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TAX & WEALTH ADVISOR ALERT: WHAT SHOULD BUSINESSES KNOW ABOUT THE TAX PLAN?

If you've been following our posts, this is the third installment in our series on the Tax Cuts and Jobs Act, the tax-legislation overhaul passed by Congress and the President at the end of 2017. Previously, we highlighted the most important changes affecting individuals and non-profits. This week, we're discussing big changes affecting businesses claiming deductions. Most people have heard that Congress reduced the corporate tax rate, but people may not realize that Congress paid for that reduction by changing how businesses claim deductions. We'll discuss some of those changes here.

To start, net operating losses (NOLs) can no longer be carried back to prior tax years, and taxpayers must limit their deduction to 80% of their taxable income instead of 100%. These changes may increase taxable income for businesses each year (relative to what taxable income would have been without this change). The good news is that NOLs may now be carried forward to future tax years indefinitely. So, businesses won't lose the benefit of their NOLs, they just lose the benefit of timing.

For businesses claiming research and development expenditures, they can no longer immediately deduct them. Instead, businesses have to capitalize these costs and deduct them over five years. This means businesses have to reduce their taxable income slowly over time instead of claiming a larger deduction immediately. This will increase taxable income; however, businesses have until 2022 before this rule takes effect.

The Act reduced some businesses' ability to deduct interest expenses. Starting in 2018, businesses must determine the amount of interest they can deduct based on a formula. Luckily for small businesses, Congress created an exception to this limitation. "Small businesses" are those with average annual gross receipts of $25 million or less. You might wonder if partners and S corporation shareholders get around this rule because their businesses pass through taxation–they do not; however partners and S corporation shareholders may be able to carry forward interest expense unused by the partnership or S corporation to future years.

Although not great news, the Act explained the above-mentioned changes relatively clearly.

Congress explained another change less clearly, and it’s causing disagreement among tax practitioners. Previously, businesses could claim a deduction for meal and entertainment expenses, ranging from 50-100% of those expenses. The Tax Cuts and Jobs Act made several changes to the rules governing this deduction, including eliminating the deduction for entertainment expenses (yes, this means those company Brewers tickets are no longer deductible), reducing the deduction for meals provided to employees at the employer’s convenience from 100% to 50%, and *potentially* eliminating the deduction for meals with clients, referral sources, and business prospects. For relationship-based businesses, this latter change may be substantial. Tax practitioners interpreting the plain meaning of the law say those meals with clients, referral sources, and business prospects will not be deductible. Tax practitioners interpreting the intent of the law say those meals will still be deductible because Congress didn’t eliminate this deduction on purpose. At this point, the confusion makes it nearly impossible for these businesses to plan for their tax liability in 2018.

On April 2, 2018, the American Institute of CPAs (the AICPA) asked the U.S. Treasury Department and IRS to issue guidance on this issue immediately. Until the Treasury or the IRS speaks up, businesses taking a conservative approach to tax planning might assume these expenses will not be deductible. As with all changes to the tax code, we will keep an eye out for updates and advise our clients as guidance is released.