# H.R. 1 – THE TAX CUTS AND JOBS ACT: BUSINESS PROVISIONS OVERVIEW

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# Speaker Introductions

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# *Agenda*

- **General Overview**
- **Taxation of C Corporation Earnings**
- **Taxation of Pass-Through Entity Earnings**
- **Depreciation and Cost Recovery Changes**
- **Small Business Reforms**
- **Changes to Business Deductions and Exclusions**
- **Changes to Business Credits**

# *General Overview*

- **H.R. 1: Tax Cuts and Jobs Act**
- **Passed by Congress on December 20, 2017**
- **Signed into Law on December 22, 2017**
- **Changes generally apply starting January 1, 2018**

# *Taxation of C Corporation Earnings*

- **Corporate income tax rate reduced to 21%**
  - Prior law: graduated tax rates; top rate was 35%
- **No special rate for personal service corporations**
  - Prior law: flat tax rate of 35%
- **Corporate AMT repealed**

# *Taxation of C Corporation Earnings*

- **Dividends received deduction reduced**
  - 50% deduction when recipient corporation owns less than 20% of distributing corporation
    - Prior law: 70% deduction
  - 65% deduction for 20% owned corporation
    - Prior law: 80% deduction

- **Individual shareholder rates remain the same for qualified dividend income**
  - Long-term capital gain rates: 0%, 15%, 20%

# Taxation of Pass-Through Entity Earnings

- **Overall scheme: owners pay tax at individual income tax rates with a newly created deduction**

| Rate | Taxable Income of Married Taxpayers Filing Jointly | Taxable Income of Single Taxpayers |
|---|---|---|
| **10%** | Up to $19,050 | Up to $9,525 |
| **12%** | $19,051 - $77,400 | $9,526 - $38,700 |
| **22%** | $77,401 - $165,000 | $38,701- $82,500 |
| **24%** | $165,001 - $315,000 | $82,501 - $157,500 |
| **32%** | $315,001 - $400,000 | $157,501 - $200,000 |
| **35%** | $400,001 - $600,000 | $200,001 - $500,000 |
| **37%** | Over $600,000 | Over $500,000 |

# *Taxation of Pass-Through Entity Earnings*

- **Deduction = 20% of “qualified business income”**
- **Deduction subject to thresholds, then limited**
- **Certain personal service providers not entitled to deduction unless owner’s income is under thresholds**
  - Includes: health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services
  - Excludes: engineering and architecture services
- **Deduction expires after 12/31/2025**

# *Taxation of Pass-Through Entity Earnings*

- **Example 1:**
  - Presume income below threshold
  - Result: Deduction = 20% of QBI

- **Illustration:**
  - Husband and Wife
  - Income of $300,000; QBI of $120,000; share of W-2 wages is $100,000; no qualifying property
  - Deduction = $24,000



*Disclaimer: examples are for illustrative purposes only; simplified facts assumed; work with your tax preparer to fully understand your individual situation and the amount of any deduction.*

# *Taxation of Pass-Through Entity Earnings*

- **Example 2:**
  - Presume income exceeds threshold but isn't fully phased out
- **Illustration:**
  - Husband and Wife
  - Income of $350,000; QBI of $250,000; share of W-2 wages is $90,000; no qualified property
  - Reduction Ratio = 35%
  - Deduction = $48,250
  - Compare deduction without limits = $50,000



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# *Taxation of Pass-Through Entity Earnings*

- **Example 3:**
  - Presume specified service trade or business and income under applicable threshold amount
- **Illustration:**
  - Husband and Wife
  - Income of $350,000; QBI of $250,000; share of W-2 wages is $90,000; no qualified property
  - Applicable Percentage = 65%
  - Reduction Ratio = 35%
  - Deduction = $31,362
  - Compare deduction without limits = $50,000



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# Depreciation and Cost Recovery Changes

