

Understanding Tax Code Changes

November 6, 2019



NFIB Small Business Legal Center

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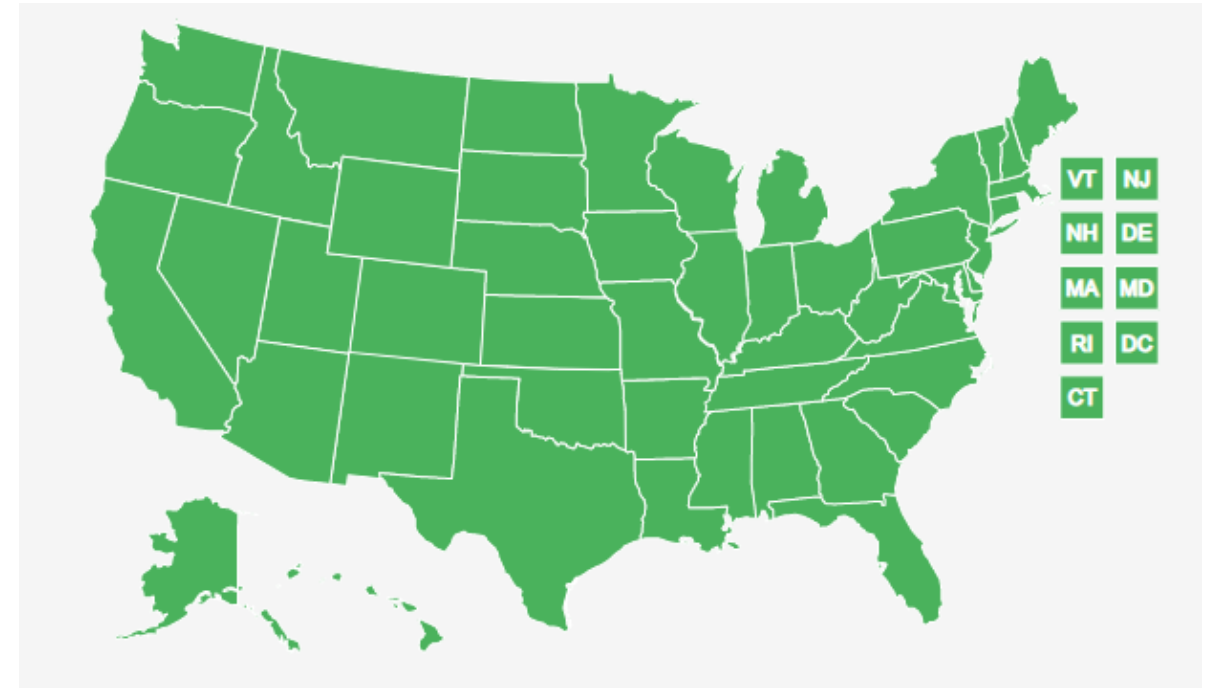
Agenda



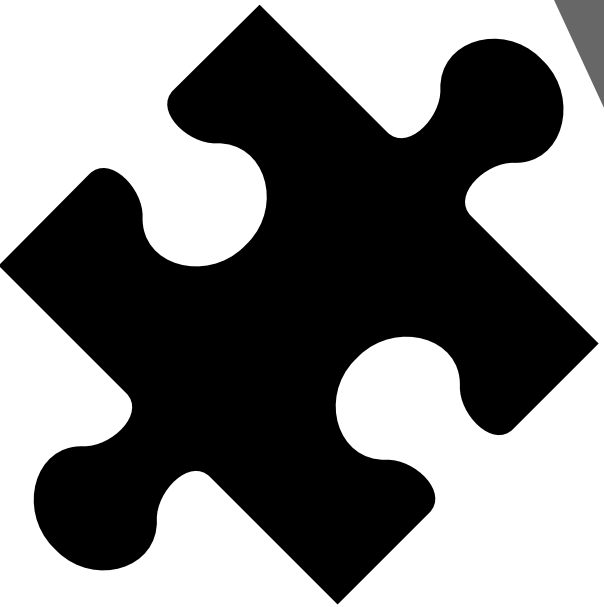
- Major changes of the Tax Cuts and Jobs Act.
- Big changes to deductions.
- How to avoid audits.
- Alternative Minimum Tax.

