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Balance sheet

Business Changes Under the Tax Cuts and Jobs Act (TCJA)

By Richard Hillabrand, CPA

On December 20, 2017, both the House and Senate passed H.R. 1, commonly referred to as the Tax Cuts and Jobs Act (TCJA). With a few exceptions, the provisions of the TCJA affect 2018 tax returns. This newsletter will examine some of the notable changes as they affect business owners.

Currently, C corporations are subject to graduated tax rates, with the top rate of 35% if taxable income exceeds 10 million. In addition, personal service corporations are taxed at a flat rate of 35%. For tax years beginning after December 31, 2017, the TCJA lowers the corporate tax rate to a flat 21% for both C corporations and personal service corporations.

For other business owners the TCJA permits individuals, estates, and trusts to deduct up to 20% of their "qualified business income." You may have heard a lot of talk in the news about a new deduction for "pass-through" income, but it is actually available for qualified business income from sole proprietorships (including a farm), as well as from pass-through entities such as partnerships, LLC's and S corporations. For taxpayers in the new 37% tax bracket (down from 39.6% in 2017), such income may be taxed at an effective top marginal rate of 29.6%.

Although the new deduction opens the door for planning opportunities for you and your business, the rules are complex. There are various limits that can substantially reduce or eliminate the deduction. Many of these limits depend on the nature of your business and how high your taxable income will be in 2018.

Expensing and Depreciating Property

Section 179 Deduction. Under pre-TCJA law, the maximum Section 179 deduction was scheduled to be $520,000 for 2018. In addition, the qualifying property phase-out threshold was scheduled to be $2,070,000. The TCJA increases the maximum Section 179 deduction and phase-out threshold to $1 million and $2.5 million, respectively, for property placed in service in tax years beginning after December 31, 2017. For tax years beginning after 2018, these amounts will be indexed for inflation. The TCJA also expands the definition of Section 179 property to include certain tangible personal property used predominantly to furnish lodging and certain improvements to nonresidential real property (roofs, HVAC, fire protection and alarm systems, and security systems).

Shortened Recovery Period for New Farming Equipment. The TCJA shortens the recovery period of new machinery or equipment placed in service after December 31, 2017 and used in a farming business (other than any grain bin, cotton ginning asset, fence, or other land improvement) from seven to five years. In addition, use of the 150% declining balance depreciation method for these assets will no longer be required.

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Immediate Expensing of Qualifying Business Assets. The TCJA establishes a 100% first-year deduction for qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023 (January 1, 2024 for certain property with longer production periods). Previously this bonus depreciation applied only to new property, but the new law expands it to include used property.

Shortened Recovery Period for Real Property. For property placed in service after December 31, 2017, the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property are eliminated. The TCJA imposes a general 15-year recovery period (20 years for ADS) and straight-line method for qualified improvement property.

Given the complexity of the new law, it is best to get a head start on determining how it will affect your tax situation in 2018. Please contact us to discuss.