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Let's Take a Closer Look at New Business Tax Reforms

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The Tax Cuts and Jobs Act (TCJA) provides businesses with more than just lower income tax rates and other provisions you may have heard about. Here's an overview of some lesser-known, business-friendly changes under the new law, along with a few changes that could affect some businesses adversely.

Good News

Many of the new law's provisions will reduce the amount of taxes your business will owe, starting in 2018. Here are four examples that you might not be familiar with:

1. Faster Depreciation for Certain Real Property

For property placed in service after December 31, 2017, the separate definitions of qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property are eliminated. Under the TCJA, those items are now lumped together under the description of qualified improvement property, which can be depreciated straight-line over 15 years.

2. Faster Depreciation for New Farming Machinery and Equipment

The TCJA shortens the depreciation period from seven years to five years for new machinery and equipment that is placed in service after December 31, 2017, and used in a farming business (other than grain bins, cotton ginning assets, fences or other land improvements). In addition, the faster double-declining balance method can be used to calculate annual depreciation deductions for these types of machinery and equipment.

3. New Credit for Employer-Paid Family and Medical Leave

For wages paid tax years beginning after December 31, 2017, and before January 1, 2020, the TCJA allows employers to claim a general business tax credit equal to 12.5% of wages paid to qualifying employees while they're on family or medical leave. There's a hitch: You must pay the employee at least 50% of his or her normal wage while on leave.

Additionally, the credit rate increases by 0.25% for each percentage point that the wage rate paid while on leave exceeds 50% of the normal rate. However, the maximum credit rate is 25%. For example, if you pay an employee 60% of her normal wage rate while on leave, you could qualify for a general business credit equal to 15% (12.5% + (10 x 0.25%)), if all other conditions are met.

Important: To be eligible for the credit, the employer must provide all qualifying full-time employees at least two weeks of annual paid family and medical leave. Part-time employees must be given proportional leave time.

4. Accounting Change for Long-Term Construction Contracts

Under prior law, construction companies were generally required to use the less-favorable percentage-of-completion method (PCM) to calculate annual taxable income from long-term contracts for the construction or improvement of real property. However, construction companies with average annual gross receipts of $10 million or less in the preceding three tax years were exempt from this requirement.

The TCJA expands this exemption to cover contracts for the construction or improvement of real property if they:

- Are expected to be completed within two years, and
- Are performed by a taxpayer with average annual gross receipts of $25 million or less for the preceding three tax years.

This beneficial change is effective for contracts entered into in 2018 and beyond.

Bad News

The tax breaks provided by the TCJA will cost the federal government a significant amount of revenue. As a result, the bill needed to raise revenue through other tax law changes. Here are two examples:

1. Less Favorable Treatment of Carried Interests

Historically, private equity funds and hedge funds have been structured as limited partnerships. Under prior law, carried interest arrangements allowed private equity fund and hedge fund managers to give up their right to receive current fees for their services and, instead, receive an interest in future profits from the private equity/hedge fund partnership.

These arrangements are called "carried interests" because a private equity/hedge fund manager doesn't pay anything for the partnership profits interest. To add to the appeal, the private equity/hedge fund manager isn't taxed on the receipt of the carried interest (because it's not considered to be a taxable event).

The tax planning objective of carried interest arrangements is to trade current fee income for partnership profits interest. Current fee income would be treated as high-taxed ordinary income and subject to federal employment taxes. But a partnership profits interest is expected to generate future long-term capital gains that will be taxed at lower rates.

For tax years beginning after 2017, carried interest arrangements face a major hurdle: The TCJA imposes a three-year holding period requirement in order for profits from certain partnership interests received in exchange for the performance of services to be treated as low-taxed, long-term capital gains.

2. Self-Created Intangible Assets No Longer Treated as Capital Assets

Effective for dispositions in 2018 and beyond, the TCJA stipulates that certain intangible assets can no longer be treated as favorably-taxed capital gain assets. This change affects:

- Inventions,
- Models and designs (whether or not patented), and
- Secret formulas.

The change will cover the above types of intangibles that are 1) created by the taxpayer, or 2) acquired from the creating taxpayer with the new owner's basis in the intangible determined by the creating taxpayer's basis. The latter situation could happen if the creating taxpayer gifts an intangible to another individual or contributes an intangible to another taxable entity, such as a corporation or partnership.

Need Help?

If you're feeling overwhelmed by the new tax law, you're not alone. The TCJA is expected to have far-reaching effects on business taxpayers. Contact us to review the substance of the bill and how your company can manage the impact.

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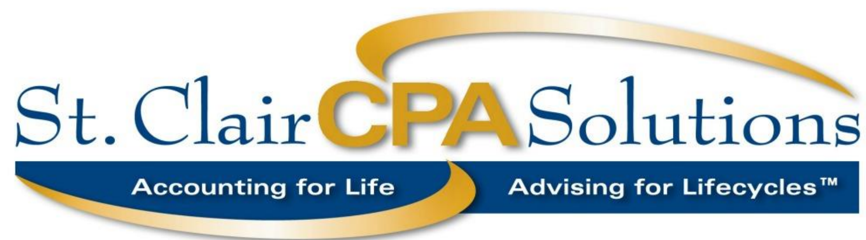

28 South Centre Street, Merchantville, NJ 08109 • 856.482.5600
101 West Elm Street, Suite 500, Conshohocken, PA 19428 • 610.862.1998
www.cpasolutions.net