Note on state tax law

- Each state has its own approach to taxation.
- States choose whether to follow the federal tax code.
- It is extremely important to check with a tax professional.



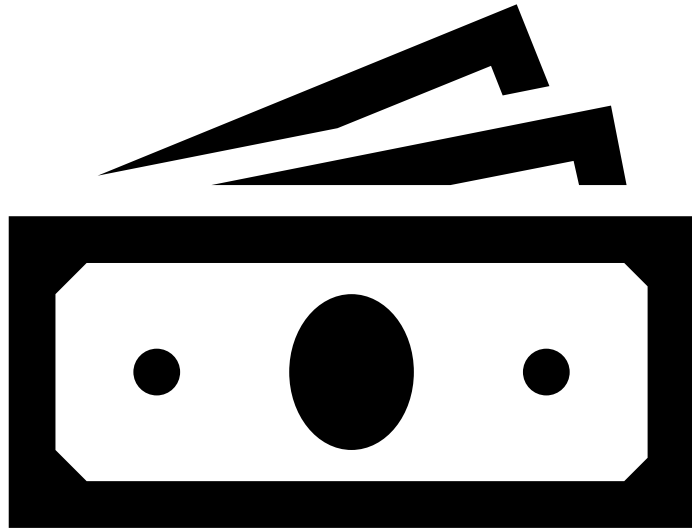
Major Changes of the 2017 Tax Cuts and Jobs Act (TCJA)



Generally
Lower
Individual Tax
Rates

2017	2018
10%	10%
15%	12%
25%	22%
28%	24%
33%	32%
35%	35%
39.6%	37%

Nearly Doubled Standard Deduction



- Roughly doubled the standard deduction to \$12,200 (single filers) and \$24,400 (joint returns) for tax year 2019.
- For many taxpayers, itemizing may no longer make sense, especially with the TCJA's changes to deductions.

Reduced Corporate Tax Rate



- TCJA: Flat 21% corporate tax rate.
 - Pre-TCJA: Graduated rate with maximum 35% rate.
 - Repealed corporate AMT.
- New deduction for pass-through businesses.

Increased Expensing Limits



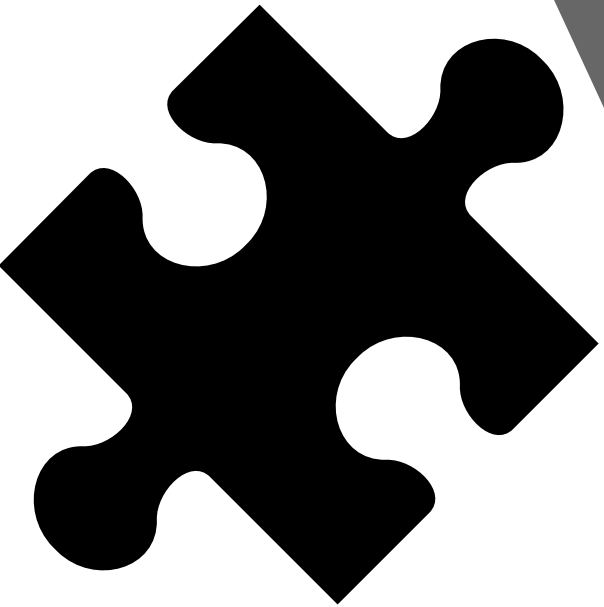
- Previously \$500K → now \$1.02M under the TCJA for tax year 2019.
- Previously the phase-out began at \$2M → \$2.55M under the TCJA for tax year 2019.

Other Major Changes



- Doubled estate tax exclusion – now \$11.4M/\$22.8M single/joint for tax year 2019.
- Expands use of cash accounting.
- Most of these dollar figures are indexed to inflation, meaning that they will increase year over year.

Tax Deductions



20% Small Business Deduction



- Allows pass-through businesses to deduct up to 20% of their “qualified business income” (QBI).
- Owners of pass-through entities, regardless of industry, are eligible for the 20 percent deduction up to \$160,700 single/\$321,400 joint in taxable income for tax year 2019.

