# Anchin Alert

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December 28, 2017

## Tax Cuts and Jobs Act Offers Favorable Tax Breaks for Businesses

The Tax Cuts and Jobs Act (TCJA), which was signed into law on December 22, contains a treasure trove of tax breaks for businesses. Overall, most companies and business owners will come out ahead under the new tax law, but there are a number of tax breaks that were eliminated or reduced to make room for other beneficial revisions. Here are the most important changes in the new law that will affect businesses and their owners.

**New 21% corporate tax rate**
Under pre-TCJA law, C corporations paid graduated federal income tax rates of 15% on taxable income of $0 to $50,000; 25% on taxable income of $50,001 to $75,000; 34% on taxable income of $75,001 to $10 million; and 35% on taxable income over $10 million. Personal service corporations (PSCs) paid a flat 35% rate.

For tax years beginning in 2018, the TCJA establishes a flat 21% corporate rate, and that rate also applies to PSCs.

**Reduced corporate dividends deduction**
Under pre-TCJA law, C corporations that received dividends from other corporations were entitled to partially deduct those dividends. If the corporation owned at least 20% of the stock of another corporation, an 80% deduction applied. Otherwise, the deduction was 70% of dividends received.

For tax years beginning in 2018, the TCJA reduces the 80% deduction to 65% and the 70% deduction to 50%. These reductions are part of the price businesses have to pay for the new 21% corporate rate.

**Corporate alternative minimum tax repealed**
Prior to the TCJA, the corporate alternative minimum tax (AMT) was imposed at a 20% rate. However, corporations with average annual gross receipts of less than $7.5 million for the preceding three tax years were exempt. For tax years beginning in 2018, the new law repeals the corporate AMT. For corporations that paid the corporate AMT in earlier years, an AMT credit was allowed under prior law. The new law allows corporations to fully use their AMT credit carryovers in their 2018–2021 tax years.

**New deduction for pass-through businesses**
Under prior law, net taxable income from pass-through business entities (such as sole proprietorships, partnerships, S corporations and LLCs that are treated as sole proprietorships or as partnerships for tax purposes) was simply passed through to owners. It was then taxed at the owners' standard rates. In other words, no special treatment applied to pass-through income recognized by business owners.

For tax years beginning in 2018, the TCJA establishes a new deduction based on a noncorporate 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 restrictions that can apply at higher income levels.

QBI is generally defined as the net amount of qualified items of income, gain, deduction and loss from any qualified business of the noncorporate owner. For this purpose, qualified items are income, gain, deduction and loss that are effectively connected with the conduct of a U.S. business. QBI doesn't include certain investment items, reasonable compensation paid to an owner for services rendered to the business or any guaranteed payments to a partner or LLC member treated as a partner for services rendered to the partnership or LLC.

The QBI deduction isn't allowed in calculating the noncorporate owner's adjusted gross income (AGI), but it reduces taxable income. In effect, it's treated the same as an allowable itemized deduction.

**W-2 wage limitation.** For pass-through entities, the QBI deduction generally can't exceed the greater of the noncorporate owner's share of:

- 50% of the amount of W-2 wages paid to employees by the qualified business during the tax year, or
- The sum of 25% of W-2 wages plus 2.5% of the cost of qualified property.

Qualified property is the depreciable tangible property (including real estate) owned by a qualified business as of year end and used by the business at any point during the tax year for the production of qualified business income.

Under an exception, the W-2 wage limitation doesn't apply until an individual owner's taxable income exceeds $157,500 ($315,000 for joint filers). Above those income levels, the W-2 wage limitation is phased in over a $50,000 range ($100,000 range for joint filers).

**Service business limitation.** Finally, the QBI deduction generally isn't available for income from specified service businesses (such as most professional practices other than engineering and architecture). Under an exception, the service business limitation doesn't apply until an individual owner's taxable income exceeds $157,500 ($315,000 for joint filers). Above those income levels, the service business limitation is phased in over a $50,000 phase-in range ($100,000 range for joint filers).

The W-2 wage limitation and the service business limitation don't apply as long as your taxable income is under the applicable threshold. In that case, you should qualify for the full 20% QBI deduction.

**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 corporate and noncorporate businesses generally can't deduct interest expenses in excess of 30% of "adjusted taxable income," starting with tax years in 2018. For S corporations, partnerships and LLCs that are treated as partnerships for tax purposes, this limit is applied at the entity level rather than at the owner level.

