Long Island Business News

Cracking the code

By: Claude Solnik December 18, 2017

While both the Republican House and Senate proposals would drastically alter the nation's tax regulations for individuals, changes to the code for business may prove to be the centerpiece.

The cuts would significantly lower basic rates for many firms, remove some deductions and otherwise remake the nation's business tax code.

This will be good news for many companies, but eliminations of state and local tax deductions could take a toll on New Yorkers, effectively diminishing take-home pay.

"This legislation is sweeping. It impacts all of us and all industries," Lance Christensen, a partner at Garden City-based Margolin, Winer & Evens, said. "It's not one size fits all. There will be some winners and losers depending upon the company's circumstances."

In the biggest change, both the House and the Senate plans initially would lower the business tax rate to 20 percent from 35 percent, taking effect for 2018 under the House proposal and in 2019 for the Senate. The final, reconciled bill calls for a 21 percent rate, slightly more than the two proposals.

"Corporations will see significant savings, because of the corporate tax rate going down," said Ed Reitmeyer, a tax partner for Manhattan-based Marcum with large Melville offices. "If you're a small business that employs people, generally, you will see a savings in this tax act."

Christensen said many changes are friendly to business owners, as Congress uses the code to reward those who start, run and invest in companies.

"The employer is out there, competing with foreign companies, taking the risks," Christensen said. "One of the goals of the tax reform is to grow the economy. One way is to compete successfully with companies overseas."

The corporate rate in the United States, including state taxes, is above 39 percent, while in France it's 34.4 percent, 30.2 percent in Germany and 30 percent in Japan, all well above Ireland's 12.5 percent, according to the Organization for Economic Cooperation and Development.

"Countries overseas have corporate tax rates that are far less," Christensen continued. "We need to bring the tax rates down. But you need to pay for it."

Still, once deductions and other incentives are factored in to calculate effective corporate tax rates, Japan's rate is 21.7 percent, the United Kingdom's is 18.7 percent and the United States' is 18.6 percent. according to the Congressional Budget Office.

"Companies that are pass-through entities are winners, although not in the service business such as accountants and lawyers and architects," Christensen said, noting they don't qualify for new benefits.

Under the House bill, 30 percent of income from a pass through entity would be subject to an alternate 25 percent business tax with the rest taxed at the individual's own rate.

The Senate bill calls for a 23 percent deduction on individual returns for income from pass-through entities up to half of wages paid by the entity.

Reitmeyer said service firms excluded from that 23 percent deduction might "want to form C corporations rather than pass through entities."

Companies could immediately write off the cost of assets such as equipment, rather than slowly depreciating it.

"There are many provisions in this bill that will provide further benefits with respect to M and A activity," Christensen said. "There would be the ability to write off certain costs of the acquisition, the assets being acquired."

Rules that let companies write off assets at once, however, would also mean no tax benefit in subsequent years.

"They'll get the benefit of immediately expensing trucks," said Margolin, Winer & Evens Co-managing Partner Craig Savell. "We always note with clients that it's great news today. It becomes a difficult item from a cash flow perspective."

Manufacturers' 9 percent deduction for domestic production would be gone under both plans after more than a decade. "This would be repealed to help pay for some other benefits," Christensen said.

And research and development tax benefits will disappear for many companies, although lower overall taxes could help fund development.

"As it stands right now, there will be less incentive for companies to do domestic R and D work," Christensen said.

Drastic changes in regulations could impact companies, by affecting lending covenants. "I'm hopeful that the credit folks at all the institutions will be able to modify financial covenants of any companies and react to it properly to not damage the company for not meeting covenants, because this is out of their control," Davi Tserpelis, senior vice president at Sterling National Bank, said.

But a $10,000 limit on property tax, state and local tax deductions could hit New York hard, impacting businesses indirectly.

"What's the effect on the New York area of the tax plan?" Adam Silvers, managing partner at Ruskin Moscou Faltischek in Uniondale, said. "A lot of things are favorable to corporations. But corporations need people."

Silvers said ending those deductions is going to make it "expensive to live here, more so than in the past" and "if people start leaving, companies are going to follow."

Christensen said the strict limits on these deductions could hit Long Island along with New York in general.

“People are not going to want to live in New York if they have to pay these taxes and can’t deduct,” he said. “They may move away. The businesses may move to lower tax jurisdictions.”

The value of houses in New York is likely to drop because of limits on property tax deductions. “That may impact the ability to get employees in New York who are qualified,” Christensen continued.

If taxes go up, that would decrease the value of compensation, which could hurt business and therefore investment in New York.

“The investment community may take heed of that and be hesitant to put money into a company that’s going to leave,” Silvers said.

Removing or limiting tax deductions could make recruiting tougher and even change the way employees are paid. “Different types of vehicles can be used, so the employee gets very good tax treatment,” Christensen said.

Changes in the code could impact the type of business entity that best suits a company, not simply impacting pass through entities.

“The structure is going to depend on the type of business and the tax advantages and disadvantages,” Silvers said.

Christensen agreed that the entity used to form a company could have new tax consequences, which could lead some firms to change their corporate structure.

“If you’re not structured properly, you may not get the benefits of the legislation,” he said.

The biggest benefit, however, could come to people who inherit their business. The House bill would roughly double lifetime gift exemptions for individuals from $5.5 million to $10 million, while the Senate would increase them to $10.98 million.

“There will be a lot of activity in terms of gifts that can be made in a lifetime,” Christensen said. “We may get an estate-tax repeal down the road.”