

Business Signals

A periodic newsletter about the legal implications of issues affecting businesses and business owners in the Central Gulf Coast region.

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Client Alert: Things Every Business Person Must Know About Tax Reform.

Section Two: Business Taxation

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Business Taxation:

In Section One of our tax alert, we addressed the changes in the new Tax Act to individual taxation and estate and gift taxation. However, there were also significant changes in the area of business taxation, for all types of entities. These changes to the tax laws relating to businesses are extensive and very important for our clients who own businesses. The most important changes for business taxes are as follows:

1. **C Corporations:** All C corporations in the U.S. are now taxed at a much lower corporate rate of twenty-one percent, with a thirty-five percent rate for personal service corporations. There has also been a change to the dividends received deduction, which covers dividends a corporation receives from another corporation. That deduction has been lowered from eighty percent to sixty-five percent if the taxpayer corporation owns twenty percent or more of the corporation paying the dividends, and from seventy percent to

fifty percent if the taxpayer corporation owns less than twenty percent of the dividend paying corporation.

Importantly, Corporations are no longer subject to corporate alternative minimum tax (AMT), which could provide significant tax savings to those corporations which would have been affected.

2. **New 20% Percent Deduction for Owners of Pass-Through Entities:**

Many of our clients own what are called under tax laws "pass-through entities" which includes such types of businesses as S corporations, limited partnerships, limited liability companies, and other kinds of entities which are not C corporations and which do not pay a double tax on both the earnings of the entity and distributions to the owner. These types of pass-through entities make up the bulk of the small businesses in the United States. Section 199A of the new Tax Act has included an extremely important deduction for owners of these businesses, allowing each business owner to deduct twenty (20%) percent of their qualified business income. Qualified business income generally means a taxpayer's net trade or business income from the pass-through



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entity. It does not include any amounts received by the owner which are attributable to W-2 wages, partnership guaranteed payments for services, and certain specified investment related items, such as capital gains or losses, dividends, and interest income unless the interest is properly allocable to the business.

To calculate the deduction, the taxpayer would start with either the lesser of the taxpayer's combined qualified business income or twenty percent of the excess of taxable income over net capital gains. This limitation applies to all pass-through entities who are attempting to take advantage of the deduction.

There is an additional limitation on the deduction for specified types of service trades or businesses. This would include physician practices, law firms, accounting firms, financial and brokerage firms, and other kinds of specified services in Section 199A, but surprisingly does not include engineering firms or architecture firms, which have been exempted from these rules. For specified service providers, trades or businesses that are covered by this rule, there is a special rule for eligibility for the deduction, which refers to the service provider's taxable income from all sources. The rules are as follows:

- If the taxpayer's taxable income is less than \$157,500 for an individual, or \$315,000 for joint returns, then he or she can take the full twenty percent deduction on qualified business income;
- If the taxpayer's taxable income is in between \$157,500 and \$207,500 for individuals, or \$315,000 and \$415,000 for joint

filers, then they may be eligible to receive a reduced deduction based on their income; and

- If the taxpayer's taxable income exceeds \$207,500 for individuals or \$415,000 for joint filers, then they will not be able to take advantage of the deduction at all.

Obviously, this new twenty percent deduction from Section 199A of the Tax Code is a very beneficial provision for small business owners, but will require some planning on the part of the business owner to assure that their owners can take advantage of the deduction.

3. Increased Expensing Limitation Bonus Depreciation: Most business owners are aware that Section 179 of the Code provides that certain purchases can simply be expensed out in the year purchased, rather than depreciated over time. Under the new Act, the expensing limits of Section 179 have been increased to \$1 million dollars, with a phase-out amount of \$2.5 million dollars. The new limitations will be adjusted for inflation from each year forward. Furthermore, the kinds of assets that can qualify for this expensing deduction have been expanded, which may be important to your business.

In addition to increases in Section 179 expensing deduction, the new Act has increased bonus depreciation to one hundred percent, with a \$1 million dollar cap. This in effect allows full depreciation of certain assets in year one, instead of depreciating the asset overtime. This bonus depreciation provision will phase-out after 2023, reducing twenty percent each year up through 2026. Surprisingly, the bonus depreciation rules will apply to the

acquisition of used property as well as new property, so long as the property is placed in service after September 27, 2017.

These increased expensing and bonus depreciation rules in the new Tax Act provide a major incentive to businesses for the purchase of necessary equipment and other assets, but there are some limitations and the time for using these deductions is limited, so you should consult with your tax advisors to properly take advantage of the new rules.

4. Limitations on Deductibility of Interest: The new Act does contain some limitations on deductibility of interest, limiting the deductibility to thirty (30%) percent of adjusted business taxable income. However, small businesses with gross receipts of less than \$25 million are exempt from this limitation. Certain kinds of business can also elect out of these new rules, so it may be important to check with your tax advisor to determine whether such an election may be made, especially if your business finances its operations through debt.

5. Net Operating Losses: The new Act modifies the rules regarding net operating loss deductions. Prior to the Act, NOLs could be carried back by corporations for two years and then carried forward for twenty years, with certain limitations. Under the new Act, all NOLs are limited to eighty (80%) percent of taxable income. The new Act has eliminated a carryback of NOLs, except for certain losses incurred in the trade or business of farming, but it has replaced the twenty year carry forward period with an indefinite carry forward.

6. Entertainment Expenses: Perhaps the most confusing change to the Tax

Code lies in the area of entertainment expenses. Most businesses spend a portion of their budget on entertaining clients, whether it is taking them to a golf course, or tickets to sporting events or other events, or even just buying the client a meal, and have always written off the expense as a business deduction. The new Act eliminates the deduction for entertainment expenses, and furthermore limits the deductions of employee meals to fifty percent. A question left unresolved by the new Act is whether or not this fifty percent deduction will still be allowed for meals with potential clients. Hopefully, the regulations that will come out on this area will clarify that issue, but at this time clients should at least be aware that the new Tax Act has placed significant limitations on deductibility of entertainment expenses, and should plan accordingly.

There are many other changes brought about by the Act in the business tax area which could apply to your business, but the above changes are the most significant.

Conclusion: The new Tax Act also made significant changes in the area of tax exempt organizations and international taxation which are not addressed here but which may impact your organization. However, the changes in the areas of individual taxation, estate and gift tax, and business tax are extensive, and will likely require planning on the part of business owners in order to assure that the full benefits of the new Tax Act may be achieved. These changes just came online as of January 1, 2018, so we recommend that you consult with your tax planning professionals to see what you need to do to take advantage of these new tax laws. ◀▶

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