Associated Press

5 things small business owners should know about tax bills

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13 December 2017 11:50

NEW YORK (AP) — Some small business owners may pay lower taxes under the Republican tax overhaul, but accountants and consultants will want to read the fine print carefully — once the details are finally settled. And some owners may want to consider changing their corporate structure if parts of the proposed changes go through.

A highlight for construction and manufacturing businesses: Both the House and Senate versions of the bill raise the deduction that lets many kinds of equipment purchases be written off right away. And for landlords, they'll be able to keep fully deducting their mortgage interest.

Lawmakers appear to be in general agreement on some broad themes, but several issues are still up in the air as House and Senate negotiators try to reconcile their differences. That includes the tax rates for all types of companies and the size of deductions for equipment, property and interest charges. How much companies will pay in tax starting in 2018 will depend on fine points, technicalities and exemptions still under discussion.

"The devil's always in the details and it's not there yet," says **Edward Reitmeyer**, a certified public accountant with Marcum LLP in Philadelphia.

Five things small business owners should know about the legislation:

PASS-THROUGH INCOME

Perhaps the biggest consideration is over the tax rate for the vast majority of businesses — those that are sole proprietorships, partnerships and the companies known as S corporations. These companies are called pass-throughs since revenue and expenses are accounted for on separate tax forms and then "passed through" to the owner's personal 1040 returns and are taxed at individual rates. They differ from the businesses known as C corporations, which pay their taxes at corporate rates.

The House version generally provides for these owners' business income to be taxed at a maximum of 25 percent, compared to the current top bracket of 39.6 percent. The Senate bill provides for 23 percent of a pass-through owner's business income to be tax-exempt, with the rest taxed at individual rates.

Both bills have limitations. Among them: Business owners who provide professional services, including lawyers, accountants and consultants, could see themselves at least partially excluded from the tax breaks.

But it's questionable how many pass-through owners would see a change in their taxes, according to Joe Rosenberg, a tax researcher with the Urban Institute, a think tank based in Washington, D.C. He says 85 to 90 percent of pass-throughs are already taxed at a 25 percent rate or less.

CORPORATE TAXES

As for C corporations, both bills set a 20 percent corporate tax rate, down from the current 35 percent. The Senate bill, however, delays the implementation of the lower rate until 2019. C corporations include all of the Fortune 500 and other publicly traded companies. However, small businesses can also be C corporations.

Owners of pass-through companies who won't get any tax breaks might decide to change their business structure to a C corporation, Reitmeyer says.

"That is something that has to be looked at for everyone going forward," he says.

BUSINESS TAX DEDUCTIONS

The deduction that lets companies write off many types of equipment purchases up front rather than depreciate them over a period of years would increase under both bills from its current level of $510,000.

The House version would raise the Section 179 deduction (named for a portion of the tax code) to $5 million, while the Senate bill raises it to $1 million. Companies most likely to benefit from the higher limits are those like construction, farming and manufacturing businesses that invest in large or expensive machinery and vehicles.

Depreciation rules that govern larger equipment and property purchases would also change. Currently, many investments in equipment or real estate must be depreciated over a period ranging from 2.5 years to decades, depending on what kind of property it is. Both bills allow for full up-front deductions of purchases each year for the next five years. The Senate version provides for a gradual phase-out of the full deduction over the following four years.

Both bills reduce the deductibility of business interest expenses to 30 percent of a company's taxable income. That may be an unwelcome change as under the current law, interest is completely deductible. The House version allows companies with up to $25 million in revenue to keep the full deduction. The Senate version ends the full deduction for companies with more than $15 million in revenue. Landlords, however, will be able to continue fully deducting their mortgage interest.

ALTERNATIVE MINIMUM TAX

Another key area of dispute is whether to repeal the alternative minimum tax, or AMT. The tax requires high-earning individuals and corporations to compute their tax liability in two different ways and pay whichever amount is higher. Some Republican lawmakers said retaining it would limit companies' ability to take advantage of some tax credits, such as for research and development.

The Senate bill keeps the AMT for corporations. House Majority Leader Kevin McCarthy, R-Calif., suggested this week that it's possible that the AMT will be repealed in the final tax bill.

Even if the AMT survives, some business owners may escape it in the future, Reitmeyer says, noting that the current bills call for an end to the individual deduction for state and local income taxes.

"The No. 1 item that puts our clients into the AMT is the state and local tax deduction," he says.

ACCOUNTING METHODS

Both bills would simplify financial record-keeping for many small businesses that have inventory, making the cash method of accounting available to them.

Under cash accounting, a company records income when it's received and expenses when they're paid. Under the more complex method of accrual accounting, income and expenses are booked when they are owed, not when they're received or paid.

Generally, manufacturers and other companies that have inventory are required to use the accrual method, but current law exempts businesses with average annual revenue of $5 million or less. The House bill would raise that exemption to $25 million, while the Senate version would set it at $15 million.