



BUSINESS TAX PLANNING

We hope that you are doing well and that business is exceeding your expectations in 2018, it is hard to believe that this year is quickly coming to a close. We wanted to take this time to go over a few year-end tax planning strategies and some important updates concerning the Tax Cut and Jobs Act ("TCJA") that will have an impact on your business. The following are some items you may want to consider with respect to your 2018 business tax planning.

DEDUCTION FOR QUALIFIED BUSINESS INCOME ("QBI")

The TCJA has added Code Sec. 199A, which provides that individuals that are sole proprietors, partners in partnerships, members of LLC taxed as partnerships and shareholders in S-corporations may qualify for a new deduction for qualified business income (Estates and Trusts are eligible for the deduction as well). The available deduction can be up to 20 percent of the taxpayer's qualifying business income. This deduction is claimed by the individual taxpayer on their personal tax return. In the case of multiple partners/shareholders the deduction is based on each individual's pro rata share of business income and their taxable income.

For taxpayers with taxable income that exceeds \$315,000 for a married filing joint, or \$157,500 for all other taxpayers, the QBI deduction generally can't exceed the *greater* of the owner's share of:

- 50% of the amount of W-2 wages paid to employees during the tax year, or
- The sum of 25% of W-2 wages plus 2.5% of the cost of qualified business property (QBP).

To qualify, you must have a qualified trade or business that is not a specific service business. A specific service business includes the fields of health, law, accounting, actuarial science, performing arts consulting, financial services and athletics; engineers and architects are excluded and permitted to claim the Code Sec 199A deduction.

The rule to disqualify specific service businesses does not apply to individuals with a taxable income of less than \$315,000 for joint filers, \$157,000 for single/head of household filers. Partial deduction will begin at the previous stated amounts and will be completely phased out at \$415,000 for joint filers and \$207,000 for single/head of household filers.

If you are approaching the thresholds, we should discuss various tax strategies that can be implemented to lower/maintain your taxable income to be qualified for this deduction such as increasing retirement plan contributions.

RETIREMENT PLANNING

As year-end approaches, this is a good time to be sure you are funding your retirement programs to the fullest extent. The amount of contributions varies depending on the type of plan the business has implemented. Some common limits are 401(k)/403(b) limit have increased to \$18,500 (increasing to \$19,000 in 2019) if under 50 years old, \$24,500 (increasing to \$25,000 in 2019) if over 50 years old; SIMPLE limit remained at \$12,500 (increasing to \$13,000 in 2019) if under 50 years old, \$15,500 (increasing to \$16,000 for 2019) if over 50 years old. Please contact us if you would like to confirm that you will



maximize the funding of your retirement plans for 2018. Also, let us know if you would like to review your current retirement plan and evaluate other options.

UPDATE QUICKBOOKS/SAGE/ZERO OR OTHER ACCOUNTING SOFTWARE

Now would be a good opportunity to review your QuickBooks records or other accounting software to see if there are any outstanding bookkeeping issues that need to be dealt with before the end of the year; such as bank reconciliations, payroll reconciliations, new asset purchases, recording new loans, adding last year's adjusted journal entries, and adjusting Accounts Receivable and Accounts Payable. It's a lot easier on all of us if these issues are dealt with before the rush of tax season deadlines.

REASONABLE COMPENSATION FOR OFFICERS

For any business operating as an S corporation, it's important to ensure that shareholders involved in running the business are paid an amount that is commensurate with their workload. The IRS scrutinizes S corporations which distribute profits instead of paying compensation subject to employment taxes. Failing to pay arm's length salaries can lead not only to tax deficiencies, but penalties and interest on those deficiencies as well. The key to establishing reasonable compensation is being able to show that the compensation paid for the type of work an owner-employee does for the S corporation is similar to what other corporations would pay for similar work. If you are in this situation, we need to document the factors that support the salary you are being paid.

