	\$ 100,000	\$ 100,000
Capital Gain	-	7,000	-
Wage income from QBI			150,000
Wages - other			150,000
	<u>100,000</u>	<u>107,000</u>	<u>400,000</u>
Deductions	<u>19,000</u>	<u>19,000</u>	<u>100,000</u>
Taxable Income	<u>\$ 81,000</u>	<u>\$ 88,000</u>	<u>\$ 300,000</u>
Deduction is the lesser of:			
QBI x 20%	20,000	20,000	\$ 20,000
Taxable Income	81,000	88,000	300,000
Remove Capital Gain		(7,000)	
	<u>81,000</u>	<u>81,000</u>	<u>300,000</u>
Taxable Income x 20%	\$ 16,200	\$ 16,200	60,000

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Comprehensive Aggregation and Limitations

	<u>QBI-1</u>	<u>QBI-2</u>	<u>QBI-3</u>	<u>Separate</u>	<u>Aggregate</u>
Total Cost of Fixed Assets	\$ -	\$ -	\$ -	\$ -	\$ -
Trade/Business Revenue	\$ 1,500,000	\$ 1,000,000	\$ 502,000	\$ 3,002,000	\$ 3,002,000
Payroll	500,000	-	500,000	1,000,000	1,000,000
Qualified Business Income (QBI)	<u>\$ 1,000,000</u>	<u>\$ 1,000,000</u>	<u>\$ 2,000</u>	<u>\$ 2,002,000</u>	<u>\$ 2,002,000</u>
Pass-through Deduction at 20%	<u>\$ 200,000</u>	<u>\$ -</u>	<u>\$ 400</u>	<u>\$ 200,400</u>	<u>\$ 400,400</u>
If individual's taxable income exceeds the threshold:					
Lesser of A or B					
A - 20% of Net Income	\$ 200,000	\$ 200,000	\$ 400	\$ 400,400	\$ 400,400
Greater of B-1 or B-2					
B-1 - 50% of Payroll	250,000	-	250,000	500,000	500,000
B-2 - 25% of Payroll	125,000	-	125,000	250,000	250,000
B-2 - 2.5% of Fixed Assets	-	-	-	-	-
	<u>125,000</u>	<u>-</u>	<u>125,000</u>	<u>250,000</u>	<u>250,000</u>
Lesser of A or B is:	<u>\$ 200,000</u>	<u>\$ -</u>	<u>\$ 400</u>	<u>\$ 200,400</u>	<u>\$ 400,400</u>

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NOL Deduction is Limited to 80% of Taxable Income

The limitation on the amount of NOLs that a corporation may deduct in a single tax year under Sec 172(a) is equal to the lesser of the available NOL carryover or 80 percent of a taxpayer's pre-NOL deduction taxable income (the "80% limitation"). The limitation only applies to losses arising in tax years that begin after Dec 31, 2017. As a result, taxpayers with historic NOLs may see a silver lining around the cloud of this limitation, because for NOLs generated in tax years ending before Jan. 1, 2018, the historic rules appear applicable.

Under prior Sec 172, NOLs were generally eligible for a two year carryback and twenty year carryforward. The Tax Cut Act disallows the carryback of NOLs but allow the indefinite carryforward of those NOLs.

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NOL Deduction Limit continued

Under an exception to the no-carryback rule, any part of an NOL for the tax year that's a farming loss of the taxpayer can be carried back to each of the two tax years preceding the tax year of the loss.

A farming loss is the lesser of:

- (1). The amount that would be the NOL for the tax year if only income and deductions attributable to farming businesses are taken into account, or
- (2). The amount of the NOL for the tax year.

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Business Deduction is Denied for Entertainment Expenses

No deduction is allowed for:

- Any activity generally considered to be entertainment, amusement or recreation
- Membership dues to any club organized for recreation or social purposes
- A facility, or portion thereof, used with the above items

That means no more deduction for a round of golf, theater tickets, spa visit, sports tickets, skybox, fishing, hunting, show tickets, etc.

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Business Meals are Still 50% Deductible Provided They are Documented

- In order for meals to be 50 percent deductible, business must be discussed and should be classified as: **Meals**. If no business is discussed the meal is not deductible for tax purposes and should be shown as: **Entertainment**.
- Meals when traveling for business are considered 50 percent deductible and should be classified as: **Meals**.
- Company activities, such as holiday parties, birthday and anniversary celebrations, picnics, etc. are fully deductible. In order to capture the 100 percent deductibility, these expenses should be classified as: **Meals-Celebratory**.

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Expenses for Employer-Operated Eating Facilities are Only 50% Deductible Through 2025, Then Become Nondeductible

Employers previously were allowed to deduct 100% of expenses related to the eating facilities that they operated. The 100% deduction has been reduced to 50% for the period Jan 1, 2018 through Dec 31, 2025. After that date no deduction is allowed.

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Employer Can't Deduct Cost of Providing Qualified Transportation Fringes and Other Transportation Benefits

The Tax Cut Act provides that no deduction is allowed for the expense of a qualified transportation fringe, as defined in Code Sec 132(f), provided to an employee of the taxpayer.

