

The TAX CUTS AND JOBS ACT of 2017 – It's Impact on You and Your Family

The Tax Cuts and Jobs Act (“TCJA”) that was enacted on December 22, 2017, was the most comprehensive tax legislation since passage of the Tax Reform Act of 1986. This Act’s provisions generally apply through the 2025 tax year. In 2026, the pre-TCJA tax law will come back into application unless otherwise changed by Congress and the President between now and then.

The following is a summary of provisions that relate to businesses and to individuals who own businesses. A separate summary is available on our website for individuals. In both cases, the reader should educate themselves and meet or contact their tax advisor to gain a more comprehensive understanding as to how these provisions affect them individually

BUSINESSES

I. BUSINESSES – applies to all businesses (Major topics)

Depreciation of tangible personal property – Section 179 expensing and bonus depreciation have been significantly increased. **Section 179 expensing** is limited to \$1 million per year but the phase-out threshold has been increased to \$2.5 million. **Bonus depreciation of 100%** is available for new and used assets placed in service from September 28, 2017, through December 31, 2022. The bonus depreciation for used assets is new as before the TCJA used property was not eligible for this enhanced depreciation. Bonus depreciation is automatic unless specifically elected out. The new depreciation provisions are very lengthy.

Depreciation on vehicles has been increased.

Business meals – Pre-TCJA deductibility at 50% of meal cost has largely been eliminated.

Entertainment expenses – will generally no longer be fully deductible, but there are very limited exceptions and modifications that may be worthwhile digging into.

Interest – Interest incurred for operating a business could be significantly reduced.

Net operating losses – Can no longer be carried back to a prior year.

Domestic production activities – The section 199 deduction for manufacturing is eliminated.

Cost of transportation-related fringe benefits. Deduction for on-site parking and mass transit passes has been temporarily repealed.

II. CORPORATIONS

For federal income tax purposes there are two kinds of corporations, each one of which is named after the letter designation of their respective subchapters in the Internal Revenue Code. C Corporations are subject to income taxes. All corporations are automatically deemed to be C Corporations.

S Corporations are not generally subject to income taxes as their income is passed through to their shareholders. In order to achieve S Corp status an election to be treated as an S Corporation must be filed with the IRS.

III. “C” CORPORATIONS

Tax rate – has been reduced from progressive 35% to a flat rate of 21%. This is a big deal, particularly for small corporations as the progressive 34% rate kicked in at \$75,000 of taxable income. Be sure to see our discussion below for S Corps where Congress and the President created a “qualified business income deduction” for businesses other than C Corporations.

Corporate AMT – has been eliminated.

AMT Credit. Corporate AMT credits that have been building up over the years have not been eliminated – they will be allowed to reduce regular tax liability.

Depreciation, business meals, entertainment expenses, etc. – same as in Section I – Businesses.

IV. “S” CORPORATIONS, PARTNERSHIPS AND LIMITED LIABILITY COMPANIES (LLCs) – also known as “pass-through entities” – AND PROPRIETORSHIPS that have filed Schedules C, E or F.

A 20% deduction is allowed on “qualified business income” for individuals (as well as trusts and estates) who are owners of these kinds of pass-through entities. **This is a brand new concept.**

Beginning on January 1, 2018, an individual taxpayer (or married couple) may generally deduct a “qualified business income deduction on their federal return if they are an owner of a business.

The new qualified business income (“QBI”) deduction affects individuals who

- own an interest in a partnership.
- are an owner of a limited liability company,
- are a shareholder in an S Corporation,
- are an owner of a business that is not incorporated (i.e., sole proprietorship)
- own a partnership interest (or “units”) in a publicly traded partnership,
- own a an interest in a real estate investment trust (“REIT”), or
- own an interest in an agricultural cooperative.

While individual income tax rates declined from a maximum of 39.6% to 37% for the highest income tax bracket and from 0% to 4% so on down the line for the rest of the brackets, the income tax rate for corporations fell dramatically from 35% to 21%.

