# 5 Things Every Hospitality Business Owner Should Consider in the Tax Reform Law

Tony Perricelli

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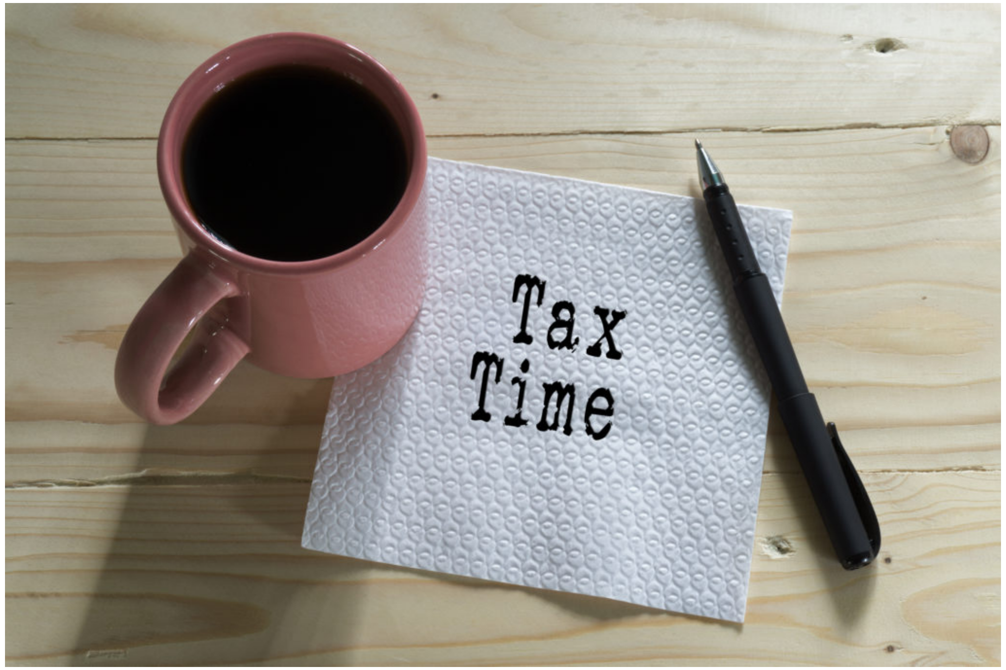
# Agenda




- Corporate Tax Rate Reduction
- Pass-through Entity Deduction
- Sec 179 expensing & Bonus Depreciation
- Interest Deduction Limitations
- Expansion of the Cash Method of Accounting
- Bonus info & Bonus Individual Changes
- Planning & Strategies

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# Tax Reform Update

## Timeline of Reform Legislative Path

| | SENATE | CONFERENCE COMMITTEE | WHITE HOUSE |
|---|---|---|---|
| **Nov. 2:** Ways and Means Releases First Draft Bill | **Week of Nov. 6** Senate Finance Chairman Release Bill | **December 15:** Resolved Differences. Send back to House and Senate for Vote | **Dec 22, 2017 President Signs P.L. 115-97** |
| **Nov. 6** Ways and Means Begins Mark-Up | **Week of Nov. 27** Senate Bill Mark-Up, Amendments and Debate | | |
| **Nov. 16** House Vote | **Dec. 2 1:51AM** Senate Vote | | |

# Corporate Tax Rate Reduction

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# Corporate Tax Rate Reduction

## Highest rate drops from 35% to 21%

- *Old Law*
  - Corporate Tax Rates graduated up to a max of 35%, personal services taxed at max 35%
  - Subject to AMT
- *New Law*
  - Corporate Tax Rates lowered to flat 21%, no special rate for personal service corporations
  - AMT is repealed
  - Permanent change, no expiration

# Pass-through Entity Deduction

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# Pass-through Entity Deduction

## 20% Pass-through deduction

- *__Old Law__* - No special deduction for pass-through entities
- *__New Law__* - New below the line 20% deduction for pass-through entities
  - S Corporations, Partnerships, Sole Proprietorships
  - Must have "qualified business income" (QBI) from a trade or business
    - *QBI does not include income earned as an employee*
    - *e.g. S Corp owners pays himself W-2 wages*

