# Highlights of the Tax Cuts and Jobs Act on Business Entities

## Overview and Discussion

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# Key Changes effecting Business Entities

- Pass-Through Entity Changes
- Corporate Tax Entities
- Expensing, Depreciation, Capitalization
- Business Deductions, Exclusions and Credits

# Pass-Through Entity Changes

- New deduction for pass-through income
  - Applicable for tax years after 12/31/17 and before 1/1/2026 for non-corporate taxpayers
  - Deduction is equal to the SUM OF:
    - 1. The LESSER OF:
      - The “combined qualified business income” (see next slide) of the taxpayer, or
      - 20% of the excess of taxable income over the sum of any net capital gain
    - 2. PLUS the LESSER OF:
      - 20% of qualified cooperative dividends, or
      - Taxable income less net capital gain.

# Pass-Through Entity Changes

- New deduction for pass-through income (cont.)
  - Combined qualified business income is:
    - 1. The SUM OF:
      - The LESSER OF:
        - 20% of the taxpayer's "qualified business income" or
        - The GREATER OF:
          - 50% of the W-2 wages* with respect to the business, or
          - 25% of the W-2 wages* with respect to the business plus 2.5%* of the unadjusted basis of all qualified property
      - PLUS
        - 20% of qualified REIT dividends
        - Qualified publicly traded partnership income

*taxpayer's allocable share

# Pass-Through Entity Changes

- New deduction for pass-through income (cont.)
  - Qualified business income:
    - QBI is generally defined as the net amount of "qualified items of income, gain, deduction, and loss" relating to any qualified US trade or business of the taxpayer
    - If the net amount of qualified income, gain, deduction, and loss relating to qualified trade or businesses of the taxpayer for any tax year is less than zero, the amount is treated as a loss from a qualified trade or business in the succeeding tax year.

# Pass-Through Entity Changes

Example: A is a 30% owner of ABC, LLC. The LLC had ordinary income of $3,000,000. The LLC paid total W-2 wages of $1,000,000 and the total adjusted basis of property held by ABC, LLC is $100,000. A is allocated 30% of all items.

A is entitled to a deduction equal to the LESSER OF:

| | Total | A's Alloc Share | 20% Deduction |
|---|---|---|---|
| QBI | $3,000,000 | $900,000 | $180,000 |

OR the GREATER OF:

| | Total | A's Alloc Share | 50% Limitation |
|---|---|---|---|
| W-2 Wages | $1,000,000 | $300,000 | $150,000 |

OR the TOTAL OF:

| | Total | A's Alloc Share | 25% Limitation | 2.5% Limitation |
|---|---|---|---|---|
| W-2 Wages | $1,000,000 | $300,000 | $ 75,000 | |
| Prop Basis | $100,000 | $30,000 | | $ 750 |
| | | | | $ 75,750 |

**A is entitled to a deduction of $150,000.**

# Pass-Through Entity Changes

- Exception to W-2 Wage Limitation
  - The wage limitation doesn't apply for taxpayers below the threshold amount of $157,500 ($315,000 MFJ), indexed for inflation
  - Phase-in of W-2 wage limitation over the next $50,000 of taxable income ($100,000 for MFJ)
- Taxpayers in service related businesses (healthcare, law, accounting, actuarial science, performing artists, consulting, athletics, financial services, brokerage services, etc.) are eligible. However, the deduction for taxpayers in service businesses is phased out if the taxpayer's taxable income exceeds the threshold amount of $157,500 ($315,000 MFJ)

# Pass-Through Entity Changes

Example: A has QBI of $200,000 from an S corporation that paid $30,000 of allocable W-2 wages and that has no qualified property. A's spouse, B, has $50,000 of W-2 income, and A and B have interest income of $20,000. Thus total taxable income is $270,000.

Normally, A's deduction would be limited to $15,000, the LESSER OF:

| | Total | A's Alloc Share | 20% Deduction | |
|---|---|---|---|---|
| QBI | $200,000 | $200,000 | $40,000 | |
| OR the GREATER OF: | | | | |
| | Total | A's Alloc Share | 50% Limitation | |
| W-2 Wages | $ 30,000 | $ 30,000 | $15,000 | |
| OR the TOTAL OF: | | | | |
| | Total | A's Alloc Share | 25% Limitation | 2.5% Limitation |
| W-2 Wages | $ 30,000 | $ 30,000 | $ 7,500 | |
| Prop Basis | 0 | 0 | | $ 0 |
| | | | | $ 7,500 |

**A's deduction would normally be limited to $15,000, but because A's taxable income is less than $315,000, the two limitations are disregarded. A is entitled to a deduction of 20% of QBI, or $40,000.**

# Pass-Through Entity Changes

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- Repeal of Partnership Technical Terminations
- Excess business loss disallowance rule
  - An “excess business loss” is the excess of the taxpayer's aggregate deductions for the tax year that are attributable to trades or businesses of the taxpayer (determined without regard to whether or not the deductions are disallowed for that tax year under Code Sec. 461(l)(1)), over the sum of:
  - (i) the taxpayer's aggregate gross income or gain for the tax year which is attributable to those trades or businesses, plus
  - (ii) $250,000 (200% of that amount for a joint return (i.e., $500,000)).
  - Disallowed excess business loss treated as NOL carryover

