



UNDERSTANDING THE TAX CUTS AND JOBS ACT HOW IT IMPACTS YOU

Dear Client:

The new Tax Cuts and Jobs act is the most sweeping tax reform I have seen in my 30-plus years in this industry and, over the course of this year, I am going to do my best to explain the provisions of this 185-page document to you with an eye on its direct impact on your finances and the overall economy.

This first monthly installment covers the two most important of the provisions that will impact the majority of business taxpayers. There is a 7-page general summary on our website which I hope you will review as well.

If you have a particular concern or question, don't hesitate to ask.

The New 20% Deduction

The new 2018 20% business deduction that you can claim on your IRS Form 1040 is a HUGE deal. There are many rules (all new, of course), as a business owner, your odds of benefiting from this new deduction are excellent.

If you operate your business as a sole proprietorship, partnership, or S corporation, your 2018 income from these businesses can qualify for some or all of the new 20 percent deduction.

You also can qualify for the new 20 percent 2018 tax deduction on the income you receive from your real estate investments, publicly traded partnerships, real estate investment trusts (REITs), and qualified cooperatives.

When can you as a business owner qualify for this new 20 percent tax deduction with no complications? OK, almost no complications. I mean, it's the government! Right?

To qualify you need two things:

First: you need qualified business income from one of the sources above to which you can apply the 20 percent.

Second, to avoid complications, you need "defined taxable income" of

-) \$315,000 or less if married filing a joint return, or
-) \$157,500 or less if filing as a single taxpayer.

What is Qualified Business Income? VERY simply, it is the profit from your business. Of course the Government has a very complicated way of stating that, but, essentially, that's what it is, the NET income, not the Gross income.

Example. You are single and operate your business as a proprietorship. It produces \$350,000 of gross income. After expenses, the net profit is \$150,000 of "qualified business income". Your other (non-business) income and deductions result in defined taxable income (the taxable line of your tax form 1040 on page 2 of the form) of \$153,000. You will qualify for a deduction of \$30,000 ($\$150,000 \times 20$ percent) against your taxable Income.

If you operate your business as a partnership or S corporation with the same income numbers above, you still qualify for the same \$30,000 deduction.

The same is true if your income comes from a rental property, real estate investment trust, or limited partnership.

Service Professions "Out of Favor"

Unfortunately, some unfriendly rules apply to what is called "A specified service trade or business" such as Lawyers, Doctors and (DARN!) Accountants, and Actors (is that a redundancy?) plus athletes, brokers, insurances, and any other trade or business where the principal asset is the reputation and/or skill of 1 or more of its employees (except engineers and architects which are not, it seems, included in the out-of-favor group).

But, in the spirit of helping the little guy, if the service provider has defined taxable income less than the listed thresholds they still qualify for the full 20 percent deduction on his or her qualified business income.

Once you are above the thresholds and phaseouts (\$50,000 single, \$100,000 married filing jointly), you can qualify for the Section 199A deduction only when

-) you are not in the out-of-favor service-industry group and
-) your qualified business pays W-2 wages and/or has property.

Phaseout for New 20% Deduction

If your pass-through business is an in-favor business and it qualifies for tax reform's new 20 percent tax deduction on qualified business income, you benefit at all times, with no phase-in or out ranges.

However, if your business is in the out-of-favor group and you benefit only when you are in or below the phaseout range, once your taxable income exceeds the threshold amounts above, you arrive at four possible positions:

1. Phase-in range for a non-specified service trade or business
2. Phaseout range for a specified service trade or business
3. Above the phase-in range for an in-favor non-specified service trade or business
4. Above the phaseout range for an out-of-favor specified service trade or business

If your taxable income is going to be above the threshold amounts that trigger the phase-in or phaseout issues, contact us so we can spend some time on your tax planning.

How the 20% Deduction Works for a Specified Service Provider

When you are a member of the out-of-favor group, your Section 199A deduction on your out-of-favor business is zero when you have taxable income of more than

-) \$415,000 if married filing a joint return, or
-) \$207,500 filing as a single taxpayer.

Preserve the Deduction with an S Corporation

Will your business operation create the 20 percent tax deduction for you?

If not, and if that is due to too much income and a lack of (a) wages and/or (b) depreciable property, a switch to the S corporation as your choice of business entity may produce the tax savings you are looking for.

