# Year-End Tax Planning in a Tax Cuts and Jobs Act World – 2019 Year-End Tax Planning Letter for Businesses

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As this year is about to end, now is an excellent time for businesses to review their current tax planning strategies to ensure they're still meeting intended goals and developing plans for 2020. It's also a good time to take advantage of last-minute planning opportunities that could save money now and in the coming year.

With that in mind, business owners are encouraged to contact us at 301.986.0600 to discuss their tax situation. CBM can develop a customized plan to save on 2019 taxes. In the meantime, here's a look at some of the issues we're recommending clients consider as they begin their end-of-year review.

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## Tax Cuts and Jobs Act (TCJA)

The first tax-filing season under the Tax Cuts and Jobs Act (TCJA) was a time of uncertainty for many businesses as they struggled with the implications of the law's sweeping changes for their bottom lines. With the next filing season on the horizon, businesses can incorporate lessons learned into current year-end tax planning strategies. Several areas are ripe with opportunities to reduce the 2019 federal tax liability.

## Cash method of accounting.

Another provision arising from TCJA was a more permissive adoption of the cash method of accounting. Beginning in 2018, corporations with gross receipts up to $25 million ($26 million for 2019) can use the method, up from $1 million in prior years. Many of the traditional end-of-year planning techniques relating to timing, such as income deferral or income acceleration, are made easier where the cash method of accounting is used.

## Entity choice

The creation of the qualified business income (QBI) deduction for pass-through entities, paired with the reduction of the corporate tax rate to a flat 21% rate from a top rate of 35%, makes it worthwhile for businesses to re-evaluate whether their current entity type is favorable to their tax situation.

Pass-through entities, including sole proprietorships, partnerships and S corporations, have traditionally been a way to avoid the double taxation C corporations are subject to at the entity and dividend levels. Pass-through entities are taxed only once, at an individual tax rate, but that rate can be as high as 37%. If they qualify for the full 20% QBI deduction, which is not always a certainty (see below) — their effective tax rate is approximately 30%.

The deduction for state and local taxes also plays a role in the entity choice. The TCJA limits the amount of the deduction for individual pass-through entity owners, but not for corporations.

Bear in mind, too, that the reduced corporate tax rate is permanent (or as permanent as any tax cut can be), while the QBI deduction is slated to end after 2025. Ultimately, a business's individual circumstances will determine the optimal structure.

**The QBI deduction**

Pass-through entities can take several steps before December 31 to maximize their QBI deduction. The deduction is subject to phased-in limitations based on W-2 wages paid (including many employee benefits), the unadjusted basis of qualified property and taxable income. Businesses could boost their deductions, therefore, by increasing wages (for example, by hiring new employees, giving raises, or making independent contractors employees). To increase the adjusted basis, consider investing in qualified property by year end.

If the W-2 wages limitation doesn't limit the QBI deduction, S corporation owners can increase their QBI deductions by reducing the amount of wages the business pays them. (This tactic won't work for sole proprietorships or partnerships, because they don't pay their owners salaries.) On the other hand, if the W-2 wages limitation limits the deduction, they might be able to take a greater deduction by increasing their wages.

**Tax credits**

Some of the most popular tax credits for businesses survived the tax overhaul, including the Work Opportunity Tax Credit (WOTC), the Small Business Health Care tax credit, the New Markets Tax Credit (NMTC) and the research credit (also referred to as the "research and development," "R&D" or "research and experimentation" credit). Smaller businesses may qualify for a credit for starting new retirement plans.

The WOTC, generally worth a maximum of $2,400 per employee (for certain employees that amount increases to $9,600), is currently scheduled to expire on December 31, so consider making those qualified hires before year end. The NMTC — 39% over seven years — also is set to expire at year end.

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## Depreciation

### *Capital asset investments – Bonus and accelerated depreciation*

Purchasing equipment and other qualified capital assets has been a valuable tool for reducing taxable income for years, but the TCJA further greased the wheels by expanding bonus depreciation and Section 179 expensing (that is, deducting the entire cost in the current tax year).