# Pass-Through Entity Changes

- Carried Interests
  - Effective for tax years beginning after Dec. 31, 2017, the Act effectively imposes a 3-year holding period requirement in order for certain partnership interests received in connection with the performance of services to be taxed as long-term capital gain.
  - **Need to finish**

# Corporate Tax Entities

- Corporate tax rates reduced
  - Tax years after 12/31/17, flat rate of 21%
    - Includes personal service corps in rate change
    - Decreases required withholding rate on certain corporate transactions (USRPIs)
- Dividends-received deduction % reduced
  - 80% dividends received deduction for 20% or more owned corporations reduced to 65%
  - 70% dividends received deduction reduced to 50%
- Corporate Alternative Minimum Tax repealed
  - MTC can offset tax regular tax liability
  - MTC refundable amount
- Cash method of accounting increased from $5 million to $25 million average annual gross receipts

# Expensing, Depreciation, Capitalization

- Increased Sec. 179 expensing
  - Increased to $1 million
  - Phase-out threshold for qualifying property - $2.5 million
  - Definition of “qualified real property” expanded to include previously excluded improvements and additions
  - $25,000 per-vehicle limit for SUVS made adjustable for inflation (after 2018)

# Expensing, Depreciation, Capitalization

- Temporary 100% cost recovery of qualifying business assets
  - 100% first-year deduction for property placed in service 9/27/17 – 12/31/2022
  - Allowed for new and ***used*** property
  - 80%/2023; 60%/2024; 40%/2025; 20%/2026
  - Sunsets after 2026
- Enhanced definition of "qualified improvement property" for 15-year recovery period

# Business Deductions, Exclusions and Credits

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- Limitation on business interest deduction
  - All businesses subject to a disallowance of a deduction for net interest expense in excess of 30% of business's adjusted taxable income
  - 2018 – 2021: Adjusted taxable income computed without regard for depreciation, amortization or former 199 deduction
  - Disallowed amount carried forward
  - Exemption for taxpayers with 3 year average annual gross receipt less than $25 million
  - Special rules apply to partnerships
  - Exceptions apply for small business, electing real property TorBs, and electing farming business

# Business Deductions, Exclusions and Credits

- Net Operating Loss Deduction
  - Tax years after 12/31/17, two-year carryback and special carryback provisions are repealed
  - NOL deduction is limited to 80% of taxable income
  - NOL carryover is indefinitely
- Domestic production activities deduction (DPAD) under Sec. 199 is repealed
- Sec. 1031 – Like-kind exchange treatment only allowed with respect to real property that is not held primarily for sale

# Business Deductions, Exclusions and Credits

- Deduction for entertainment expenses are disallowed (includes entertainment, amusement, or recreation)
  - Taxpayers may still generally deduct 50% of food/beverage expenses associated with operating their trade or business (e.g. meals consumed by employees on work travel)
  - Beginning after 12/31/2025, all employer's deductions for expenses associated with meals provided for convenience of employer will also be disallowed
- Exceptions to $1M 162(m) limitation for deductible compensation repealed

# Business Deductions, Exclusions and Credits

- 2018 and 2019: New credit for employer paid family and medical leave
  - General business credit = 12.5% - 25% based on % of payment to qualified employees

# Accounting Method Changes

- Taxable year of inclusion
  - Taxpayer is required to recognize income no later than the tax year in which it reports the income on an applicable financial statement. Certain exceptions apply.
- Cash method of accounting
  - Limitation increased to $25 million
- Taxpayers with Inventory
  - May use cash method
- UNICAP (263A)
  - Extended to $25 million

# Individual Taxation

| | Old Law (2018) | | | New Law (2018) | |
|---|---|---|---|---|---|
| Rate | Taxable | Income | Rate | Taxable | Income |
| | Single | MFJ | | Single | MFJ |
| 10% | $0 to $9,525 | $0 to $19,050 | 10% | $0 to $9,525 | $0 to $19,050 |
| 15% | $9,526 to $38,700 | $19,051 to $77,400 | 12% | $9,526 to $38,700 | $19,051 to $77,400 |
| 25% | $38,701 to $93,700 | $77,401 to $156,150 | 22% | $38,701 to $82,500 | $77,401 to $165,000 |
| 28% | $93,701 to $195,450 | $156,151 to $237,950 | 24% | $82,501 to $157,500 | $165,001 to $315,000 |
| 33% | $195,451 to $424,950 | $237,951 to $424,950 | 32% | $157,501 to $200,000 | $315,001 to $400,000 |
| 35% | $424,951 to $426,700 | $424,951 to $480,050 | 35% | $200,001 to $500,000 | $400,001 to $600,000 |
| 39.6% | $426,701 or more | $480,051 or more | 37% | Over $500,000 | Over $600,000 |

# Standard Deduction and Itemized Deductions

- Increased standard deductions:
  - $24,000 Married Filing Joint
  - $18,000 Head of Household
  - $12,000 Single
    - All indexed for inflation
- Personal Exemptions are Eliminated
- AGI Phase-out Limitation on Itemized Deductions Eliminated
- All of the above expire after 2025

# Standard Deduction and Itemized Deductions

- Mortgage Interest on $750,000 of personal residence acquisition indebtedness deductible (second home still qualifies)
- Deduction for State and Local taxes limited to $10,000
- Miscellaneous itemized deductions eliminated
- All of the above expire after 2025