# ADAPTING TO THE NEW TAX ENVIRONMENT

## Understanding a Few of the Effects on Small Businesses

The Tax Cuts and Jobs Act (TCJA), legislation that has been characterized as the first major reform of the Internal Revenue Code in 31 years, received final approval from the House and the Senate on December 20, 2017 and was signed into law by President Trump on December 22, taking effect on January 1, 2018.

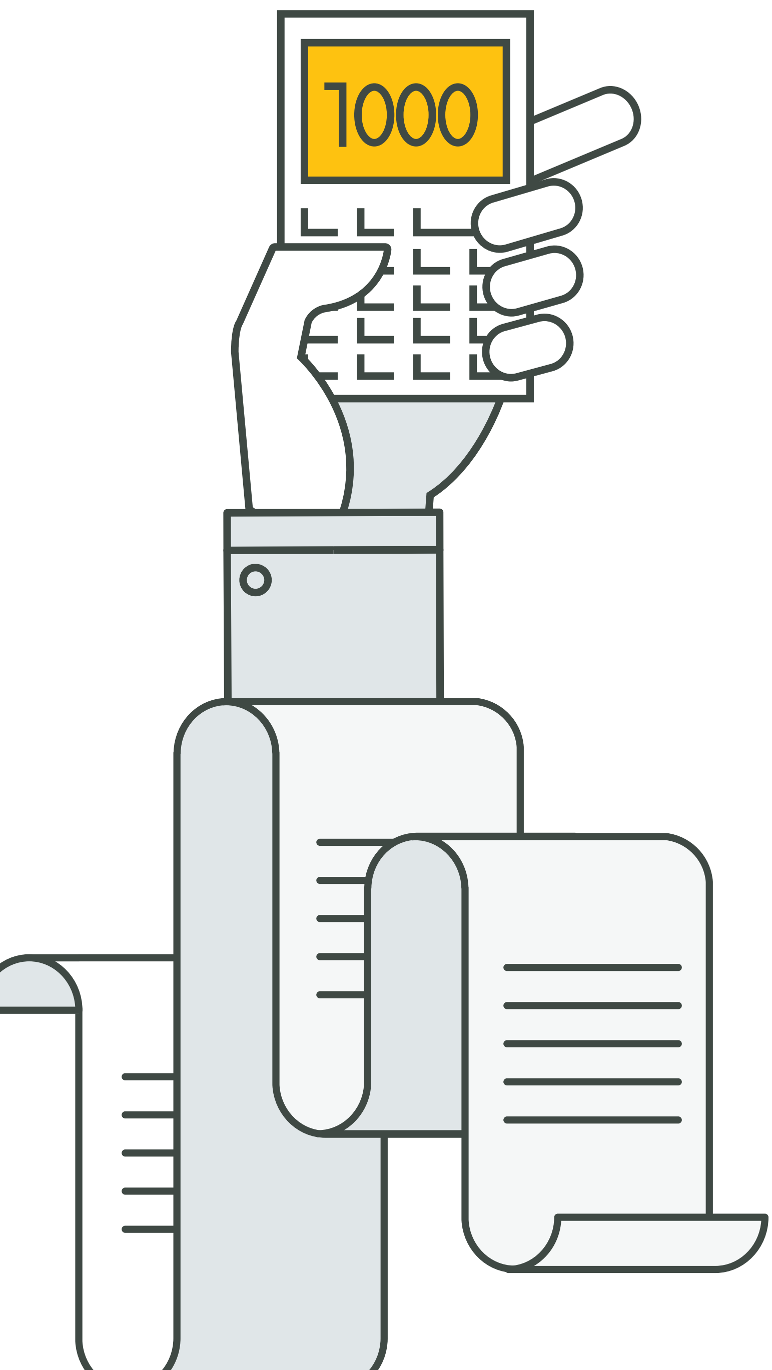
Intended to drive economic growth by adjusting certain tax structures for businesses, the new law is already impacting the way small businesses operate now and how they might operate in the future. Let's explore a few of the main effects.