# Pass-through Entity Deduction

## 20% Pass-through deduction (continued)

- *New Law - continued*
  - Subject to limits and exclusions unless your overall taxable income is less than $157,500 (single) or $315,000 (married filing joint)
  - If income is over the limits, then:
    - QBI cannot be from specified service businesses such as law, medicine, accounting, consulting, investment services, etc.
      - Architecture & engineering are not specified service businesses
    - Deduction allowed only if business has W-2 wages and/or tangible property in use by the business to produce income
    - Phaseout range is $50,000 for single and $100,000 for married filing joint

# Pass-through Entity Deduction

## 20% Pass-through deduction (continued)

- *New Law - continued*
  - Way too early to have solid guidance
  - Many commentators expect further legislation to clarify the deduction
  - New Sec 199A Replaces old Sec 199 Domestic Production Activities Deduction

# Pass-through Entity Deduction

## 20% Pass-through deduction (continued)

- ***New Law - continued***
  - Example for operating entity
    - S corporation with single owner
    - Restaurant net income = $2,000,000 (assume this equals QBI)
    - W-2 wages = $4,000,000
    - Unadjusted basis of qualified property = $11,000,000

**20% of QBI = $400,000 deduction**

*Limited to the greater of:*

- 50% of W-2 wages = $2,000,000 **OR**
- 25% of W-2 wages ($1,000,000) + 2.5% of unadjusted basis of qualified property ($275,000) = $1,275,000

**Deduction for owner =**
**$400,000 (since limits are higher than 20% of QBI)**

# Pass-through Entity Deduction

## 20% Pass-through deduction (continued)

- ***New Law - continued***
  - Example for active real estate entity

    - Real estate net income = $350,000 (assume this equals QBI)
    - W-2 wages = $0
    - Unadjusted basis of qualified property = $5,000,000

    **20% of QBI = $70,000**

    Limited to the greater of:
    - 50% of W-2 wages = $0 **OR**
    - 25% of W-2 wages ($0) + 2.5% of unadjusted basis of qualified property ($125,000) = $125,000

    **Deduction for owner =**
    **$70,000 (since limits are higher than 20% of QBI)**

# Sec 179 Expensing & Bonus Depreciation

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# Sec 179 Expensing & Bonus Depreciation

## Bonus Depreciation

- *<u>Old Law</u> – 50% of basis of qualified property*
  - Only new purchases, no used items
  - Personal property and limited types of real estate improvements
  - Scheduled to be phased out by 2020
- *<u>New Law</u> – 100% expensing from 9/27/17 through 2022,*
  - Allowed for new and used property
  - Personal property and a larger group of eligible real estate improvements including most interior improvements
  - Phased out from years 2023 – 2028

# Sec 179 Expensing & Bonus Depreciation

## Cost Recovery – Section 179

- *Old Law – Election to expense up to $510,000 of qualifying property in 2017 instead of depreciating it over time*
  - $510,000 cap is reduced dollar for dollar for all property in excess of $2,030,000 placed in service in 2017
  - Assets include tangible personal property & off-the-shelf software
  - Some real property improvements allowed if elected, but only if used in a business, no rental assets, qualified restaurant property was included
  - Deduction limited to taxable income each year

# Sec 179 Expensing & Bonus Depreciation

## Cost Recovery – Section 179 (continued)

- *New Law – Beginning after 2017*
  - Maximum expense amount increased to $1,000,000
  - Phase out threshold increased to $2,500,000
  - Includes qualified real property (if elected):
    - *Qualified improvement property (covers interior improvements to existing buildings)*
    - *Certain exterior improvements to existing buildings including roofs, HVAC, fire protection, alarm & security systems*
    - *No more qualified restaurant property*

- ***One advantage of Sec 179 over bonus depreciation - most states allow Sec 179 but not bonus depreciation***

# Sec 179 Expensing & Bonus Depreciation

## Cost Recovery – Section 179 (continued)

| Tax Years | Max Deduction allowable | Deduction phaseout begins at |
|---|---|---|
| **2017** | $510,000 | $2,030,000 |
| **2018** | $1,000,000 | $2,500,000 |
| **2019 & later** | $1,000,000 + inflation adj. | $2,500,000 + inflation adj. |

# Sec 179 Expensing & Bonus Depreciation

## Cost Recovery – Real property changes

- *Old Law* –
  - Non-residential real property depreciated over 15-39 years
  - Default life was 39 years, no bonus, no Sec 179, exceptions:
    - *Qualified restaurant or retail property – 15 years, eligible for Sec 179*
    - *Qualified leasehold improvement property - 15 years, eligible for Sec 179*
    - *Qualified improvement property – 15 or 39 years w/ bonus*

