Long Island Business News
https://libn.com/2019/12/02/forecast-tax-reforms-many-impacts/

Forecast: Tax reform's many impacts

By: Bernadette Starzee December 2, 2019

It's been a long, complicated year for accounting firms as accountants and their clients felt the full impacts of the Tax Cuts and Jobs Act of 2017 for the first time.

In the wake of the law's sweeping tax reform, accounting firms formed committees to develop expertise in specific areas of the act and then share it firm-wide. CPAs spent countless hours explaining changes to clients and exploring ways that their clients could best take advantage of tax-saving opportunities. There were new forms and schedules, and record numbers of taxpayers had to be put on extension since in many situations, accountants did not know in March and April the best way to proceed as the IRS was slow to issue guidance and clarifications.

"Some clients were not happy to go on extension, but we made them see that it was not in their best interest to rush and take a position that might not be advantageous in the end," said Erick Torres, a tax partner at Citrin Cooperman in Melville.

Going into 2020, guidance and clarifications continue to flow from the IRS, but accountants and their clients now have a full year of dealing with tax reform under their belt.

Certain areas of tax reform have had major impacts on the Long Island business community, and this will continue next year.

Qualified business income deduction
With tax reform, C corporations are now taxed a flat 21 percent rate, down from a maximum of 35 percent.

Diane Giordano

"The idea behind this is that businesses from around the world will be more apt to do business here," said Diane Giordano, a partner in the Melville office of Marcum.

Of course, existing U.S. corporations benefited from this tax cut, as well. However, most Long Island companies are not C corporations, but pass-through entities, including sole proprietorships, partnerships, limited liability companies and S corporations.

“Since lawmakers gave the C corporations a really good tax break, they realized they had to do something for family-owned businesses and other non-C-corporations,” Giordano said. Enter the Code Section 199A qualified business income deduction, which provides a 20 percent deduction on qualified business income.

“Business owners recognize income from the pass-through entity on their personal income tax returns,” Giordano said. For some taxpayers, that income is now reduced by 20 percent, “which is a nice deduction,” Giordano said.

But the law is not that simple. For taxpayers with taxable income under $315,000 in 2018 and $321,400 in 2019 for joint filers, and $157,500 in 2018 and $160,700 in 2019 for other filers, the 20 percent deduction applies to all qualified trade or business income. But for higher incomes there are limitations. There is a phase-out period, and when taxable income exceeds $415,000 in 2018 and $421,400 in 2019 for joint filers, and $207,500 in 2018 and $210,700 in 2019 for other filers, the deduction is limited to the greater of 50 percent of W-2 wages or 25 percent of W-2 wages and 2.5 percent of the unadjusted basis of investment assets (UBIA) used in the business, according to Marcum. Also, many specified service trades or businesses do not qualify, including those in the fields of law, accounting, health, consulting, financial services and performing arts. Generally any business in which the principal asset is the reputation or skills of one or more of its employees or owners does not qualify.

“Many of our clients were over the income thresholds, so we had to figure out who was eligible and how we could maximize the benefit,” said Mordecai Lerer, a tax partner in the commercial business group at Marks Paneth in Woodbury. This was further complicated by the late issuance of guidance and clarifications.

When the Tax Cuts and Jobs Act was first announced, many accountants were bombarded with questions from flow-through entity owners about whether they should switch their structure to C corporations.

“It was the number one question for a while, but after going through calculations, projections and modeling, I have not had one client switch,” said Don Crotty, a partner at Mazars USA in Woodbury. “In many cases, a C corporation is less tax-efficient. Many clients who asked about switching weren’t aware of the double taxation.” C corporations are taxed on their earnings, and then the shareholders are taxed when they take out dividends.

Bonus depreciation

Many companies in the region benefited from the bonus depreciation provided by the Tax Cuts and Jobs Act, which allows companies to take a 100 percent deduction on assets such as machinery, vehicles and furniture in the first year. Bonus depreciation applies to assets acquired after Sept. 27, 2017 and before Jan. 1, 2023. Previously, 50 percent depreciation could be deducted in the first year. In the past, equipment had to be new to qualify for bonus depreciation.

“Now used equipment qualifies – it doesn’t have to be new, just new to the taxpayer,” Lerer said. “So you can go in and buy a company with $5 million worth of equipment and have a $5 million tax deduction on day one. I think the bonus depreciation was a good boost for the economy.”

But what happens next year?
"A company that bought $1 million in equipment got a great deduction this year, but there will be no deductions from that equipment next year," Crotty said. "The trouble with accelerating a benefit that is usually spread over multiple years is that there will be no deduction next year unless you buy more stuff. One client called the bonus depreciation a 'short-term loan from the government.' You're going to have to pay for it later."

Crotty added, "It's going to come down to communication with clients and managing expectations and staying on top of activity to plan around if there is going to be a lot more taxable income next year."

SALT deduction cap
Individual taxpayers on Long Island, like other high-income, high-tax areas, were disproportionately hurt by the $10,000 cap in state and local tax (SALT) deductions imposed by the Tax Cuts and Jobs Act. Many Long Islanders who previously itemized things like property tax, state and local income tax and mortgage interest are now only able to take a $10,000 deduction for all of those items – in a region where many homeowners pay more than $10,000 for property taxes alone.

"This gave a lot of people sticker shock," Torres said. "The refunds were less than they expected."

Many so-called "blue state workarounds" have been considered to try to limit the impacts of the SALT deduction, including lawsuits filed by several states against the federal government. "But none of these attempts have worked so far," Giordano said.

Entertainment expenses
Companies that entertain clients on a regular basis were hurt by the elimination of the entertainment deduction. But while outings like concerts and baseball games can no longer be written off, meals are still 50 percent deductible.

"Expense reports have to be separated into meals and entertainment," Giordano said. "If you're taking your client to a tennis game, that's no longer deductible. But if you're taking your client to dinner, that's still 50 percent deductible."

The overall impact of tax reform is hard to quantify.

"Every client is different, with a different set of circumstances," Crotty said. "Some were only nominally affected by the new law. In other cases, the impact was very favorable or unfavorable."