

Business Tax Law Changes for 2018

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Presenter



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Agenda

- Tax Cuts and Jobs Act (TCJA)
 - Business Changes:
 - Overview of Business Changes
 - New 20% Pass-through Deduction (Sec. 199A)
 - Accelerated Depreciation
 - Meals and Entertainment



Overview of Business Changes

- 20% pass-through deduction (Sec. 199A)
- Corporate rate reduction to flat 21% and repeal of corporate AMT
- Loss limitation for other than C corps (Sec. 461)
- Repeal of Domestic Production Activities Deduction (DPAD)
- Accelerated depreciation
 - Increases to Sec. 179 (\$1 million and threshold \$2.5 million)
 - Changes to bonus depreciation
- Expanded accounting method exceptions for small businesses
- Changes to meals and entertainment expenses
- Limit on use of and carryback of NOL
- Limitation on interest expense deduction for non-small businesses (over \$25 million receipts); limited exceptions
- Corporate shift from worldwide to territorial system

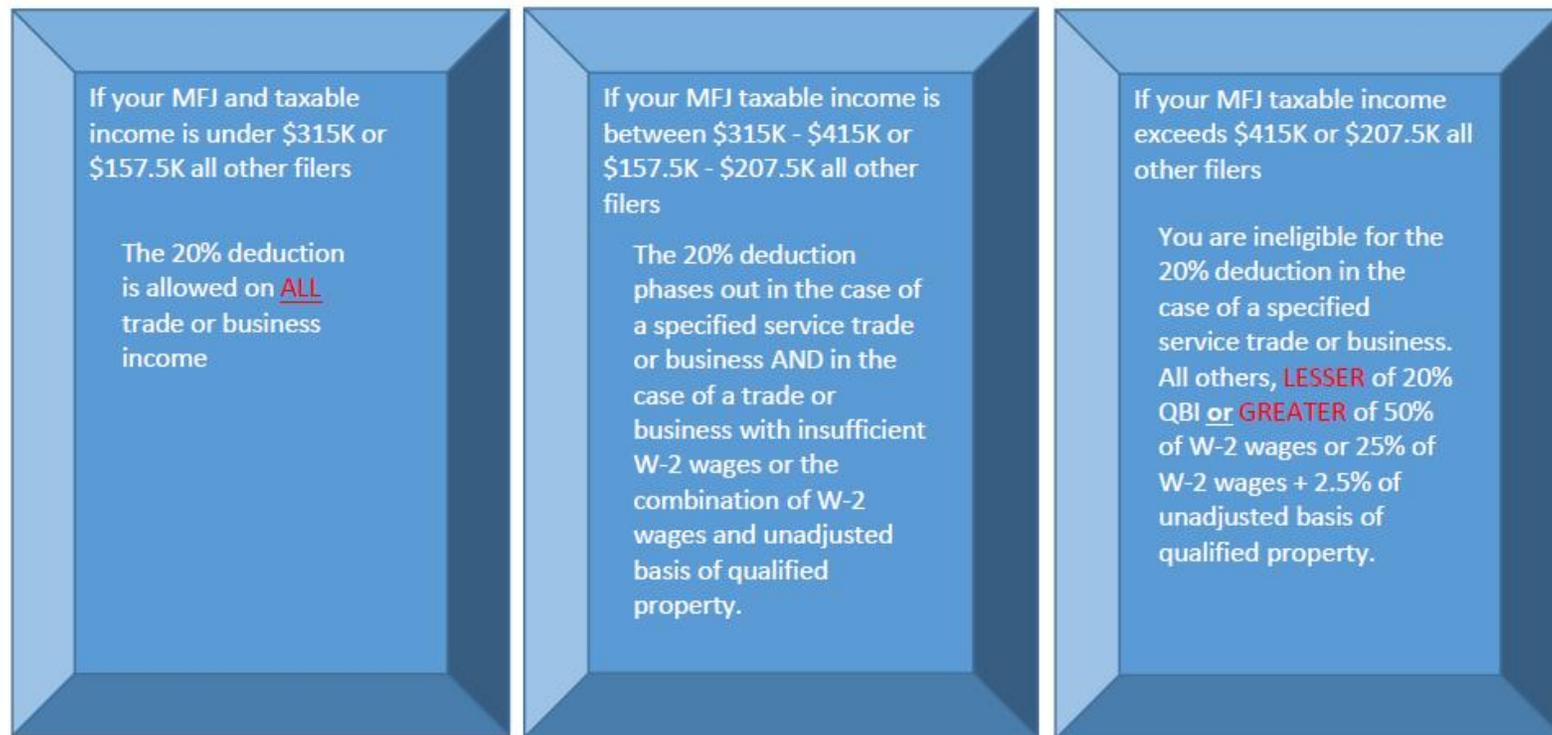
New 20% Pass-through Deduction

- For tax years beginning after December 31, 2017, deduction is 20% of qualified business income
- Qualified business income (QBI):
 - QBI does not include investment income (e.g. capital gains, dividends or interest)
 - QBI does not include reasonable compensation paid from S corporation or guaranteed payments paid to a partner
 - QBI is determined separately for each qualified business
 - QBI deduction is taken on the individuals' income tax return



New 20% Pass-through Deduction

Summary of Taxable Income on Deduction Calculation



New 20% Pass-through Deduction

- Limitations
 - QBI deduction cannot exceed 20% of “modified” taxable income
 - For this purpose, taxable income is reduced by net capital gain (including qualified dividend income)
- Calculation for taxpayers with taxable income below the thresholds are relatively simple
 - The QBI deduction equals the **LESSER** of:
 - 20% of QBI plus 20% of qualified REIT dividends and qualified PTP income, **or** 20% of taxable income in excess of net capital gain



New 20% Pass-through Deduction

- **Modified Taxable income below the thresholds:**