# Sec 179 Expensing & Bonus Depreciation

## Cost Recovery – Real property changes (continued)

- *New Law – Property placed in service after 2017*
  - Qualified restaurant/retail and qualified leasehold improvement property definitions have been eliminated
  - Qualified improvement property remains
    - *15 year life*
    - *Eligible for Sec 179 if elected and bonus depreciation*
    - *Technical correction needed and is expected*
  - Non-residential real property not meeting definition of qualified improvement property has a 39-year life

# Interest Deduction Limitation

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# Interest Deduction Limitations

Interest Expense limited to 30% of taxable income

- *Old Law* –
  - Interest paid by a business is generally deductible in calculating taxable income
- *New Law – Beginning after 2017*
  - Deduction for business interest expense is limited to the sum of:
    - Business interest income +
    - 30% of the adjusted taxable income +
    - Floor plan financing interest for dealerships
  - Disallowed interest is carried forward indefinitely

# Interest Deduction Limitations

## Interest Expense limited to 30% of taxable income (continued)

- *New Law* - *(continued)*
  - Business interest defined as interest paid or accrued on indebtedness properly allocable to a trade or business. It does not include investment interest.
  - Adjusted taxable income is defined as taxable income computed without regard to:
    - Any item of income, gain, deduction, or loss which is not properly allocable to a trade or business
    - Any business interest or business interest income
    - Net operating losses
    - For 2018-2021 only – depreciation, amortization, or depletion (eases the transition)

# Interest Deduction Limitations

## Interest Expense limited to 30% of taxable income (continued)

- *New Law - (continued)*
  - This rule not applicable to taxpayers with average annual gross receipts of $25 million or less for the three-year period ending with the prior taxable year
  - Also does not apply to rental property activity if not considered a trade or business. If rental is a trade or business, then taxpayer can elect out of the interest rules in exchange for different (slower) depreciation rules for the rental property.
  - Previously mentioned floor plan financing exception

# Expansion of the Cash Method of Accounting

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# Expansion of the Cash Method of Accounting

Cash method can be used up to $25 million revenue

- *Old Law* –
  - Cash method only allowed for tax purposes if either:
    - *Revenue less than $1 million with inventory, or*
    - *Revenue less than $5 million without inventory*

- *New Law – Beginning after 2017*
  - Cash method allowed for any company with average gross receipts of less than $25 million, calculated over 3-year period before the tax year
  - Can simplify bookkeeping for smaller restaurants/retail and hotels
  - Track inventory for mgmt decisions but immediately expense for tax

# Bonus Info

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# Bonus Info

## Business Entertainment Expenses Disallowed

- *Old Law* –
  - 50% deduction for business-related meals & entertainment
  - Meals provided on premises for convenience of employer are 100% deductible and excluded from employee's income (no W-2 reporting)
- *New Law* – *Beginning after 2017*
  - No deduction for entertainment
  - Meals provided on premises for convenience of employer are 50% deductible but still excluded from employee's income (no W-2 reporting)
    - *This deduction also scheduled to be eliminated but only after 2025*

# Bonus Info

## Net Operating Losses

- *Net Operating Losses* – For 2018 – 2025 the deduction allowed is now equal to the lesser of:
  - (1) the aggregate of the net operating loss carryovers to such year, plus the net operating loss carrybacks to such year, or
  - (2) 80 percent of the taxable income computed without regard to the NOL.
    - *NOLs can now only be carried forward to future tax years.*
      - The amount of the carryover is limited to a maximum of 80 percent of the taxable income computed without regard to the NOL.

# Bonus Info

## Like-kind exchanges

- *Prior Law* –
  - No gain or loss recognized if property is exchanged for property of a like-kind
    - *Both old and new properties must be held for productive use in a trade or business or for investment*
    - *Applied to both tangible personal property (such as vehicles & equipment) and real property*
- *New Law – Beginning after 2017*
  - Non-recognition of gain for a like-kind exchange is limited to real property only

# Bonus Info

## Estate, Gift, and Generation-Skipping Transfer Taxes

- ***Estate and Gift Taxes*** – Beginning in 2018, the exemption for estate and gift taxes is increased to $10,000,000 (and adjusted forward for inflation from 2011).
  - *Inflation - There will be a roughly $11,000,000 estate and gift exemption starting in 2018.*