For tax years beginning in 2018 through 2021, adjusted taxable income is calculated by adding back allowable deductions for depreciation, amortization and depletion. After that, these amounts aren't added back in calculating adjusted taxable income.

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.

Taxpayers (other than tax shelters) with average annual gross receipts of $25 million or less for the three previous tax years are exempt from the interest deduction limitation. Some other taxpayers are also exempt. For example, real property businesses that elect to use a slower depreciation method for their real property with a normal depreciation period of 10 years or more are exempt. Another exemption applies to interest expense from dealer floor plan financing (for example, financing by dealers to acquire motor vehicles, boats or farm machinery that will be sold or leased to customers).

**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 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. Various other employer-provided fringe benefits were also deductible by the employer and tax-free to the recipient employee.

Under the new law, for amounts paid or incurred after December 31, 2017, deductions for business-related entertainment expenses are disallowed. Meal expenses incurred while traveling on business are still 50% deductible, but the 50% disallowance rule will now also apply to meals provided via an on-premises cafeteria or otherwise on the employer's premises for the convenience of the employer. After 2025, the cost of meals provided through an on-premises cafeteria or otherwise on the employer's premises will be nondeductible.

**Changes to some employee fringe benefits**

The new law disallows employer deductions for the cost of providing commuting transportation to an employee (such as hiring a car service), unless the transportation is necessary for the employee's safety.

It also eliminates employer deductions for the cost of providing qualified employee transportation fringe benefits (for example, parking allowances, mass transit passes and van pooling), but those benefits are still tax-free to recipient employees.

**Foreign tax provisions**

The TCJA includes a bevy of changes that will affect taxpayers who conduct foreign operations. In conjunction with the reduced corporate tax rate, the changes are intended to encourage multinational companies to conduct more operations in the United States, with the resulting increased investments and job creation in this country.

**Other changes**

Here are some of the other business-related changes in the TCJA:

- For business net operating losses (NOLs) that arise in tax years *ending* after December 31, 2017, the maximum amount of taxable income that can be offset with NOL deductions is generally reduced from 100% to 80%. In addition, NOLs incurred in those years can no longer be carried back to an earlier tax year (except for certain farming losses). Affected NOLs can be carried forward indefinitely.
- More generous business asset expensing and depreciation tax breaks are available. The maximum Section 179 deduction increases to $1 million, and the phaseout threshold amount is increased to $2.5 million (from $510,000 and $2.03 million respectively). There are also much better first-year bonus depreciation rules.
- The Section 199 deduction, also commonly referred to as the domestic production activities deduction or manufacturers' deduction, is eliminated for tax years beginning after December 31, 2017, for noncorporate taxpayers and for tax years beginning after December 31, 2018, for C corporation taxpayers.
- A new limitation applies to deductions for "excess business losses" incurred by noncorporate taxpayers. Losses that are disallowed under this rule are carried forward to later tax years and can then be deducted under the rules that apply to NOLs. This new limit kicks in after applying the passive activity loss rules. However, it applies to an individual taxpayer only if the excess business loss exceeds the applicable threshold.
- The eligibility rules to use the more-flexible cash method of accounting are liberalized to make them available to many more medium-size businesses.
- The Section 1031 rules that allow tax-deferred exchanges of appreciated like-kind property is allowed only for real estate for exchanges completed after December 31, 2017. Beginning in 2018, there are no more like-kind exchanges for personal property assets. However, the prior-law rules still apply if one leg of an exchange has been completed as of December 31, 2017, but one leg remains open on that date.
- Faster depreciation is allowed for eligible farming assets.
- Compensation deductions for amounts paid to principal executive officers generally cannot exceed $1 million per year, subject to a transition rule for amounts paid under binding contracts that were in effect as of November 2, 2017.

- Specified R&D expenses must be capitalized and amortized over five years, or 15 years if the R&D is conducted outside the United States instead of being deducted currently. This begins with tax years beginning after December 31, 2021.

**Any questions?**

The TCJA is the largest overhaul of the tax code in more than 30 years, and we've covered only the highlights of the business-related tax provisions here. We'll keep you apprised as more information becomes clear about how the TCJA will affect your business. If you have any questions, feel free to contact your Anchin Relationship Partner.

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