For qualified property purchased after September 27, 2017, and before January 1, 2023, businesses can deduct the entire cost of new and used qualified property in the year the property is placed in service, subject to certain conditions. Special rules apply to property with a longer production period.

Eligible property includes computer systems, computer software, vehicles, machinery, equipment and office furniture. Starting in 2023, the amount of the deduction will drop 20% each year going forward, disappearing altogether in 2027, absent congressional action.

Congress has thus far failed to act to correct a drafting error in the TCJA that leaves qualified improvement property (generally interior improvements to nonresidential real property) ineligible for bonus deprecation.

Qualified improvement property is, however, eligible for Sec. 179 expensing. The TCJA makes this expensing available for several improvements to nonresidential real property, including roofs, HVAC, fire protection systems, alarm systems and security systems. It also increases the maximum deduction for qualifying property: For 2019, the limit is $1.02 million. (The maximum deduction is limited to the amount of income from business activity.) The expensing deduction begins phasing out on a dollar-for-dollar basis when qualifying property placed in service this year exceeds $2.55 million.

### *Real Property*

The general depreciation system recovery periods remain 39 years for nonresidential real property and 27.5 years for residential rental property. The alternative depreciation system

recovery period for nonresidential real property remains 40 years. However, the TCJA changes the alternative depreciation system recovery period for residential rental property from 40 years to 30 years. Qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property are no longer separately defined and given a special 15-year recovery period under the new law.

**Tax-Favored Investments**

Under certain conditions, new investments in Opportunity Zones, which are economically-distressed communities, may be eligible for preferential tax treatment. Opportunity Zones provide tax benefits to investors, such as temporarily deferring tax on capital gains that are reinvested in a Qualified Opportunity Fund (QOF). In addition, investments held in the QOF for at least ten years may be eligible for a permanent exclusion of any capital gain realized when it is sold or exchanged.

**Deferring income / accelerating expenses**

This technique has long been employed by businesses that don't expect to be in a higher tax bracket the following year. Businesses that use cash-basis accounting, for example, might consider deferring income into 2020 by sending December invoices toward the end of the month. (Note that the TCJA now allows businesses with three-year average annual gross receipts of $25 million or less to use cash-basis accounting.) Businesses that use accounting on an accrual basis can delay the delivery of goods and services until January.

Any business can accelerate deductible expenses into 2019 by putting them on a credit card in late December and paying it off in 2020 (subject to limitations). Cash-basis businesses can prepay bills due in January, as well as certain other expenses. Some caveats now apply to this approach. First, it could affect the amount of the QBI deduction for pass-through entities. It might make more sense to maximize the deduction before 2025, when the deduction is scheduled to sunset. Moreover, this tactic isn't advisable for businesses likely to face higher tax rates in the future.

## Retirement Planning

CBM also provides recommendations for business owners regarding their retirement situation, which should be considered annually at the very least, with revisions and adjustments as needed. That includes making the most of tax-advantaged retirement saving options.

Owners whose businesses already have a retirement plan should consider maximizing allowable contributions for the plan year. Contribution limits vary depending on the type of plan.

Owners whose businesses don't already have a retirement plan, may want to consider starting one because current rules allow for significant deductible contributions. In addition, offering a workplace retirement plan may help recruit and retain workers. Plan types range from SEPs and SIMPLE IRAs, which are easy to set up and administer to defined benefit (pension)/contribution (401(k)) plans, which require more administration and reporting. Some smaller employers may greatly benefit from the cash balance plan that allows them to contribute as much as $300,000 per year on a pre-tax basis. This plan may significantly reduce an owner's tax liability and help achieve their retirement goals.

We are available to help business owner determine whether they are on track to reach their savings goals or to assist in determining the right plan for a business and setting it up.

## Act now, before tax planning opportunities for 2019 pass

Business owners still have time to make a significant dent in their business's federal tax liability for 2019. CBM is available to help chart the best course forward to minimize your business' tax bill and put your business on solid ground for upcoming tax years.

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***Please contact CBM Tax Practice Director Richard Morris with any questions about your tax situation at 301.986.0600 or via email at rmorris@cbmcpa.com.***

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