- ***Generation-Skipping Transfer Tax*** – Beginning in 2018, the amount of the generation-skipping transfer tax exemption is increased to $10,000,000 (and adjusted forward for inflation from 2011).
  - *Inflation - There will be a roughly $11,000,000 generation-skipping transfer tax exemption starting in 2018.*
    - These increases are set to expire on December 31, 2025, and the exemption amounts will return to the pre-tax reform amounts.
      - *This makes the current planning techniques still relevant, even for estates that do not exceed the increased exemption amount.*

# More Bonus Info – Individual Tax Changes

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# Individual Tax Changes

## Ordinary Income Tax Rates 2017 Tax Year

- The current seven tax bracket system is retained, but the rates are lowered for all taxpayers. Below are the current rates for 2017.

| Tax Rate | Married Filing Jointly and Surviving Spouse | Single | Head of Household | Married Filing Separately | Estates & Trusts |
|---|---|---|---|---|---|
| 10% | $0-$18,650 | $0-9,325 | $0-$13,350 | $0-$9,325 | N/A |
| 15% | $18,650-$75,900 | $9,325-$37,950 | $13,350-50,800 | $9,325-$37,950 | $0-$2,550 |
| 25% | $75,900-153,100 | $37,950-$91,900 | $50,800-$131,200 | $37,950-$76,550 | $2,550-$6,000 |
| 28% | $153,100-233,350 | $91,900-$191,650 | $131,200-$212,500 | $76,550-$116,675 | $6,000-$9,150 |
| 33% | $233,350-416,700 | $191,650-$416,700 | $212,500-$416,700 | $116,675-$208,350 | $9,150-$12,500 |
| 35% | $416,700-$470,700 | $416,700-$418,400 | $416,700-$444,550 | $208,350-$235,350 | N/A |
| 39.6% | Over $470,700 | Over $418,400 | Over $444,550 | Over $235,350 | Over $12,500 |

# Individual Tax Changes

## Ordinary Income Tax Rates 2018 Tax Year (inflation adj. through 2025)

- The current seven tax bracket system is retained, but the rates are lowered for all taxpayers and the thresholds are adjusted below. These rates and other changes are effective 2018 through 2025.

| Tax Rate | Married Filing Jointly and Surviving Spouse | Single | Head of Household | Married Filing Separately | Estates & Trusts |
|---|---|---|---|---|---|
| 10% | $0-$19,050 | $0-9,525 | $0-$13,600 | $0-$9,525 | $0-$2,550 |
| 12% | $19,050-77,400 | $9,525-38,700 | $13,600-51,800 | $9,525-38,700 | N/A |
| 22% | $77,400-165,000 | $38,700-82,500 | $51,800-82,500 | $38,700-82,500 | N/A |
| 24% | $165,000-315,000 | $82,500-157,500 | $82,500-157,500 | $82,500-157,500 | $2,550-9,150 |
| 32% | $315,000-400,000 | $157,500-200,000 | $157,500-200,000 | $157,500-200,000 | N/A |
| 35% | $400,000-600,000 | $200,000-500,000 | $200,000-500,000 | $200,000-300,000 | $9,150-$12,500 |
| 37% | Over $600,000 | Over $500,000 | Over $500,000 | Over $300,000 | Over $12,500 |

# Individual Tax Changes

## Kiddie Tax

- Children that are subject to the "Kiddie Tax" will have two different tax regimes for their earned and unearned income:
  - Earned Income:  Taxed at the rates applied to single filers.
  - Unearned Income: Taxed at ordinary income and preferential rates applied to trusts and estates.
    - *Children will no longer be subject to their parents' tax rate.*
    - *Ages for application of kiddie tax are unchanged*

# Individual Tax Changes

## Above-the-Line Deductions

- *Moving Expenses* – Suspended through tax year 2025; however, still available for members of the U.S. military who move pursuant to a military order.

- *Alimony* – Effective for divorce or separation agreements entered into after December 31, 2018*:
  - Deduction - The deduction for alimony or separate maintenance payments is repealed.
  - Inclusion - The inclusion of income by the recipient is repealed.
    - *Existing alimony or separate maintenance agreements are grandfathered, as are modifications to existing agreements.*
      - **Please note the 1-year delay on the implementation of this provision*

# Individual Tax Changes

## Standard Deduction & Personal Exemptions

- The standard deduction is increased to the following amounts:
  - Married Filing Jointly: $24,000 (up from $12,700)
  - Head-of-Household: $18,000 (up from $9,350)
  - All Other Taxpayers: $12,000 (up from $6,350)
    - *The deduction is indexed for inflation in future years, 2018-2025*

- The personal exemption is suspended through tax year 2025.
  - The personal exemption for estates and trusts remains at $100 (complex), $300 (simple), $600 (estates).