20% Small Business Deduction



- What is “qualified business income?”
 - Taxable income generated from a qualified pass-through business.
 - Net amount of income, gain, deduction, and loss.
- What doesn’t qualify?
 - Capital gains and losses
 - Reasonable compensation
 - Interest income

20% Small Business Deduction



- What if my income exceeds \$160,700 single/\$321,400 joint in tax year 2019?
 - For an owner of a specified service trade or business (SSTB), the deduction phases out from \$160,700 to \$210,700 for single filers and \$321,400 to \$421,400 for joint filers in tax year 2019.

20% Small Business Deduction

What is a specified service trade or business?

A trade or business involving the performance of services in the fields of:

- health
- law
- accounting
- actuarial science
- performing arts
- consulting
- athletics
- financial services
- investing and investment management

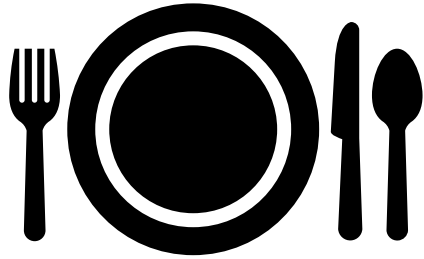
Or a trade or business where the principal asset is the reputation or skill of one or more of its employees or owners.



20% Small Business Deduction



- If a small business owner's income exceeds \$160,700 single/\$321,400 joint for tax year 2019:
 - For an owner in any other business type, the deduction is limited to 50 percent of W-2 wages paid by the business and the unadjusted basis of certain property used by the business.



Entertainment and Meals

- Entertainment – deduction was eliminated entirely.
- Meals – may continue to deduct 50% of the cost of business meals if an employee of the business is present and the meal is not “extravagant.”

Commuting and Moving Expenses



- Bicycle commuting reimbursement eliminated.
- Employer deductions for parking, transit, and carpooling eliminated (but employees may still receive this benefit tax-free).
- Moving expenses no longer deductible.

Bonus Depreciation (Bonus Expensing)



- New 100% depreciation deduction lets your business write off depreciable business assets the year you place them in service.
- This deduction is retroactive, applying to qualifying assets placed in service after Sept. 27, 2017.
- The 100% up-front deduction decreases 20% per year beginning after 2022 and expires Jan. 1, 2027.

Bonus Depreciation (Bonus Expensing)



- What assets qualify for the deduction?
 - Generally assets with a recovery period of 20 years or less, such as machinery, computers, furniture, etc.
 - Check with a qualified accountant to make sure.
- Automobile deductions have their own special rules and are usually capped.

Bonus Depreciation (Bonus Expensing)



- Even if your asset doesn't qualify for bonus depreciation, you may still be able to write it off over time.
- Again, check with a qualified accountant to ensure that you are correctly writing off losses.

Home Office Deduction



- Unchanged for businesses.
- But employee itemized deduction for unreimbursed misc. expenses repealed, including home office expenses.

Medical Expense Deduction



- Can deduct unreimbursed medical expenses that exceed 10% of AGI in 2019.
- (Threshold was 7.5% in 2018).
- Check the tax guide for some insights on how S-Corp shareholders can receive company-provided health insurance as a tax-free fringe benefit.

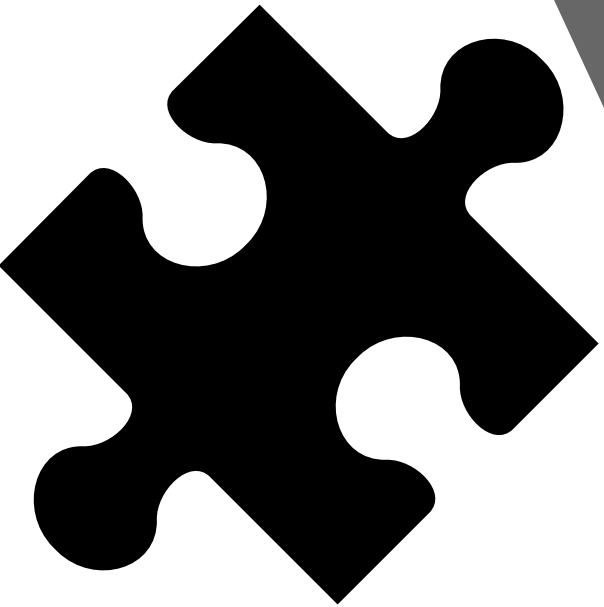
Other big changes to deductions:

