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CERTIFIED PUBLIC ACCOUNTANTS

TAX ALERT

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Year-end Tax Strategies for Businesses in the New Tax Environment

New tax laws implemented from the Tax Cuts and Jobs Act (TCJA) in late 2017 have made this coming tax season a completely different landscape for businesses. Now is the time to re-think your existing tax strategies in order to minimize your tax burden. We'll highlight the major changes to expect this year and the traditional tax benefits that are still in effect.

Identifying Fresh Opportunities for Tax Savings

The TCJA creates several new avenues of potential tax savings for businesses. Here is a brief overview of each one to help you weigh the pros and cons.

Restructuring as C Corporation vs. Pass-through Entity

The new tax law has prompted some businesses to question whether they should restructure to become a C corporation or a pass-through entity. The former is subject to potential double taxation (at the entity and dividend levels) but now enjoys a lower corporate tax rate, down from 35% to just 21%.

The latter faces only an individual tax rate, which can run as high as 37%, but might qualify for a new, full 20% deduction on qualified business income (QBI). With a full QBI deduction, the maximum effective 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. Plus, the new corporate rate is permanent, while the QBI deduction is scheduled to sunset after 2025.

A business that goes the pass-through route, though, has several tactics available to maximize its QBI deduction while in effect.

The deduction is subject to limits based on W-2 wages paid, the unadjusted basis of a taxpayer's qualified property, and taxable income. Consequently. a business could potentially benefit by one or more of the following strategies:

- Increase its wages by converting independent contractors to employees (if added costs are offset by the tax savings)
- Purchase assets before year end to increase its unadjusted basis
- Maximize above-the-line and itemized deductions to reduce their taxable income (for individual pass-through owners)

Ultimately, the optimal entity choice depends on the specific circumstances of each business.

Implementing a Paid Family and Medical Leave Policy

Another new tax savings opportunity from the TCJA is the establishment of a business tax credit for paid family and medical leave. Businesses can claim this credit 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.

TCJA Changes to Existing Tax Strategies

Not surprisingly, the TCJA alters several year-end strategies that businesses have used in the past to curb their tax liability.

Expanded Bonus Depreciation

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

Businesses, for example, 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 nonresidential real property).

The TCJA extends and modifies bonus depreciation for qualified property purchased after September 27, 2017, and before January 1, 2023. Businesses can expense the entire cost of such property (both new and used) in the year the property is placed in service.

The amount of the allowable deduction will begin to phase out in 2023, dropping off 20% each year for four years until it disappears completely in 2027, absent congressional action. Be aware that certain property with a longer production period will be eligible for the bonus depreciation for an extra year, as the phaseout doesn't start until 2024.

Congressional Error in Defining QIP

Another related issue is that Congress removed 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 15-year property, so it defaults to a 39-year recovery period. Without a 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 Section 179. The TCJA expands this depreciation to several improvements to nonresidential real property, including roofs, HVAC, fire protection systems, alarm systems, and security systems.

The TCJA almost doubles the maximum deduction for qualifying property to $1 million, up from $510,000 in 2017. It also increases the phaseout threshold to $2.5 million, up from $2.03 million in 2017.

Limited Tax Breaks for Employee Benefits

Businesses have traditionally used employee benefits to shrink their tax liability, but the TCJA narrows these opportunities (though some changes are only temporary).

For example, it eliminates or tightens the following benefits-related tax breaks:

- Transportation benefits
- On-premises meals
- Moving expenses reimbursement
- Achievement awards

Businesses might, however, reap tax benefits from the following:

- Health Savings Accounts
- Flexible Spending Accounts
- Health Reimbursement Accounts
- Health insurance
- Group term-life insurance

Popular Tax Credits that Remain

Although many tax credits were in the crosshairs as the TCJA was drafted, several of the most popular survived, including:

- Work Opportunity tax credit
- Small Business Health Care tax credit
- New Markets tax credit
- 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 computed 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 can also turn to the 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.

How to Maximize Your 2018 Tax Strategy

Whether your business operates on a calendar- or fiscal-year basis, your 2018 tax bill isn't written in stone. It's not too late to execute new strategies to reduce your business's tax liabilities and improve its bottom line.

Contact your Seiler tax advisor to discuss in detail the tax changes that are relevant to your business and craft the most effective strategy before 2018 ends.