# Individual Tax Changes

## Itemized Deductions

- *Medical Expenses* – The AGI threshold is lowered from 10% to 7.5% for all taxpayers for tax years 2017 and 2018.

- *State and Local Taxes* – Taxpayers are permitted a maximum $10,000 deduction (2018 – 2025) on the sum of:
  - (i) state and local real property taxes,
  - (ii) state and local personal property taxes, and
  - (iii) state and local income taxes (or sales tax, if elected).
    - *This limitation does not apply to real property taxes and personal property taxes paid or accrued in carrying on a trade or business.*

# Individual Tax Changes

## Itemized Deductions (Continued)

- *Mortgage Interest* – Taxpayers are permitted to deduct the interest paid on acquisition indebtedness of up to $750,000.
  - *Debt incurred on or before December 15, 2017, is grandfathered under the previous law of interest paid on acquisition indebtedness of up to $1,000,000.*

- *Home Equity Interest* – The deduction for interest paid on home equity indebtedness is suspended. No grandfather provision for home equity interest.

  - Both effective 2018-2025

# Individual Tax Changes

## Itemized Deductions (Continued)

- *Charitable Contributions* – Three modifications for years 2018-2025:
  - (1) Cash contributions to public charities now have a 60 percent of AGI limitation (previously it was 50 percent).
  - (2) Denial of charitable deduction for payments made in exchange for athletic seating rights (previously able to deduct 80 percent of amounts paid).
  - (3) Removal of substantiation exception for certain contributions reported by the charitable organization.

# Individual Tax Changes

## Itemized Deductions (Continued)

- *Casualty Losses* – Suspended through tax year 2025, unless the loss is attributable to a Federally declared disaster loss.
  - *If a taxpayer has a personal casualty loss gain, they may deduct personal casualty losses not attributable to a Federal declared disaster loss in the amount equal to no more than the personal casualty loss gain.*
- *Wagering Transactions* - In addition to the limitation on gambling losses, expenses incurred in carrying on any wagering transaction are also limited to the extent of gambling winnings.

# Individual Tax Changes

## Itemized Deductions (Continued)

- *Miscellaneous Itemized Deductions Subject to 2-percent floor* - These have been suspended through 2025 and include:
  - investment fees and expenses
  - tax preparation fees
  - unreimbursed business expenses

- *"Pease" Limitation* – Repeals the overall limitation on itemized deductions through 2025.

# Individual Tax Changes

## Alternative Minimum Tax (AMT)

- The individual AMT has been retained.
  - The exemption amounts have been increased to the following thresholds:
    - Joint Filers: $109,400 ($54,700 for MFS)
    - All other Filers: $70,300
  - The exemption phase-out thresholds are increased to:
    - Joint Filers: $1,000,000
    - All other Filers: $500,000
    - Trusts and Estates – Remains unchanged.
  - *Many of the tax preference items that are AMT addbacks have been suspended.*

# Individual Tax Changes

## Business Losses

- *<u>Businesses Losses</u>* – For 2018-2025 business losses are only permitted in the current year to the extent that they do not exceed the sum of:
  - (i) Taxpayer's gross income and
  - (ii) $500,000 for joint filers or $250,000 for other taxpayers
    - Excess businesses losses will be disallowed and added to the taxpayer's net operating loss (NOL) carryforward.
      - Carryforwards are limited to the lesser of:
        - (i) the carryforward amount or
        - (ii) 80-percent of taxable income determined without regard to the NOL deduction.
    - *For pass-through entities, this is applied at the partner/shareholder level.*

# Individual Tax Changes

## Miscellaneous Provisions

- *Inflation Adjustments –* Inflation will be now measured using the Chained Consumer Price Index (C-CPI). This method is a generally slower inflationary adjustment than the current Consumer Price Index (CPI).
    - This provision is permanent.
- *Child Tax Credit – For 2018 – 2025* Increased to $2,000 per qualifying child, with up to $1,400 being refundable. Also, there is a new $500 non-child dependent credit.
    - Qualifying Child is defined as a dependent who is under the age of 17 at the end of the tax year.
        - *Credit starts to phase-out for joint filers at AGI of $400,000 and for other filers at AGI of $200,000.*
- *Sec 529 Savings Plans –* For distributions after Dec. 31, 2017, "qualified higher education expenses" include tuition at an elementary or secondary public, private, or religious school, up to a $10,000 limit per tax year.

