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BUSINESS TAX UPDATE (VOLUME 18.01)

By now, you have probably heard quite a bit about the new tax law - *The Tax Cuts and Jobs Act* (ACT). The Act, signed by President Trump on December 22, represents the most comprehensive U.S. tax reform enacted since the Tax Reform Act of 1986.

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 expensing provisions 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.

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 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 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 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.

Deductions and Credits

Numerous business tax preferences are eliminated. These include the Code Sec. 199 domestic production activities deduction, non-real property like-kind exchanges, most entertainment and more. Additionally, the rules for business meals are revised, as are the rules for the rehabilitation credit.

However, the Act leaves the research and development credit in place, but requires five-year amortization of research and development expenditures. It also retains the low-income housing and work opportunity credits and creates a temporary credit for employers paying employees who are on family and medical leave.

Interest Deductions

In an attempt to "level the playing field" between businesses that capitalize through equity and those that borrow, the 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 on their share of income passed through from theses businesses, with the highest rate at 39.6 percent. Starting in 2018, the Act allows a temporary deduction by the owner in an amount equal to 20 percent of qualified income of pass-through entities, subject to a number of limitations and qualifications.

By focusing on non-owner wages, the Act contains complex rules that are designed to 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.

Net Operating Losses

The 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.

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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 - and there are many areas that need clarification which the Internal Revenue Service is working to provide.

As additional guidance emerges, we will provide additional *Business Tax Updates*. In the meantime, feel free to call our office for additional information or to ask questions on any of the provisions that may impact you and your business.