 - Example 1 - You are an unmarried individual and operate your business as a sole proprietorship. It produces \$150,000 of qualified business income. Your other income and deductions result in modified taxable income of \$153,000. You qualify for a **deduction of \$30,000 (\$150,000 x 20%)** – the lessor of 20% of modified taxable income (\$30,600) or 20% of QBI (\$30,000)
 - Example 2 - You are an unmarried individual and operate your business as a sole proprietorship. It produces \$100,000 of qualified business income. Your other income and deductions result in modified taxable income of \$81,000. You qualify for a **deduction of \$16,200 (\$81,000 x 20%)** - the lessor of 20% of modified taxable income (\$16,200) or 20% of QBI (\$20,000)



New 20% Pass-through Deduction

- **Modified Taxable Income Phase-out Range**
 - For the single taxpayer, the taxable income phase-out range is the \$50,000 between \$157,500 and \$207,500
 - For the married filing jointly taxpayer, the taxable income phase-out range is the \$100,000 between \$315,000 and \$415,000
- **Calculation for taxpayers with taxable income ABOVE \$207,500 (all other filers) or \$415,000 (married filing jointly)**
 - The QBI deduction equals the **LESSER** of:
 - 20% of QBI, **or** the **GREATER** of (a) 50% of that business's W-2 wages or (b) the sum of 25% of the W-2 wages, plus 2.5% of the unadjusted basis immediately after acquisition of all the business's qualified property



New 20% Pass-through Deduction

- Specified Service Trade or Business (SSTB)
 - **Health**
 - Disqualified: doctors, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists, and other similar healthcare professionals who provide services directly to a patient
 - Not disqualified: people who provide services that may improve the health of the recipient, such as the operator of a health club or spa, or the research, testing, and sale of pharmaceuticals or medical devices



New 20% Pass-through Deduction

- Specified Service Trade or Business (SSTB) continued
 - **Consultants**
 - Disqualified: those who provide professional advice and counsel to clients to assist in achieving goals and solving problems, including government lobbyists
 - Not disqualified: Salespeople and those who provide training or educational courses. This category also does not include any services ancillary to the sale of goods in a business that is NOT a SSTB (such as a building contractor) as long as there is no separate fee for the consulting services.