CORPORATE TAX RATE AND DIVIDEND RECEIVED DEDUCTION

The TCJA eliminated the graduated corporate tax rate structure in favor of a flat rate of 21% for corporate taxable income. Also eliminated is the special tax rate for personal service corporations.

Dividend received deduction available to corporations that receive a dividend from another taxable domestic corporation has been reduced from 70% to 50%. The TCJA also reduces dividends received deduction of a 20% ownership from 80% to 65%.

CORPORATE ALTERNATIVE MINIMUM TAX ("AMT")

The TCJA repeals the corporate AMT. The provision allows the AMT credit to offset the regular tax liability for any taxable year. In addition, the AMT credit is refundable for any taxable year between 2018-2021 in an amount equal to 50% of the excess of the minimum tax credit for the taxable year over the amount of the credit allowable for the year against regular tax liability.

CODE SEC. 179 AND BONUS DEPRECIATION (EXCLUDES VEHICLES)

One of the biggest tax benefits to a business is the Section 179 election, which allows taxpayers to write off certain, property purchases that would otherwise be capitalized and depreciated over time. Under TCJA, property placed in service in 2018 ("new" or "used"), the Section 179 expense deduction cap is doubled to \$1,000,000 as well as increasing the phase-out threshold to \$2,500,000.

The TCJA expands on the definition of qualified real property that is eligible for Code Sec. 179 to include the following improvements to nonresidential real property made subsequent to the property first being placed into service: roofs, HVAC, fire protection and



alarm/security systems. It's worthwhile to evaluate whether it is appropriate in your situation to increase capital improvement purchases to take advantage of this deduction.

In addition, the TCJA expands the definition of Code Sec. 179 property to include certain depreciable tangible personal property used predominantly to furnish lodging that includes large appliances, beds, furniture and other equipment used in the living quarters of a lodging facility.

The TCJA also enhanced the bonus depreciation deduction. The provision allows a business to claim a 100 percent additional first-year depreciation deduction on qualified property, **new or used**, placed into service after September 27, 2017.

This provision is applicable through 2022 and the 100 percent allowance will be phased down by 20 percent per calendar year for property placed in service thereafter. So if you are considering the purchase of large equipment, you should consider making such purchases in the near future.

VEHICLE DEDUCTIONS AND SUBSTANTIATION

Expenses relating to business vehicles can add up to major deductions. If your business could use a large passenger vehicle, consider purchasing a sport utility vehicle weighing more than 6,000 pounds. If the vehicle is more than 6,000 pounds, up to \$25,000 of the cost of the vehicle can be immediately expensed.

The TCJA has increased the amount of depreciation that can be taken per vehicle. If the vehicle is placed into service in 2018, the allowable depreciation will be: \$10,000 for the first year, \$16,000 for the second, \$9,600 for the third and \$5,760 or any subsequent years. The TCJA retained the \$8,000 limit for additional first-year depreciation for passenger automobiles, so the maximum amount a taxpayer can deduct for a passenger vehicle in the first year is \$18,000 (plus the additional \$25,000 for vehicles over 6,000 pounds for a total of \$43,000 in the first year).

There is an additional credit for plug-in electric drive vehicles up to \$7,500. The original use of the vehicle must commence with the taxpayer and the vehicle must be used predominantly in the United States.

Vehicle expense deductions are generally calculated using one of two methods: the standard mileage rate method or the actual expense method. If the standard mileage rate is used, parking fees and tolls incurred for business purposes can be added to the total amount calculated, as well as any interest paid for financing.

Since the IRS tends to focus on vehicle expenses in an audit and disallow them if they are not properly substantiated, you should ensure that the following are part of your business' tax records with respect to each vehicle used in the business: (1) the amount of each separate expense with respect to the vehicle (e.g., the cost of purchase or lease, the cost of repairs and maintenance); (2) the amount of mileage for each business or investment use and the total miles for the tax period; (3) the date of the expenditure; and (4) the business purpose for the expenditure. The following are considered adequate for substantiating such expenses: (1) records such as a notebook, diary, log, statement of



expense, trip sheets or the use of apps to track mileage; and (2) documentary evidence such as receipts, canceled checks, bills, or similar evidence. Records are considered adequate to substantiate the element of a vehicle expense only if they are prepared or maintained in such a manner that each recording of an element of the expense is made at or near the time the expense is incurred.

