Anchin Alert

July 25, 2019

6 Recent Tax Law Changes That Technology Companies Need to Know

The Tax Cuts and Jobs Act (TCJA), which was signed into law over a year ago, has ushered in many changes that impact taxpayers, and in particular, technology companies. Following are six tax law changes that technology companies should be aware of before filing their annual income tax returns.

1. New Corporate Tax Rate

The TCJA substantially reduces the federal income tax rate on C corporations to 21% and eliminates the corporate AMT. Broadly, this reduces the value of Net Operating Loss carryovers as they will now shelter income taxed at only 21% compared to the prior 35%, however it will extend the term that such carryovers are available to be used against future income. In addition, the elimination of the corporate AMT will increase the potential usage of income tax credits, such as the Research & Development Tax Credit which also became permanent as part of the TCJA. Lastly, the choice between C Corporation and pass-through entity status will now be more complex and will require additional analysis.

2. 20% Tax Deduction for Certain Consulting Services

For tax years beginning in 2018, the TCJA established a new deduction from income, based on a non-corporate owner's qualified business income (QBI). This new tax break is available to individuals, estates and trusts that own interests in pass-through business entities. The deduction generally equals 20% of QBI, subject to certain wage and property limitations as well as individual income thresholds.

The IRS has recently issued guidance on what types of companies qualify for this 20% tax deduction. Consulting services have been generally excluded. The business lines and services offered by a technology company to its customers should be carefully examined to determine what is deemed to be true consulting and what would be considered as ancillary services in conjunction with a product sale or non-consulting service, such as installation, implementation, design or development. This deduction adds further complexities into entity type selection.

3. Accelerated Depreciation and Section 179

The TCJA increased the amount a business or taxpayer may expense under bonus depreciation from 50% to 100% for property placed in service after September 27, 2017 and before January 1, 2023. The amount allowed as bonus depreciation after 2022 will be reduced by 20% until it is fully phased out in 2027.

Beginning in 2018, the amount a business may claim as an immediate deduction under Section 179 will increase from $500,000 to $1 million. Also the phase-out threshold that eliminates the Section 179 deduction is increased to $2.5 million of fixed asset additions. It's important to note that certain states decouple from the accelerated Federal depreciation rues. Thus, an analysis should be performed to maximize benefits at the Federal & State levels.

4. New Limits on Business Interest Deductions

Subject to some restrictions and exceptions, prior law stated that interest paid or accrued by a business generally is fully deductible. Under the TCJA, affected businesses generally cannot deduct interest expense in excess of 30% of "adjusted taxable income," starting in 2018.

Taxpayers with average annual gross receipts of $25 million or less for the three previous tax years are exempt from the interest deduction limitation. Certain other taxpayers are also exempt.

Business interest expense that's disallowed under this limitation is treated as business interest arising in the following taxable year. Amounts that cannot be deducted in the current year can generally be carried forward indefinitely.

5. Reduced or Eliminated Employer Deductions for Business-Related Meals and Entertainment

Prior to the TCJA, taxpayers generally could deduct 50% of expenses for business-related meals and entertainment. Meals, entertainment and various other employer-provided fringe benefits that are provided to an employee for the convenience of the employer on the employer's business premises were 100% deductible by the employer and tax-free to the recipient employee.

Under the new law, no deductions are allowed for business-related entertainment expenses incurred after December 31, 2017. Meal expenses incurred while traveling on business are still 50% deductible, but the 50% disallowance rule will now also apply to meals provided at an on-premises cafeteria or otherwise on the employer's premises for the convenience of the employer. After 2025, this cost will be fully non-deductible.

6. Tax Deferral for Certain Forms of Equity Compensation

Under new IRS code section 83i, the TCJA has implemented a deferral for up to five years of the vesting of restricted stock or the exercise of non-qualified stock options for certain employees of companies that adopt a new plan in compliance with 83i. There are several requirements that a company must meet to qualify for 83i, such as an issuance of restricted stock or non-qualified stock options to at least 80% of its U.S. based employees. Certain corporate officers and more than 2% owners are restricted from using this deferral mechanism.

If you would like to discuss these changes, planning opportunities or have any specific questions, please contact Michael Brennan, Tax Director of the Technology Industry Group (michael.brennan@anchin.com), Chris Noble, Partner and Leader of the Technology Industry Group (christopher.noble@anchin.com), or your Anchin Relationship Partner at 212.840.3456.

Anchin Alert, Copyright © 2019 Anchin Block & Anchin LLP. The Anchin Alert is published periodically by Anchin, Block & Anchin LLP, Accountants & Advisors. The Alert contains articles which are general in nature and based on sources which are believed to be authoritative. Specific applications would require consideration of all facts and circumstances by qualified professionals familiar with a taxpayer and therefore we are not liable for the application of any information contained herein. No part of this correspondence may be reproduced or utilized in any form or by any means without written permission from Anchin, Block & Anchin LLP.