New 20% Pass-through Deduction

- Specified Service Trade or Business (SSTB) continued
 - **Financial Services**
 - Disqualified: Those who provide financial services to clients including managing wealth, developing retirement or transition plans, M&A advisory, valuation work. In other words, financial advisors, investment bankers, wealth planners, and retirement advisors
 - Not disqualified: Banking or Insurance Sales



New 20% Pass-through Deduction

- Specified Service Trade or Business (SSTB) continued
 - **Brokerage Services**
 - Disqualified: A broker who arranges transactions between a buyer and a seller with *respect to securities*; i.e., a stock broker
 - Not disqualified: A real estate broker
 - **Investment Management**
 - Disqualified: Those who receive fees for providing investing, asset management, or investment management services
 - Not disqualified: Real estate management



New 20% Pass-through Deduction

- You have two ways for the IRS to treat your rental activity as a trade or business for the Section 199A deduction:
 1. The rental property qualifies as a trade or business under tax code Section 162, or
 2. You rent the property to a “commonly controlled” trade or business
- Good News: Most rentals likely qualify as Section 199A businesses
 - 20% Pass-through deduction possibility if your rental property
 - (a) has profits and
 - (b) can qualify as a trade or business



New 20% Pass-through Deduction

- Trade or Business Route
 - If you have **regular and continuous involvement** with your rental activities, then you'll likely meet the Section 162 trade or business test.
 - Unfortunately, there's no bright-line test: you have to look at case law and make a judgment call.
 - Your non-recurring and/or non-devotion ventures likely don't qualify as a trade or business.



New 20% Pass-through Deduction

- Commonly Controlled Route
 - For purposes of this rule, “commonly controlled” means the same person or group of persons, directly or indirectly, owns 50 percent or more of each trade or business
 - The law attributes any interest in a trade or business owned by your spouse, children, grandchildren, and parents to you as well.



New 20% Pass-through Deduction

- Rentals that achieve trade or business status creates the following five possible tax benefits:
 1. Section 199A tax deduction of up to 20 percent of the rental property's qualified business income (QBI).
 2. Receives tax-favored Section 1231 treatment, which upon sale can provide an ordinary loss (the best kind of loss) or a tax-favored capital gain.
 3. Home-office deduction if you meet the other home-office requirements of exclusive and regular use.
 4. Creates rental property deductions for the cost of your attendance at rental property meetings, seminars, and conventions.
 5. Enables Section 179 expensing for certain assets used in the business (special rules apply to the real property).
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New 20% Pass-through Deduction

- Aggregation of activities
 - To aggregate, your activities must meet the following five requirements
 1. The same person or group of persons, directly or by attribution, must own 50 percent or more of each trade or business;
 2. The ownership above must exist for a majority of the taxable year, including the last day of the taxable year, in which the items attributable to each trade or business are included in income;
 3. All the items attributable to each trade or business must be reported on returns with the same taxable year, not taking into account short taxable years;



New 20% Pass-through Deduction

- Aggregation of activities continued
 4. The trades or businesses must not include any out-of-favor specified service trades or businesses; and
 5. The trades or businesses must satisfy at least two of the three “facts and circumstances” factors described below
 - The trades or businesses provide products, property, or services that are the same or are customarily offered together.
 - The trades or businesses share facilities or share significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.
 - The trades or businesses are operated in coordination with, or in reliance upon, one or more of the businesses in the aggregated group (for example, supply chain interdependencies).



New 20% Pass-through Deduction

- Aggregation of activities continued
- Now for the big question: can you aggregate your multiple rental businesses?
 - The final regulations tell us you can, in most circumstances, provided that the rental activities share centralized administrative functions, such as accounting, legal, and human resources functions.
- The big wrinkle is the type of rental business: you generally can't aggregate residential rental businesses and commercial rental businesses with each other because they aren't the same type of property.
- **Warning.** If your rental business qualifies for the Section 199A tax deduction under the commonly controlled rental rule but is an out-of-favor specified service trade or business, you can't aggregate it with your other rentals.



New 20% Pass-through Deduction

- New Safe Harbor presumably provides little or no benefit
 - In Notice 2019-7, the IRS announced its rental property Section 199A tax deduction safe harbor that you can use to qualify your rentals as trades or businesses for purposes of Section 199A regardless of what they really are.
 - The automatic business treatment in this safe harbor likely does nothing for you. I say this because it's likely that your rental qualifies as a trade or business without considering the safe harbor.
 - Another problem with the safe harbor is that it does not make your rentals trades or businesses for Section 1231, the home-office deduction, seminars, or the Section 179 deduction. Therefore, if you want to enjoy true business tax benefits from your rentals, you need to know whether they qualify, as a matter of law, as trades or as businesses.