- **Alimony** – The paying spouse no longer receives deduction, and the receiving spouse no longer counts it as income.
- **State and Local Tax (SALT) Deduction** – Capped at \$5,000/\$10,000 (single/joint). Previously unlimited.
- **Mortgage Interest Deduction** – Mortgage limit reduced from \$1M to \$750,000.
- **HELOC Interest Deduction** – Eliminated except in narrow circumstances relating to primary residence.

Other big changes to deductions:

- **Casualty and Theft Deduction** – Eliminated
- **Special Disaster Deduction** – Only available if located in presidentially declared disaster zone.
- **Misc. Itemized Deductions** – Eliminated; this category previously included things like:
 - Un-reimbursed job expenses;
 - Investment expenses (e.g. fees for investment advice);
 - Tax preparation fees;
 - Hobby expenses (but income from hobbies is still reportable).

How to Avoid Audits



General tips for avoiding an audit:

- **Rule 1:** Gross receipts should agree with bank deposits.
 - Auditors will look first to the bank deposits.
 - **Pro Tip:** Use a business checking account and do not mix with a personal account.



General tips for avoiding an audit:

- **Rule 2:** Do not use round numbers for deductions.
- **Rule 3:** Keep original receipts of expenses.
 - For large deductions, such as medical bills, the best practice is to attach copies of receipts or checks to prove the legitimacy of the deduction.
- **Rule 4:** Keep tax records and related documents for at least 7 years.
 - IRS may audit up to 3 years back.
 - IRS has up to 6 years to recover underreported income.
 - These timers only start running if you have filed a tax return.

General tips for avoiding an audit:

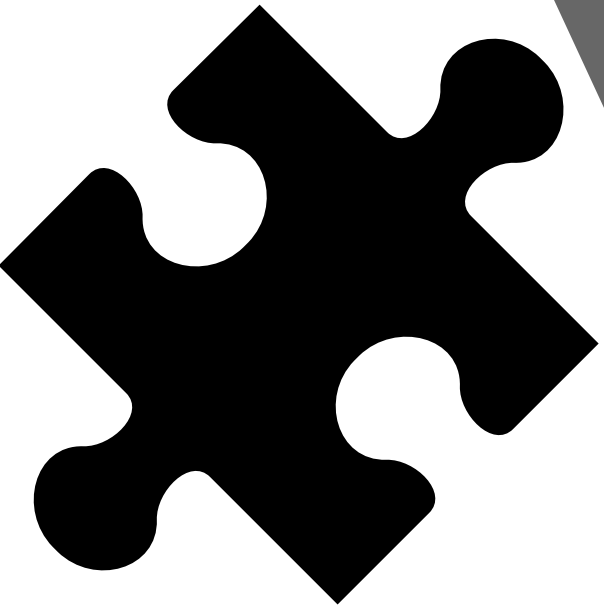
- **Rule 5:** Avoid handwriting your return.
 - Opens your tax return to closer scrutiny.
- **Rule 6:** Limit itemized deductions.
 - **Pro Tip:** Attach a note to explain unusual situations.



General tips for avoiding an audit:

- **Rule 7:** Report all taxable income, including:
 - Cash prizes; Bartering;
Cash payments; Tips;
1099-MISC; 1099-R; W-2G
Gambling; Capital Gains.
- **Rule 8:** Keep a written diary of expenses.
- **Rule 9:** Avoid offshore accounts or credit cards.
- **Rule 10:** Be careful when taking a home office deduction.

Alternative Minimum Tax (AMT)



What is the AMT?

- The AMT is a parallel tax system to the normal income tax.
- It works by adding back into the taxpayer's income items that were tax-free under the normal income tax and disallowing many deductions and credits.



The TCJA Dramatically Reduced the number of Taxpayers Subject to the AMT

- Reduced the expected number of AMT taxpayers from over 5 million to around 200,000.
 - AMT exemption increased.
 - Exemptions phase out dramatically increased.
 - Many normal deductions eliminated.
- Corporate AMT eliminated.



