TEN OPPORTUNITIES FOR YOUR BUSINESS UNDER THE TAX LAW

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Tax Cuts and Jobs Act Overview

- Enacted December 22, 2017
- Comprehensive and far reaching changes
- Generally effective for tax years beginning in 2018 (with several key exceptions)
- Many unanswered questions for which guidance is still needed

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Tax Cuts and Jobs Act Overview

- Income tax rate reductions
- Elimination or limitations placed on deductions
- Sunset on many provisions
- Designed to meet revenue neutrality rules to enable law to be enacted by a majority vote

Tax Cuts and Jobs Act Overview

- Individual rates – reductions in most brackets with top rate capped at 37% (no changes in capital gain/qualified dividend rates)
- 3.8% Net investment income tax retained
- Corporate rates – reduced to a flat 21%
- Flow through entities – new provision that brings top rate potentially down to 29.6%

Tax Cuts and Jobs Act Overview

- State and local income tax deduction significantly reduced
- Real estate tax deduction significantly reduced

Tax Cuts and Jobs Act Overview

- Standard deduction greatly increased ($24,000 for married taxpayers filing jointly from $12,700 last year)
- Personal exemptions eliminated

Tax Cuts and Jobs Act Overview

- New Section 199A added
- Generally designed to permit owners of sole proprietorships, partnerships, LLCs and S corporations the opportunity to obtain a tax deduction of up to 20% of their business income which will effectively reduce the tax rate on this income to 29.6% or less
- One of the most complicated provisions in the new law

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Tax Cuts and Jobs Act Overview

- Interest incurred by a business on borrowings to support Its operations may no longer be deductible in full
- Rules impact highly leveraged companies and real estate enterprises (although the real estate industry did receive opportunities for some significant relief)
- Carry over of disallowed amounts are provided
- Many thresholds and rules in this new limitation

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Tax Cuts and Jobs Act Overview

- The availability to utilize losses from a business in which a taxpayer material participates to offset other sources of income has been limited
- Losses that are unavailable to use can be carried over to future years, subject to further limitations

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Tax Cuts and Jobs Act Overview

- Depreciation and expensing of acquisitions of capital assets has been significantly liberalized
- The availability of expanded deductions was one of the principal reasons why interest expense limitations were imposed

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Tax Cuts and Jobs Act Overview

- Modifications and liberalizations were enacted with respect to accounting methods permitted to be utilized by taxpayers, including the expanded availability to use the cash method for reporting income and deductions

Tax Cuts and Jobs Act Overview

- The deduction for meals and entertainment expenses was significantly reduced and/or eliminated

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Deduction for Qualified Business Income – IRC § 199A

- **PLANNING POINT**
- Hire more employees and avoid independent contractors
- Buy more depreciable assets and limit leasing
- Own real estate in sister pass-through entity and use active lease
- Spread ownership among multiple taxpayers including children and non-grantor trusts
- Maybe split up business into two businesses
- S Corp has advantage over LLC

Business Income Deduction

- **PLANNING POINT** – Sole proprietors who exceed threshold amounts should consider adding spouse or family member to payroll to take advantage of new 20% business income deduction
- Must be reasonable salary based on actual services performed
- Income tax benefits must be compared to the extra payroll taxes incurred by paying wages
- Added benefit – potential increase in Social Security benefits for the spouse or family member

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Real Estate Lease Arrangements

- **PLANNING POINT**– Review real estate lease arrangements between operating entities where the owners of the operating entity also separately own and lease real estate to the operating entity
- Must be fair and reasonable rent
- Rental income may qualify for 20% business income deduction BUT this may require revision of leasing arrangement to create sufficient activity at the lessor level to qualify the income for the deduction (typical triple net leases will be detrimental)
- If applicable, review new interest limitations to determine if special depreciation election should be made

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Deductibility of Business Interest

- **PLANNING POINT**
- Make electing real property trade or business election
- For investors, use LLC with preferred returns or guaranteed payments in lieu of debt
- Avoid related party loans

Net Excess Business Loss Limitation

- **PLANNING POINT**
- Reduce salary from S Corps so as to limit losses
- Reduce interest income

Choice of Entity – "C" Corporate or Pass-Through

- **PLANNING POINT**
- Use C Corp if owners take only a de minimis salary and business needs to retain cash to grow or pay debt
- Use S Corp or LLC if owners wish to take the profits
- Use S Corp or LLC if business will be sold in the relevant future
- Use S Corp or LLC if business is eligible for the 199A deduction

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Section 179 Expensing and Section 168(k) – Bonus Depreciation

- **PLANNING POINT**
- Bonus Depreciation and a Section 179 Deduction is available for used equipment – insist on an asset purchase as opposed to a stock purchase
- Time purchases of equipment to avoid creating a loss

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Advance Payments Received by Accrual Basis Taxpayers

- **PLANNING POINT**
- Limit advance payments to two years
- Check with CPA on when an advance payment is taken into account on financial statements

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Temporary Increase in Estate, Gift and GST Exemptions

- $11,180,000 in 2018 (inflation adjusted)
- Reverts to $5,490,000 (increased by inflation) in 2026

Income Tax Planning with Trusts

- Multiplying the "Ceilings"

SALTY SLAT - Maximize the $10,000 SALT Limitation

- **PLANNING POINT**
- Irrevocable non-grantor trust
- Completed gift
- Funded with real estate and securities
- Spouse as beneficiary
- Adverse party trustee

Trusts Funded with Interests in Pass-Thru Business Interests

- **PLANNING POINT**
- Irrevocable non-grantor trust
- Completed gift
- Income under $157,500 (including beneficiary's income for QSSTs)

Trust Cannot Revert To Settlor after 2025

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Meal and Entertainment Expenses

- Effective for amounts paid or incurred after 12/31/2017 – taxpayers can NO longer deduct entertainment, amusement or recreation expenses that were otherwise directly related or associated with active conduct of their business
- Examples = Tickets to sporting events, Stadium license fees, Private boxes at sporting events, Theatre tickets, Golf club dues/greens fees, Hunting/Fishing trips
- Business meals still appear to be generally deductible (at 50%) BUT Guidance is needed
- **PLANNING POINT** – Companies should strictly account for meal and entertainment costs separately and maintain records supporting the expense. Meals incurred at an entertainment venue will likely NOT be allowed

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Itemized Deductions

- Individual itemized deduction for state and local income and real estate taxes limited to $10,000
- Does not appear to eliminate deduction for income taxes paid by an entity that is imposed on and at the entity level
- Some states (ex – NJ) enacted legislation attempting to convert what are otherwise taxes subject to new limitations into charitable contribution
- **PLANNING POINT**– US Treasury Secretary Steve Mnuchin has announced that the Federal Government will challenge the treatment of these amounts as charitable contributions. This will need to be monitored and taxpayers should be cautioned before utilizing any new programs to try to bypass new limitations. It could have an adverse economic impact- the new and proposed state laws do not necessarily provide full credit for the charitable contribution against the tax obligation.

Direct Contributions from IRAs to Charities

- The elimination or reduction of many itemized deductions will mean that many taxpayers will NO longer itemize but instead, use the increased standard deduction
- **PLANNING POINT** – For retirees over Age 70 and ½, consider making direct contributions from Their IRAs to charities. This satisfies the required minimum distribution, is not reported as income (and NOT a deduction). Limited to $100,000.

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