As mentioned above, to qualify for the full 20 percent deduction on your qualified business income under new tax code you need defined taxable income of less than \$157,500 (single) or \$315,000 (married).

If your taxable income is greater than \$207,500 (single) or \$415,000 (married), you don't qualify for the Section 199A deduction unless you pay W-2 wages or have property.

Example. Sam is single, not in the out-of-favor specified service trade or business group (doctors, lawyers, consultants, etc.), operates a sole proprietorship that generates \$400,000 of proprietorship net income, and has taxable income of \$370,000. In this condition, Sam's gets no 20% deduction.

The S corporation can help by paying Sam a reasonable salary, let's say that's \$100,000. With this salary, Sam saves:

1. \$10,871 on his self-employment taxes, and
2. \$17,500 on his newfound 20 percent deduction under new tax code

Tax Reform Eliminates Entertainment and Meal Deductions for Businesses

This area is one of the most scrutinized and altered of all the tax deductions. First, lawmakers reduced the directly related and associated entertainment deductions to 80 percent with the 1986 Tax Reform Act. In 1993, they reduced that 80 percent to 50 percent. And now, the newest tax reform, has simply eliminated the deductions for directly related and associated entertainment effective January 1, 2018.

For example, during 2017, you could take a prospect or client to a business dinner followed by the theater or a ballgame and deduct 50 percent of all the monies spent, providing you could prove the expenses were related to the production of income from the client.

Now, in what you and I thought was a business-friendly tax reform package, you find that lawmakers exterminated a big chunk of business entertainment. You can no longer deduct entertainment that has as its mission the generation of business income or other specific business benefit.

The 2018 tax reform prohibition against deductible entertainment is true regardless of your business discussion, negotiation, business meeting, or other bona fide transaction.

Here's a short list of what died on January 1, 2018, so you can get a good handle on what's no longer deductible:

-) Business meals with clients or prospects
-) Golf
-) Skiing
-) Tickets to sports games—football, baseball, basketball, soccer, etc.
-) Disneyland or other amusement parks

Entertainment That Survived Tax Reform

The good news is that you can continue to deduct

-) entertainment, amusement, and recreation expenses you treat as compensation to employees and that are included as wages for income tax withholding purposes (your employees are going to LOVE that one)
-) expenses for recreational, social, or similar activities (including facilities therefor) primarily for the benefit of employees (other than employees who are highly compensated employees)
-) expenses that are directly related to business meetings of employees, stockholders, agents, or directors (here, the law limits expenses for food and beverages to 50 percent)
-) expenses directly related and necessary to attendance at a business meeting or convention such as those held by business leagues, chambers of commerce, real estate boards, and boards of trade (here, the law also limits expenses for food and beverages to 50 percent)
-) expenses for goods, services, and facilities you or your business makes available to the general public;
-) expenses for entertainment goods, services, and facilities that you sell to customers
-) expenses paid on behalf of nonemployees that are includable in the gross income of the recipient of the entertainment, amusement, or recreation as compensation for services rendered or as a prize or award.

When you are considering using the above survivors of tax reform's entertainment cuts, you will find some good strategies in the following:

1. Renting your home to your business (easy with corporations, harder with proprietorships and partnerships)
2. Making your business lunches into educational seminars for multiple clients with a nominal 'fee'
3. Taking your employees on an employee party trip.
4. Making your vacation home a deductible entertainment facility or creating some other a deductible employee entertainment facility.

If you would like our help implementing any of the strategies above, please don't hesitate to contact us.

Tax Reform Cuts Deductions for Employee Meals to 50 Percent

Employers who, for their convenience, provided business meals for their employees are now limited to 50 percent, and that 50 percent becomes a big fat 0% deduction beginning January 1, 2026.

Employee meals that are now 50 percent deductible beginning January 1, 2018, include:

-) meals served at required business meetings on your business premises;
-) meals served at required business meetings in a hotel or other meeting place that passes the test for business premises but is located outside of the office;
-) meals for employees who are required to staff their positions during breakfast, lunch, and/or dinner times;
-) meals served to employees at in-office cafeterias; and
-) food and meal costs for employees who are required to live on premises for the convenience of the employer.

For 2018, you will need to add an account to your books for "meals subject to 50 percent cut." where you can track travel and other deductible business-related meals.