NFIB's On-Going Efforts

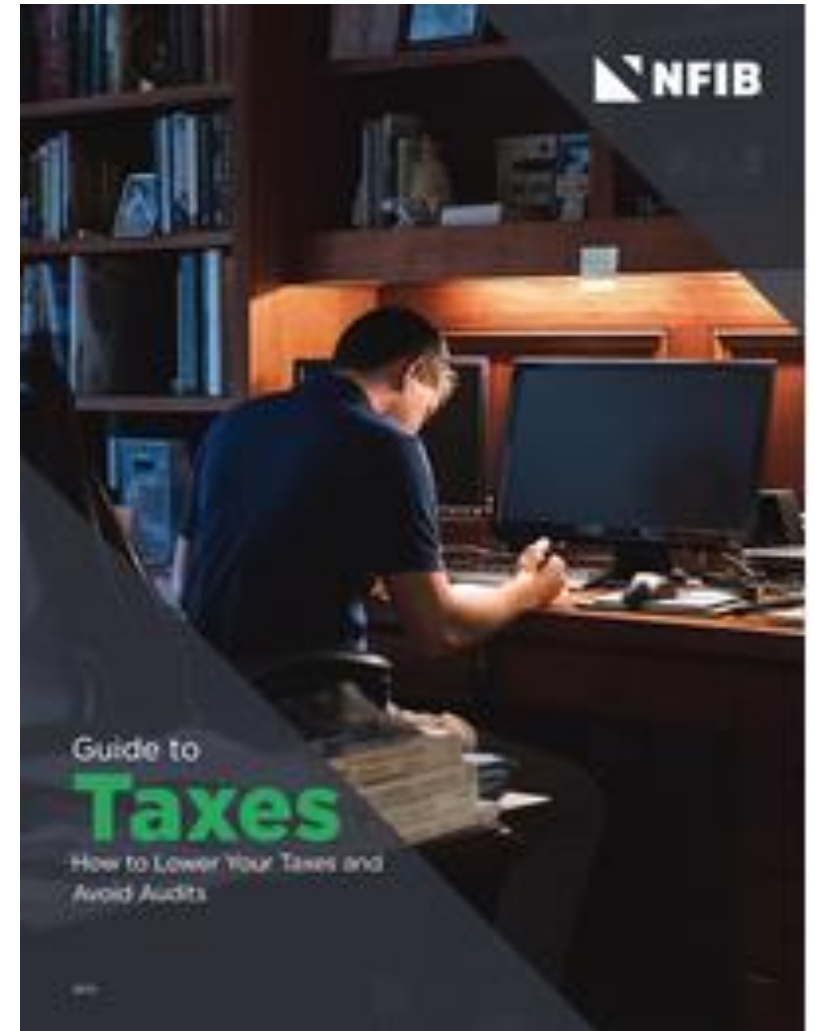


ISSUE	PROVISION
Corporate Taxes	Rates consolidated to 21%; corporate AMT repealed
Section 179 Expensing	Raised from \$500,000 to \$1 million per year, indexed
Bonus Depreciation	100% bonus depreciation of business property; phases out by 2024
Cash Accounting Method Eligibility	Expanded to \$25 million gross receipts
Individual Tax Rates	Reduces individual rates for many taxpayers: 37%, 35%, 32%, 24%, 22%, 12%, 10%, and 0% until 2026
Standard Deduction	Roughly doubled to \$12,000 individual/\$24,000 joint, indexed, until 2026
Alternative Minimum Tax for Individuals	Applies only above \$500,000 individual/\$1 million joint, indexed, until 2026
Estate Tax Relief	Excludes roughly \$11 million individual/\$22 million joint, indexed, until 2026
20% Small Business Deduction	Newly-created deduction available for eligible taxpayers, indexed, until 2026

Help is Available!

NFIB Small Business Guides

- Guide to Wage and Hour Laws
- Model Employee Handbook for Small Business
- Small Business Guide to Document Retention
- Guide to Independent Contractors
- Guide to OSHA inspections.





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