DE MINIMIS SAFE HARBOR ELECTION

It may be advantageous to elect the annual de minimis safe harbor election for amounts paid to acquire or produce tangible property. By making this election, and as long as the items purchased don't have to be capitalized under the uniform capitalization rules and are expensed for financial accounting purposes or in your books and records, you can deduct up to \$2,500 per invoice or item.

ACCURATE ASSET DISPOSALS

Please review your 2018 asset listing attached to your tax return closely and let us know if any of the property on the 2017 tax return has been disposed. This will aid in the preparation of your County/City personal property tax returns and ensure that you are not being taxed on equipment that is no longer in service. Henrico/City of Richmond/Chesterfield personal property tax returns and business license renewals are due March 1, 2019 (Hanover and Caroline is due May 1, 2019). If we are preparing the returns please make sure we have the information by **February 1, 2019** to ensure that they are submitted by the due dates.

REVENUE AND EXPENSE TIMING

If you are a cash basis taxpayer, the revenue and expenses reported on your tax returns are recorded when they are received and paid. The timing of when you receive payments from customers and make payments to vendors can greatly alter the amount of revenue and expenses your business is required to report. Please contact us if you are considering shifting your income to reduce your flow-through income.

NET OPERATING LOSS ("NOL") CARRYFORWARD/CARRYBACK

Under TCJA, excess business losses of a taxpayer other than a corporation are not allowed for the taxable year. Such losses are carried forward and treated as part of your NOL future years (the 2-year NOL carryback is no longer permissible). The new provision increased the 20 year carryforward limit to an indefinite amount of time. The amount of the carryforward is limited to 80 percent of your taxable income prior to the NOL deduction. NOL's from prior years will be grandfathered in and the income limitation will apply.

CHILDREN WORKING IN BUSINESS

Children working in closely-held businesses can offer a tax planning opportunity and potentially be targeted toward educational planning. The wages paid to children working in your closely-held business are tax deductible. The amount of compensation must be reasonable. Children can earn approximately \$12,000 without paying Federal individual income taxes because of the increased standard deduction amount; Virginia allows \$11,950 in gross income before any tax is due. This would allow your children to supplement educational planning without incurring additional income tax liability. The business would benefit from the deduction of the wages paid to your children. If you have



school-aged children working in your business, please let us know so we can help you determine if they should be added to the payroll.

CREDITS

Business credits are available for certain energy efficiency improvements; disabled access improvements, and adding certain employees under the work opportunity credits. Please let us know if you have made access improvements to your facilities and/or equipment, completed any energy efficiency upgrades, or added to your staff with any workers from certain veteran/disadvantaged groups.

QUALIFIED EQUITY AND SUBORDINATED DEBT INVESTMENTS CREDIT

Individual and fiduciary taxpayers are allowed a credit up to 50% of qualified business investments in the form of equity or subordinated debt of a pre-qualified business venture. This could be a good way to incentivize investors for your business.

In order for the taxpayer to claim the credit your business would first have to file Form QBA with the Virginia Department of Taxation by December 31st of the year that you request the qualification. Once you have submitted Form QBA, the investor would have to file Form EDC by April 1st of the year following the investment to apply for the credit.

It should be noted that an investment will not qualify if the taxpayer who holds the investment, any of the taxpayer's family members, or entities affiliated with the taxpayer receives compensation from the qualified business for services provided. This would include employees, officers, directors, managers, or independent contractors within one year before/after the date of the investment.

If you believe that this credit could be advantageous to your business please call office so that we can discuss in detail if you will qualify for credit.