# Planning & Strategies

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# Planning & Strategies

## Individuals

- *Increased Standard Deduction*
  - Bunching Strategies to maximize itemized deductions
    - *Defer/Accelerate Income - examples*
      - Large gain on sale of stock/mutual funds could cause you to lose medical deductions since it raises the 7.5% of AGI amount
      - Plan for best year to receive W-2 bonus payments from employer if possible
      - Other phase outs based on income such as child tax credits, new pass-through deduction
    - *Defer/Accelerate Itemized Deductions - examples*
      - Plan elective medical procedures to bunch with other medical expenses to exceed the 7.5% of AGI amount
      - Plan your charitable giving to make sure you can itemize at least every other year

# Planning & Strategies

## Individuals

- *Increased Standard Deduction*
  - Case Study – Married taxpayers with:
    - *2018*
      - $150,000 income
      - $10,000 mortgage interest
      - $8,000 state & local tax
      - $5,000 charity
    - *2019*
      - $160,000 income
      - $9,500 mortgage interest
      - $8,500 state & local tax
      - $5,000 charity

| | **No bunching** | | **Bunching Charity** | |
|---|---|---|---|---|
| Year | 2018 | 2019 | 2018 | 2019 |
| Income | 150,000 | 160,000 | 150,000 | 160,000 |
| Deductions | (24,000) | (24,000) | (24,000) | (28,000) |
| Taxable income | 126,000 | 136,000 | 126,000 | 132,000 |

# Planning & Strategies

## Businesses

- *Depreciation*
  - Cost Segregation Study to re-characterize components of real property from long to short life
  - Take advantage of new bonus depreciation and Sec 179 rules
  - Be careful with interplay between this strategy and new deductible interest limits after 2021. More depreciation expense results in lower taxable income which limits interest.
  - Also remember new excess business loss and NOL rules – might limit current year benefit of big deductions

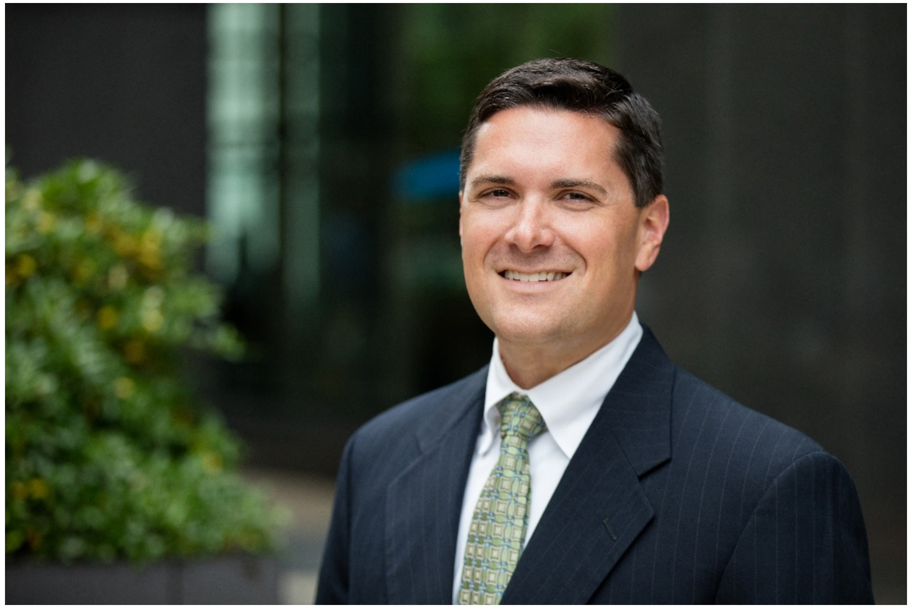
# Contact

## Tony Perricelli

tperricelli@scottandco.com

Twitter @tonypcpa

**Scott and Company**
**1441 Main Street, Suite 800**
**Columbia, SC 29201**
**803.256.6021**



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