In order to sort of make up the difference for businesses that were not subject to the corporate income tax assessed on C Corporations, Congress stated in section 199A that certain individuals and pass through businesses, could claim up to a 20% deduction on their “qualified business income.”

While filled with new terminology, limitations and thresholds, this deduction potentially affords a noticeable federal tax benefit to taxpayers who own one or more qualifying businesses that have a profit. Be sure to talk to your tax advisor about this piece of the new act if you are an owner of a pass-through entity or have your own unincorporated business. The proposed regulations on this subject are extensive.

Here are some general rules.

First general rule: Every individual whose pre-199A taxable income is less than \$157,500 (\$315,000 for a married couple filing jointly (MFJ)) and who has a sole proprietorship or ownership interest in a pass through entity qualifies for the qualified business income (“QBI”) deduction. You need to have made a profit from the qualified business in order to claim the deduction.

Second general rule (the phase out): An individual with a qualifying business who has taxable income before section 199A in the range of \$157,500 to \$207,500 for single individuals and \$315,000 to \$415,000 for a married couple filing a joint return will qualify for a reduced QBI deduction.

Third general rule: Once the individual is over \$207,500 (\$415,000 for married filing jointly) cap whether you get to claim the QBI deduction depends upon whether the business you are in is a “specified service trade or business (“SSB,” “SSTB” or “out-of-favor business”). See discussion further below. If you are in a specified service trade or business, then you cannot claim the deduction for any business that is an SSB. For any trade or business that is not amongst the excluded SSBs, then you can potentially claim the QBI deduction.

Fourth general rule: Qualified business income and loss is determined on a business by business basis – i.e., individual record keeping is required for each such business. If the qualified business has a qualified business loss, such loss is carried forward and future income from that business must be applied against the cumulative loss before any subsequent QBI deduction can be claimed.

“Qualified business income” (QBI) includes “the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer.” IRC 199A(c)(1). The provision then goes on to exclude various forms of investment income from pre-199A taxable income to calculate the base that the 20% is applied against.

The term “qualified trade or business” means any trade or business except for a “specified service trade or business” (SSB) or for merely being an employee. A “specified service trade or business” (SSB) means any trade or business involving the performance of services in the fields of

- health, law, accounting, actuarial science,
- performing arts, consulting, athletics,
- financial services, brokerage services,
- investing and investment management, trading, and dealing in securities, partnership interests or commodities and
- any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

In addition, *even if you are not an owner of a qualifying trade or business* and your taxable income is over the phase out thresholds (\$207,500/\$415,000) if you own an interest in a REIT (real estate investment trust), publicly traded partnership or qualified cooperative (think of these as “QBI Investments”), then a portion of the dividends or income you received from them may also be deductible against your taxable income.

See all 184 pages of the proposed regulations and commentary issued by the IRS on August 8, 2018.

The qualified business income deduction is equal to the sum of (1) the lesser of (a) the combined qualified business income amount for the taxable year; or (b) an amount equal to 20% of the excess, if any, of the individual’s taxable income for the taxable year over the sum of any net capital gain and qualified cooperative dividends, plus (2) the lesser of 20% of qualified cooperative dividends for the taxable year or taxable income (reduced by net capital gain). The calculation is not easy to calculate without having a whole host of facts. See your tax advisor.

V. CALIFORNIA CONFORMITY AND NON-CONFORMITY

California does not automatically piggy back on federal tax legislation. Rather, it passes legislation from time to time that identifies federal tax acts or provisions that it will adopt as its own while at the same time normally identifying provisions to which it will not conform.

At present California tax law conforms to federal tax law as of January 1, 2015. Because there have been few announced conformity changes since then one should assume that the federal tax rules that differed from California in 2017 and which will differ from California in 2018 due to the passage of the TCJA will continue to be reported on the California return. Unlike individuals whose conforming and non-conforming tax items are set forth primarily in Schedule CA, the non-conforming provisions are scattered throughout the California business income tax returns, forms and schedules.

CAUTION: This summary is brief. It is not intended to cover all provisions of this tax act.

If you have any questions or need any assistance, please feel free to contact us.

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