But first, please know this:

> ***This is intended to help understand a few of highlights from the 429-page Tax Cuts and Jobs Act (TCJA) and does not provide tax or financial advice. For specific questions or more in-depth advice, please consult your financial advisor, tax professional, or accountant.***

## New Corporate Tax Rate

The hallmark of the TCJA is a new lower rate for regular C corporations. As you probably know, C corporations are separate taxpaying entities with their own tax rates. Under the TCJA, all C corporations are subject to single flat tax rate of 21 percent. This replaces the tax rates ranging from 15 percent to almost 40 percent, goes into effect starting in 2018, and is permanent.




## New Pass-through Tax Deduction

While the lower tax rate for regular C corporations might be a welcome change, the fact is that most smaller businesses are not C corporations. Instead, they are organized as pass-through entities, which include sole proprietorships, LLCs, partnerships, and S corporations.

The principal difference is that these entities don't pay taxes themselves and instead, the profits from these businesses are "passed-through" to the owners and the owners pay tax on them at their individual tax rates.

The TCJA creates a brand-new tax deduction for people who earn income through pass-through entities. More specifically, these individuals now may be eligible to deduct an amount up to 20 percent of their net business income. So, if this deduction applies—and it won't always apply—then a "pass-through owner" is effectively taxed on only 80 percent of business income.

Therefore, the combination of lower individual tax rates (also outlined by the TCJA) and the new 20 percent deduction could reduce the top federal tax rate on income from those entities from 39.6 percent to 29.6 percent.

Generally speaking, a pass-through owner will qualify if they:

- operate the business as a sole proprietor, LLC owner, partner in a partnership, or S corporation shareholder, and their
- total taxable income for the year from all sources after deductions is below $315,000 if married filing jointly, or $157,500 if single.

## But Wait, There Is More…

Certain professional services firms with incomes above specified thresholds are not eligible for these tax breaks, which incidentally expire in 2025.

Special rules apply to some business including health, law, accounting, performing arts, consulting, athletics, financial services, brokerage, or just about any business where the principal asset is the reputation or skill of one or more of its owners.

## Section 179 Expensing

Under prior law, Section 179 allowed business owners to deduct in a single year up to $510,000 of the cost of personal property they purchased and used for their business over 50 percent of the time. The TCJA increases this amount to $1 million.

## Interest Deductions Limited

The TCJA generally caps the deduction for net interest expenses at 30 percent of earnings before interest, taxes, depreciation, and amortization. The law provides for the exemption of small businesses with average gross receipts of $25 million or less.

## Elimination of Certain Deductions and Credits

The new TCJA also eliminates various business tax deductions and credits, including the:

- deduction for business entertainment expenses, except for meals;
- starting in 2026, the deduction for meals provided to employees for the convenience of the employer;
- deduction for payment of employee parking, mass transit, or commuting expenses;
- domestic production activities deduction; and
- deduction for local lobbying expenses.

And those are just some of the changes outlined in the TCJA. When you layer on the changes aimed at individuals, it gets even more complicated.

## Going Forward

The reality is that there are so many changes put forth in the TCJA, that all businesses should examine their structure and determine whether changes would be advantageous.

For example, is your business better off as a C-Corp or an S-Corp? Take a business operating as a regular C corporation—it's top tax rate was reduced from 35 percent to 21 percent.

Take an S corporation, the combination of lower individual tax rates (which were also adjusted under the TCJA) and the new 20 percent "Qualified Business Income" deduction could reduce the top federal tax rate on income from those entities from 39.6 percent to 29.6 percent.

Since 29.6 percent is greater than 21 percent, switching to C corporation status may be beneficial. But then again, it may not be….

## The Only Sure Thing in Taxes is Change

Although the 21 percent federal corporate tax rate is currently considered to be permanent, based on history the only sure thing in taxes is that the law is likely to change. In fact, it is very likely that a different administration or Congress might increase the corporate tax rate in the future—or maybe even lower it.

**So, for specific questions or more in-depth advice, please consult your financial advisor, tax professional, or accountant.**