What Business Owners Need to Know About the Tax Cuts & Jobs Act

By: Ben Kaup

Last week we reviewed the top changes affecting individual taxpayers under the Tax Cuts & Jobs Act. While there are major changes for individuals within the new tax code, the real shakeup happened with the taxation of business income. In this article I will first cover the major change to C-Corporation taxation, then we will finish with the major changes to "pass through" entities and sole proprietorships.

C-Corporations pay their own taxes as opposed to passing it through to the owners. As you have likely heard, the corporate tax rate has been changed to a "flat tax" of 21%. This is a huge tax break for large corporations who were used to paying up to a 39% tax rate in the past. Although it helps the big guys, there are some C-Corporation owners who managed their prior operations to produce just enough income to stay in the old 15% bracket (taxable income below 50,000.) Those corporations just received a 6% tax increase under the new law. Because of this change, many C-Corporation owners need to take a hard look at whether it makes sense to change their entity type to take advantage of the new tax code for pass through entities. There is no "one-size-fits-all" approach to selecting the best entity structure for your operation. Many other non-tax variables come into play. We can help you sort through the issues and determine the best structure for your family moving forward.

Now I will cover the major changes to pass through entities and sole proprietorships. Below are the entity types the changes will affect:

-S-Corporations (passed through to owner)
-Partnerships (passed through to owner)
-Schedule C Businesses
-Schedule F Farmers & Ranchers
-Schedule E Rental Income

The biggest change affecting these businesses is the new "Qualified Business Income

Deduction." In a nutshell, this deduction takes the net income your business made for the year then deducts 20% of that amount before you pay taxes. For example, let's say your business nets $100,000 of income for the year less the 20% business deduction. Assume that you are in the 25% bracket. You just saved ($20,000 x 25%) $5,000 in federal income tax. Now I say "in a nutshell" because determining this amount is subject to MANY limitations that will become a headache for tax preparers. For the sake of brevity, I will not bore you with the numerous tests involved in calculating the deductible amount.

After the initial passing of the bill in December, there has been some discussion around the fact that the Qualified Business Income Deduction may have had a broader reach than originally intended. There is the possibility that some of those who may currently benefit from it could be squeezed out if legislators try to change its current structure. We feel it is best to use a wait and see approach until we get some final clarity on the issue.

Other major changes include:

-100% Bonus Depreciation for any business property placed in service until 2022. In the past Bonus Depreciation was only allowed on new assets. It now includes both new and used assets. This will allow some taxpayers to expense the entire amount of asset purchases in the first year without being hampered by the old section 179 limitations.

-100% Bonus Depreciation is retroactive to September 27th, 2017. So, any assets purchased in the last three months of 2017 will get this same tax break as they will in 2018. This is the only major provision that will affect taxpayers for their 2017 filing.

-Domestic Production Activities Deduction is going away. It is replaced by the new Qualified Business Income Deduction.

-Like Kind Exchanges will only be available for real estate transactions moving forward. The 100% bonus depreciation mitigates any negative effect this would have on other asset transactions.

-Net Operating Loss deductions will be limited to 80% of taxable income. This means avoiding a NOL will be even more important moving forward since it is not available to offset 100% of future income.

-Section 179 limitation is increased from $500,000 of asset purchases to $1,000,000. In the past you were limited to expensing on only $500,000 of assets before you had to use the standard depreciation methods whereas now you can expense up to $1,000,000 in the first year. This revision becomes less important with the new 100% bonus depreciation rule.

As you can see many of the old rules of thumb are out the window with the new tax code. It will benefit most taxpayers with lower taxes, but it will require some adjustments for everyone to get up to speed on the new regulations. We are working diligently to provide our clients with the best planning we can as we move forward under the new tax law. As we are in contact with you regarding the filing of your 2017 tax return, please let us know what questions you have about how the new tax law affects you and your operation.

Thanks,

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