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Pre-Adjustment Code Sec 179 Limits Raised to \$1 Million and \$2.5 Million

The Tax Cuts Act raises the pre-inflation-adjusted annual dollar limit from \$500,000 to \$1 million and the pre-inflation annual beginning-of-phase-down threshold from \$2 million to \$2.5 million.

The inflation adjustment formula is changed to provide that the above \$1 million and \$2.5 million figures are each increased for any tax year beginning after calendar 2018 for inflation

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Eligibility of Building Improvements for a 15 Year Recovery Period is Expanded

The Tax Cuts Act eliminates the separate definitions of qualified leasehold improvements, qualified restaurant property and qualified retail improvement property

Now is simply referred to as Qualified Improvement Property:

1. Property without regard to what business it is used in
2. Must be placed in service at least 3 years after the building being improved
3. Excludes restaurant buildings and some restaurant improvement

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More Building Improvements are Made Eligible to be Sec 179 Property

The changes made by the Tax Cuts Act are generally expansive of what property qualifies because

- (1) “qualified improvement property” includes without regard to what business it is used in or whether the improved space is leased space,
- (2) qualified improvement property must be placed in service at least three years after the building that they improve was placed in service,
- (3) qualifying roofs, HVAC property, fire protection and alarm systems and security systems that are structural components of buildings are treated as qualified real property even if they are qualified improvement property, and
- (4) the only way in which the Tax Cuts Act definition of qualified real property is more restrictive than the definition before the Tax Cuts Act is in its exclusion of restaurant improvements.

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Bonus Depreciation is Increased to 100% and is Extended and Modified

The Tax Cuts Act extends the deadline for placing into service qualified property eligible for bonus depreciation and AMT relief from Dec 31, 2019 to Dec 31, 2026.

Increases bonus depreciation for qualified property from 50% to 100%.

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Used Property is Allowed 100% Bonus Depreciation (Full Expensing)

The Tax Cuts Act eliminates the requirement that the original use of qualified property “must” begin with the taxpayer thus allowing purchases of both used and new items by providing instead that property either:

- Meet the original use requirement, or
- Meets the requirement if the property wasn’t used by the taxpayer at any time before the acquisition

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\$25,000 Per-Vehicle Limit on Code Sec 179 Expensing of Heavy SUVs is Made Adjustable for Inflation

The Tax Cuts Act makes adjustable for inflation the \$25,000 pre-vehicle limit on the cost of an SUV eligible for Code Sec 179.

Note: This \$25,000 limit only applies to Code Sec 179
- it is circumvented through the new 100% bonus depreciation

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\$8,000 Increase for “Qualified Property” in the First Year Depreciation Cap for Passenger Autos is Extended

The Tax Cuts Act provides that the placed-in-service deadline for “qualified property” is Dec 31, 2026. Thus, for a passenger automobile that satisfies the other requirements for qualified property and for which the taxpayer doesn’t elect to decline bonus depreciation, the Tax Cuts Act extends the placed-in-service deadline for the \$8,000 increase applicable first year depreciation limit.

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Annual Caps on Depreciation of Passenger Automobiles are Raised

The Tax Cuts Act provides that the base amounts of depreciation caps for a passenger automobile are as follows:

- \$10,000 for the year a vehicle is placed in service
- \$16,000 for the second year in the recovery period
- \$9,600 for the third year in the recovery period
- \$5,760 for the fourth, fifth and sixth year in recovery period
- \$5,760 for any years after the recovery year

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Most New Farming Equipment and Machinery is Made 5-Year MACRS Property

The Tax Cuts Act applies, without a limited placed-in-service window, a 5-year MACRS recovery period to items of machinery and equipment used in a farming business.

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Treatment of Computer Equipment as Listed Property is Ended

The Tax Cuts Act ends the inclusion of computer and peripheral equipment as a type of property included in the definition of listed

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Like-Kind Exchanges are Limited to Exchanges of Real Estate

- In light of the increased and expanded expensing under Code Sec 168(k) and Code Sec 179 for tangible personal property and certain building improvements, Congress believed that Code Sec 1031 should be limited to exchanges of real property not held primarily for sale.
- Under the Tax Cuts Act, exchanges of machinery, equipment, vehicles, patents and other intellectual property, artwork, collectibles, and other intangible business assets do not qualify for nonrecognition of gain/loss.

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Limit on Deduction of Business Interest Expense

- Applies to every business, regardless of its form
- Generally applies at the taxpayer level
 - However, for partnerships and S corporations – applies at the entity level
- The deduction is limited to 30% of the business's adjusted taxable income (initially calculated as EBITDA through 2022, then EBIT)
 - Plus floor plan financing
 - If floor plan financing is elected to be used, the 100% bonus depreciation is not available
 - Excess interest will be carried forward

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Limit on Deduction of Business Interest Expense

Small Business Exception:

- The business interest deduction limitation does not apply to a taxpayer if:
- The average annual gross receipts for the three prior years is less than \$25 million.

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Limit on Deduction of Business Interest Expense

Electing Real Property Trade or Business Exception:

- Applies to any trade or business that enables the taxpayer to qualify as a real estate professional and
- Makes an election to be so treated
- The consequence that the electing trade/business must use the alternative depreciation system for any real property, including qualified improvement property.
- A farming business can also make a similar election with a similar consequence.

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And Done!

THANK YOU!

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