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Year-End Tax Planning for Businesses: Looming Tax Reform Creates Planning Challenges

As the end of 2017 approaches, the prospect of dramatic tax reform makes year-end tax planning especially challenging. In late September, the Trump administration and Republican congressional leaders unveiled their *Unified Framework for Fixing Our Broken Tax Code*. The framework proposes reduced tax rates for businesses as well as changes to a variety of business tax benefits. But there's a great deal of uncertainty over when — and if — tax reform will be implemented and which proposals could make their way into possible new tax legislation.

So, what can you do now? Start by projecting your business's income and expenses for 2017, 2018 and beyond and see what your tax picture would look like under various tax reform scenarios. You may want to delay implementing year-end strategies until further details emerge about proposed tax reform. But unless Congress makes significant progress in the coming weeks, you may have to make some educated guesses and plan accordingly.

What are the key business-related proposals?
The proposed framework calls for:

- Reducing the top corporate income tax rate from 35% to 20%. (It also suggests that tax-writing committees consider methods to reduce double taxation of corporate earnings.)
- Eliminating the corporate alternative minimum tax.
- Providing for 100% bonus depreciation, for at least five years, for new investments in depreciable assets (other than structures) made after September 27, 2017. Current law allows 50% bonus depreciation for such assets, dropping to 40% next year and 30% in 2019, after which it will be eliminated.
- Partially limiting the deduction for net interest expense by C corporations.
- Preserving the research and low-income housing tax credits. Most other business tax credits would be eliminated, although some may be retained if budgetary limitations allow it.
- Eliminating the Section 199 deduction for domestic production activities, as well as most industry-specific deductions and exclusions.
- Taxing "business income of small and family-owned businesses conducted as sole proprietorships, partnerships and S corporations" at a top rate of 25%. Currently, sole proprietors and owners of pass-through entities are taxed at individual rates as high as 39.6%. Antiabuse provisions would "prevent the recharacterization of personal income into business income."

The framework would also have significant implications for U.S. multinational corporations. It contemplates moving from our current worldwide tax regime to a territorial regime under which U.S. parent corporations would enjoy a 100% exemption on dividends received from foreign subsidiaries in which they own at least a 10% stake. As part of the transition to this new system, there would be a deemed repatriation of deferred foreign profits accumulated prior to the change. The framework doesn't specify the tax rate that would be applied to those profits, except to say that foreign earnings held in illiquid assets would be taxed at a lower rate and that payment of the tax would be spread out over several years.

What does this mean for year-end tax planning?
Traditional year-end planning principles say that, if you expect your marginal tax rate to remain roughly the same or go down in 2018, you should consider strategies for deferring income to 2018 or accelerating deductions into 2017. On the other hand, if you expect your business's marginal tax rate to be substantially higher next year, you may be better off doing the opposite: accelerating income into 2017 and deferring deductions to 2018. However, keep in mind that, even though this strategy reduces your overall tax liability for 2017 and 2018, paying taxes sooner rather than later can strain your cash flow.

If the proposals outlined in the framework become law, it's a good bet that many, if not most, businesses will see their effective tax rates go down in 2018. But there are no guarantees. For example, limits on net interest deductions may hurt highly leveraged corporations. And businesses currently benefiting from industry-specific deductions or exclusions or other tax breaks slated for elimination may see their taxes go up next year. For sole proprietorships and pass-through entities, the answer may depend in part on how tax reform legislation defines certain terms, such as "business income" and "small and family-owned businesses."

What about capital expenditures?
Timing capital expenditures is particularly challenging. Businesses often acquire equipment or other depreciable assets before the end of the year to take advantage of enhanced depreciation tax breaks, such as bonus depreciation and Section 179 expensing. Sec. 179 allows you to deduct 100% of the cost of qualified new or used depreciable assets. (Bonus depreciation is available only for new assets.) But there's a limit on Sec. 179 deductions ($510,000 this year) and the deduction is phased out after a business's total purchases exceed a specified threshold ($2,030,000 this year). Keep in mind that the framework is silent regarding the future of Sec. 179 expensing, although many believe it will be retained.

Typically, businesses try to time these purchases when the deductions will do them the most good. Usually, that means this year rather than next, to enjoy the cash-flow benefits of a lower tax bill. Another issue to consider is the effective date of the proposed 100% bonus depreciation. The framework would offer this tax break for investments after September 27, 2017, but tax reform legislation could make it effective January 1, 2018, or some later date. Should businesses otherwise entitled to 50% bonus depreciation postpone asset purchases until the effective date for 100% bonus depreciation becomes clear? That's a tough question.

Are you entitled to Sec. 199 deductions?
The Section 199 deduction, also commonly referred to as the manufacturers' deduction or the domestic production activities deduction (DPAD), allows you to deduct up to 9% of your income from qualified domestic production activities, including certain manufacturing, construction, engineering, architecture, software development and agricultural activities. If you believe the deduction will be eliminated, as the tax reform framework proposes, it may pay to accelerate qualifying income into 2017 to avoid losing these deductions permanently.

Next Steps
Given the uncertainty over the timing and content of new tax legislation, it may be advisable to delay implementing year-end planning, if practical, until the tax reform picture becomes clearer. But don't wait too long; some year-end strategies take time to execute. For example, to take advantage of deductions for capital investments, it's not enough to purchase an asset — you'll need to place it into service by year's end.

Your Anchin Relationship Partner will continue to collaborate with you to develop a tax planning strategy for your business. If you have questions, feel free to reach out to them or Clarence Kehoe, Anchin's Tax Group Leader, at 212.840.3456.

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