New 20% Pass-through Deduction

- Strategies to Consider
 - **Sole Proprietor elects to be taxed as an S corporation**
 - **Situation** - Harry is self-employed, not in a SSTB, single, with taxable income of \$400,000 and qualified business income of \$370,000. With no wages or property, Harry's Section 199A deduction is \$0.
 - **Solution** - Harry elects to be taxed as an S corporation and has his S corporation pay him \$100,000 in wages. With the wages, Harry's taxable income is still \$400,000, his qualified business income is now \$270,000, the wages are \$100,000, and Harry's pass-through deduction is \$50,000 (50 percent x \$100,000 of wages).
 - **Bonus money** - Harry also saves \$10,834 in self-employment taxes



New 20% Pass-through Deduction

- Strategies to Consider continued
 - **Consider reassessing S corporation salary**
 - **Situation** - Fred operates his business as an S corporation. He takes a \$128,000 salary. The S corporation generates \$132,000 of qualified business income. Fred is married, and the couple has taxable income of \$300,000. Fred's pass-through deduction is \$26,400.
 - **Solution** - Fred learns how to prove that a \$68,000 salary is reasonable. This gives Fred **three** benefits:



New 20% Pass-through Deduction

- Strategies to Consider continued
 - **Consider reassessing S corporation salary continued**
 1. The lower salary increases the S corporation's qualified business income to \$196,590 (\$132,000 + \$60,000 + \$4,590). Now, Fred's pass-through deduction is \$39,318 **(a \$12,918 increase)**.
 2. The \$60,000 in reduced salary saves \$4,590 of personal FICA taxes and puts that money in Fred's pocket.
 3. The \$60,000 in reduced salary also reduces the S corporation's FICA taxes by \$4,590, which increases the corporation's income to Fred. On the \$4,590 from the corporation, Fred pays an additional \$1,102 in taxes.
 - » Net result: Fred puts **another** \$3,488 (\$4,590 - \$1,102) in his pocket



New 20% Pass-through Deduction

- Strategies to Consider continued
 - **Create or Enhance Your Retirement Plan**
 - **Situation** - You are married, in an out-of-favor business, with no W-2 wages or property, and taxable income of \$365,000
 - **Solution** - Create a retirement plan that allows you a business deduction of \$50,000 or more so that you can drive your taxable income down to \$315,000 or lower. Let's say you did that and that your qualified business income is now \$335,000 and your taxable income is \$315,000. Your 20% pass-through deduction is \$63,000 ($\$315,000 \times 20\%$)



Accelerated Depreciation

Bonus Depreciation

- Additional first year/bonus depreciation- 100% for property acquired after 9/27/17
- Phase down schedule for years after 2022
- Now allowed for new and used property
- Qualified improvement property – new definition and recovery life
- Luxury auto limits – (note that the TCJA retained the additional \$8K depreciation - see following slide)

Section 179

- Increases to Sec. 179 (\$1M and threshold \$2.5M)
- SUV limitation remains at \$25,000
- Limits are indexed for inflation
- Expansion for certain real property (roofs, HVAC) - see following slide
- Expanded to include depreciable personal property used predominantly to furnish lodging - see following slide

Accelerated Depreciation

- Liberalized Section 179 Deduction Rules
 - Eligible property includes improvements to an interior portion of a nonresidential (i.e. commercial) building if the improvements are placed in service after the date the building was placed in service.
 - The TCJA also expands the definition of eligible property to include the expenditures for nonresidential buildings:
 - Roofs,
 - HVAC equipment,
 - Fire protection and alarm systems, and
 - Security systems
 - Trade or business requirement still applies (real estate rentals are still not eligible)