INCREASED PENALTIES FOR FAILURE TO TIMELY FILE INFORMATION RETURNS

In addition to the accelerated filing deadlines for 2018 Forms W-2, Forms W-3, and Forms 1099-MISC, higher penalties apply for (1) the failure to file correct Forms W-2 by the due date; (2) the intentional disregard of filing requirements; (3) the failure to furnish Forms W-2; and (4) the intentional disregard of payee statement requirements. In addition to applying to Forms W-2, W-3, and 1099-MISC, other common forms subject to these increased penalties include: Schedules K-1 for Forms 1041, 1065, and 1120S. Penalties for the late filing of these information returns have also increased. For each information return or payee statement with respect to which a failure occurs, the penalty has been increased from \$250 to \$260, and the maximum penalty that may be imposed has been increased from \$3,000,000 to \$3,178,500. The per-failure penalty for intentionally disregard the filing requirements also has been increased, from \$500 to \$520.

CHANGES MADE TO TAX RETURN DUE DATES

In general, **C-Corporations** with tax years ending in 2018 now have an extra month to file their federal income tax returns. Such returns are due by the 15th day of the fourth month following the close of the tax year, rather than the 15th day of the third month following the close of the tax year. Thus, 2018 calendar-year C-corporation federal income tax returns are due April 15, 2019. A special rule exempts C-corporations with fiscal years ending on



June 30th from this change until tax years beginning after December 31, 2025. Thus, the filing deadline for such corporations remains September 15th until 2026 (when it will change to October 15th).

Partnerships with tax years ending in 2018 are now required to file their federal income tax returns by the 15th day of the third month following the close of the tax year, rather than the 15th day of the fourth month following the close of the tax year. Thus, 2018 calendar-year partnership federal income tax returns are due March 15, 2019. While partnerships were previously allowed a five-month extension of time in which to file their tax returns, they are now allowed a six-month extension so that the extended due date is the same as under prior law (i.e. September 15th).

The filing deadline for **S-Corporation** returns remains unchanged, meaning that partnerships and S corporations will now share the same due dates.

All business returns that go on extension will be due September 16, 2019, due to the 15th falling on a weekend.

INCREASING BASIS IN PASS-THRU ENTITIES

If you are a partner in a partnership or a shareholder in an S- corporation, and the entity is passing through a loss for the year, you must have enough basis in the entity in order to deduct the loss on your personal tax return. If you don't, and if you can afford to, you should consider increasing your basis in the entity in order to take the loss in 2018.

MEALS AND ENTERTAINMENT

Under TCJA, you will no longer be able to deduct expenses related to entertainment, amusement, or recreation. This includes any membership dues of clubs organized for business, recreation/social purposes, or any facility used in connection with aforementioned items.

You will be allowed to deduct 50 percent of food and beverage expenses that are business related. The TCJA has expanded the meals deduction to include 100 percent of expenses by the employer associated with providing food or beverages to employees for the convenience of the employer. Simply put you are allowed to deduct on-sight "working lunch/dinners".

MISCELLANEOUS TAX CONSIDERATIONS

Other considerations for 2018 include the following:

- (1) The 100 percent exclusion from gross income of gain from the sale of small business stock;
- (2) The reduction to five years of the recognition period for the built-in gains of S-corporations;
- (3) The deduction for charitable deductions of food inventory by taxpayers other than C-corporations;
- (4) The expensing allowance for certain film and television productions and the cost of live theatrical productions;
- (5) The deduction for income attributable to domestic production activities in Puerto Rico;



- (6) Tax rules relating to payments between controlled foreign corporations and dividends of regulated investment companies;
- (7) The basis adjustment rule for stock of an S-Corporation making charitable contributions of property;
- (8) Tax incentives for investment in empowerment zones.

Let us know if you have any questions, or if you require any clarification of any of these subjects. We wish you a successful conclusion to the year and a Happy New Year!