Year-End Tax Planning for Businesses in the New Tax Environment

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Summary

The passage of the Tax Cuts and Jobs Act (TCJA) in late 2017 brought significant changes to the tax landscape. As the first tax season under the law looms on the horizon, new year-end tax planning strategies are emerging. Meanwhile, some of the old tried-and-true strategies have changed and others remain viable. We have summarized some of the changes brought about in the Tax Cuts and Jobs Act that can affect your business.

Fresh Opportunities

The TCJA creates several new avenues of potential tax savings for businesses. Some of these, though, may require tough decisions.

For example, the new tax law has prompted some businesses to question whether they should restructure to become a C corporation for a pass through entity. The former is subject to potential double taxation (at the entity and dividend levels) but now enjoys a corporate tax rate that falls from 35% to 21%. The latter faces only an individual tax rate, which can run as high as 37%, but might not qualify for a new, full 20% deduction on qualified business income (QBI).

With a full QBI deduction, the maximum tax rate for pass-through entities comes out to 29.6%. But there are other factors to consider. For example, the TCJA limits the state and local tax deduction for individual pass through owners but not for corporations. Further, the new corporate tax rate is permanent, while the QBI deduction is scheduled to sunset after 2025.

Fresh Opportunities Continued

Ultimately, the optimal entity choice depends on each business' facts and circumstances. A business that goes the pass-through route, though, has several tactics available to maximize its QBI deduction.

The deduction is subject to limits based on W-2 wages paid, the unadjusted basis of a taxpayers qualified property, and taxable income. A business, therefore, might increase its wages by converting independent contractors to employees, assuming the benefit isn't outweighed by higher payroll taxes, employee benefit costs and similar considerations. It could also purchase assets before year end to pump up its unadjusted basis. And individual pass-through owners can maximize their above-the-line and itemized deductions to reduce their taxable income.

> **"The optimal business' entity choice depends on each business' facts and circumstances"**

The TCJA also establishes a business credit for paid family and medical leave – a credit that businesses claim for 2018 as long as they adopt a retroactive policy before the end of the year. Eligible employers may claim the credit if they have a written policy that provides at least two weeks of annual paid family and medical leave to all employees who meet certain requirements, at a pay rate of at least 50% of normal wages. The maximum credit is 25% of wages paid during leave.

Shifting Strategies

Not surprisingly, the TCJA alters the several year-end strategies businesses have used in the past to curb liability. It bolsters some strategies, while trimming or ending the advantages of others.

For several years, for example, asset acquisitions have offered a smart way to cut taxes through bonus depreciation and Section 179 depreciation deductions. The TCJA expands both types of deductions, potentially making investments in equipment and other assets even more advisable.

Businesses could immediately write off 50% bonus depreciation on qualified new property purchased in 2017. Before the TCJA, eligible property included new computers, software, vehicles, machinery, equipment, office furniture and qualified improvement property (QIP, generally defined as interior improvements to non-residential real property).

Be aware that Congress moved QIP from the definition of qualified property eligible for bonus depreciation, intending that it would nonetheless remain eligible because its recovery period would be reduced to 15 years. (Qualified property must have a recovery period of 20 years or less.) Due to a drafting error, though, the TCJA didn't define QIP as a 15-year property, so it defaults to a 39-year recovery period. Without technical correction or regulatory guidance, QIP won't qualify for bonus depreciation in 2018.

QIP placed in service after December 31, 2017, is eligible for immediate expensing (deducting the entire cost) under Sec. 179. The TCJA expands this depreciation to several improvements to nonresidential real property – roofs, HVAC, fire protection systems, alarm systems and security systems, too. It also almost doubles the maximum deduction for qualifying property to $1 million from $510,000 in 2017. (The maximum deduction remains limited to the amount of income from business activity.) The TCJA increased the phase-out threshold to $2.5 million from $2.03 million in 2017

Businesses traditionally have used employee benefits to shrink their tax liability, too, but the TCJA narrows the benefits-related opportunities. For example, it eliminates or tightens tax breaks for transportation benefits, on-premises meals, moving expenses reimbursement and achievement awards. (Some of these changes are only temporary.) Businesses might, however, reap tax benefits from Health Savings Accounts, Flexible Spending Accounts, Health Reimbursement Accounts, health

Old Favorites

Although many tax credits were in the cross hairs as the TCJA was drafted, several of the most popular survived, including the Work Opportunity tax credit, Small Business Health Care tax credit, the New Markets tax credit and the research credit.

The TCJA even boosts the value of the research credit. That's because taxpayers generally must either reduce their business deductions by the amount of their research credit or take a reduced research credit to preempt a double tax benefit. The reduced credit is based on the maximum corporate tax rate. By cutting that rate from 35% to 21%, the TCJA increases the net benefit of the research credit to 79% vs 65% in previous years.

Businesses looking to trim their tax bills also can continue to turn to the trusty standby strategy of deferring income into 2019 and accelerating deductions into 2018. For example, a business that uses cash-basis accounting might “slow roll” its invoices to push the receivables into the new year or prepay expenses. Notably, the TCJA has greatly expanded eligibility for cash-basis accounting, making it generally available to businesses with three-year average annual gross receipts of $25 million or less.

There’s Still Time

Whether your business operates on a calendar- or fiscal-year basis, your 2018 tax bill isn’t yet written in stone. It’s not too late to execute some strategies that reduce your business’s tax liabilities and improve its bottom line. If you have any questions regarding your tax plan or want further guidance, please contact your DDK Advisor.

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