Accelerated Depreciation

- Liberalized Section 179 Deduction Rules continued
 - TCJA expands the definition of eligible property to include depreciable tangible personal property used predominantly to furnish lodging
 - Examples of such property include:
 - Beds and other furniture,
 - Appliances, and
 - Other equipment used in the living quarters of a lodging facility, such as an apartment house, dormitory, or other facility where sleeping accommodations are provided and rented out
- Important: Sec. 179 deductions can't create or increase an overall tax loss



Accelerated Depreciation

- TCJA has dramatically accelerated the depreciation schedules for “passenger vehicles” or light duty truck or vans used in a trade or business
 - \$10,000 for 1st taxable year in the recovery period (was \$3,160)
 - \$16,000 for 2nd taxable year in the recovery period (was \$5,100)
 - \$9,600 for 3rd taxable year in the recovery period (was \$3,050)
 - \$5,760 for each succeeding taxable year in the recovery period (was \$1,875)
- TCJA retained \$8,000 limit for additional first-year depreciation for passenger autos, so the maximum amount of depreciation in the first year is \$18,000



Accelerated Depreciation

- Bonus Depreciation - 100% Write-off for heavy SUVs, Trucks and Vans (GVWR above 6,000 lbs.) **used entirely for business**
 - To be eligible for bonus depreciation, business use must exceed 50% of total use
 - Taxpayer that buys and places in service a new heavy SUV after Sept. 27, 2017, and before Jan. 1, 2023, and uses it 100% for business, may write off its entire cost in the placed-in-service year.
 - Example - Taxpayer buys a \$70,000 heavy SUV in March of 2018 and uses it entirely for business, it may write off the full \$70,000 cost of the vehicle on its 2018 return.
 - May elect 50% bonus depreciation for first year ending after September 27, 2017



Accelerated Depreciation

- Computers and Peripheral Equipment
 - Under the new tax law, computers and peripherals are no longer considered “listed property,” subject to special depreciation rules
- Cost Segregations
 - 100 percent expensing of tangible personal property, for both new and previously owned assets, creates an immediate opportunity for tax savings.
- Like-kind exchanges preserved for real estate
 - The allowance of tax-free “like-kind” exchanges of rental real estate is preserved under section 1031 of the tax code, but repeals exchanges of personal property, such as art work, auto fleets, heavy equipment, etc.



Meal and Entertainment Expenses

- Entertainment expenses that **were 50% deductible are no longer deductible beginning January 1, 2018**
- Entertainment includes activities like entertaining at nightclubs, cocktail lounges, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation, and similar trips, including such activity relating solely to the taxpayer or the taxpayer's family
- Entertainment should not be interpreted to mean only the entertainment of others
- Taxpayer's trade or business matters
 - For example, me attending a baseball game would be considered entertainment, but it would not be considered entertainment for a scout to attend a game in a professional capacity



Meal and Entertainment Expenses

- Employee meals that **were 100%, but are now 50% deductible beginning January 1, 2018**, include:
 - Meals served at required business meetings on your business premises (e.g. monthly staff meeting);
 - Meals served at required business meetings in a hotel or other meeting place that passes the test for business premises but is located outside the office;
 - Meals served to employees who are required to staff their positions during breakfast, lunch, and/or dinner times for the convenience of the employer;
 - Meals served to employees at in-office cafeterias; and
 - Food and meal costs for employees who are required to live on premises for the convenience of the employer



Meal and Entertainment Expenses

- How the TCJA treats 12 meal and/or entertainment events:

Description	Amount Deductible for Tax Year 2018		
	100%	50%	\$0
Meals with clients and prospects		X*	
Entertainment with clients and prospects			X
Employee meals for convenience of employer		X	
Employee meals for required business meeting		X	
Meal served at Chamber of Commerce meeting		X	
Meals while traveling away from home overnight		X	
Year-end party for employees and spouses	X		
Golf outing for all employees and spouses	X		
Year-end party for customers			X
Meals for general public at marketing presentation	X		
Team-building recreational event for all employees	X		



Meal and Entertainment Expenses

- Make sure you have your 2018 business meals documented as follows:
 - The name of the person you had the meal with
 - The name of the restaurant where you had the meal
 - A short description of the business discussed
 - If the meal costs \$75 or more, keep the receipt that shows the name of the restaurant, number of people at the table, and itemized list of food and drink consumed.



Questions



Thank you!