- **Code § 168(k): 100% bonus depreciation on qualified property**
  - Prior law: 50% of qualified property's cost basis could be deducted in year property placed in service
    - Qualified property was depreciable property the original use of which commenced with the taxpayer
  - Now: deduction increased to 100% until 2023, then percentage is decreased by 20% each year until phased-out
    - Qualified property now includes acquired property, including used property

# *Depreciation and Cost Recovery Changes*

- **Changes to Code § 179 expensing**
  - Prior law: in lieu of depreciation, full expensing of "Section 179 Property" was permitted up to $500,000, phased-out beginning at $2 million in aggregate cost of such property
  - Now: deduction limitation increased to $1 million and phase out beginning at $2.5 million
    - Section 179 Property now also includes qualified real property

# *Depreciation and Cost Recovery Changes*

- **Other various changes to depreciation and cost recovery**
  - Farm property is no longer required to use 150% declining balance method; new 5-year recovery period for certain farm property
  - UNICAP changes – increase gross receipts threshold to $25 million, which broadens the exception to the UNICAP rules for small businesses

# *Changes to Business Deductions & Exclusions*

- **Code § 172: Net Operating Loss (NOL) Deduction**
  - Prior law: may not be deducted in year generated; may be carried back 2 years and carried forward 20 years
  - Now: amount and timing changed
    - Deduction limited to 80% of taxable income, except for P&C insurance companies
    - Repeals the carry-back period, except for certain farming losses and for P&C insurance companies
    - Carryover period is now indefinite for losses arising in tax years beginning after 12/31/17

# *Changes to Business Deductions & Exclusions*

- **Code § 163(j): New limitation on deduction for net interest expenses**
  - Prior law: business interest generally allowed as a deduction in the tax year in which the interest was paid or accrued
  - Generally limited to the sum of business interest income plus 30% of taxpayer's adjusted taxable income
  - Limitation is determined at the entity-level for partnerships and S corporations

# *Changes to Business Deductions & Exclusions*

- **Code § 274: Entertainment, etc. Expenses**
  - Prior law: 50% deduction allowed for entertainment, amusement, or recreational activities if directly related to business
  - No deduction allowed for entertainment, amusement, or recreational activities, even if directly related to business
  - Deductions for transportation fringe benefits and for providing commuting transportation disallowed

# *Changes to Business Deductions & Exclusions*

- **Other changes**
  - Like-kind exchanges limited to real property not held primarily for sale (§ 1031)
  - Domestic production deduction is repealed (§ 199)
  - Local lobbying expense deduction is repealed (§ 162)
  - Certain research and experimental expenses must be amortized over 5 years (15 if outside U.S.) (§ 174)
  - Self-created property is not treated as a capital asset in the hands of the creator or person for whom it was created (§ 1221(a)(3))

# Small Business Reforms

- **The gross receipts test threshold is increased to $25 million under the new UNICAP rules**
  - Applies to inventory accounting for small businesses
  - Also applies to determine whether a small business is exempted from the new limitation on the deduction for net interest expenses (§ 163(j))

# *Changes to Business Credits*

- **New Code § 45S: Credit for paid FMLA leave**
  - 12.5%-25% of wages paid to qualifying employees on FMLA leave in 2018 and 2019.
- **“Orphan drug” credit reduced from 50% to 25% (§§ 45C, 280F)**
- **Rehabilitation credit changes (§ 47)**
  - 20% credit taken ratably over 5 years
- **Other credits proposed by the House, including energy credits, were not included in the Conference Agreement**

## *Thank you for attending!*

# Questions?

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# *Tax Reform Webinar Series*

- **Part 2: Impact of Tax Reform on Business Planning**
  11:30 am - 12:30 pm
  Tuesday, January 9, 2018
- **Part 3: Considering Whether to Convert a Flow Through to a C Corporation**
  11:30 am - 12:30 pm
  Wednesday, January 10, 2018

If you registered for Parts 2 and 3 of our Series you should have received the login information via email. If you have any questions please contact events@koleyjessen.com