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Dear Client,

The recently enacted Tax Cuts and Jobs Act (TCJA) is a sweeping Federal tax package. These changes are the first major tax law revisions, that will impact all taxpayers, approved in several decades. The complete list of tax law revisions is too numerous for one letter, so we have highlighted selected items that affect many of our clients. We expect that most of our clients will face real change, either for better or worse, on their tax returns for 2018 and future years. Please note that the TCJA is for federal tax law, so states, including California, may not conform to these changes.

- *Corporate tax rates changed.* One of the more significant new law provisions changes the corporate tax rate to a flat 21%. Before the new law, rates were graduated, starting at 15% for taxable income up to \$50,000, with rates at 25% for income between 50,001 and \$75,000, 34% for income between \$75,001 and \$10 million, and 35% for income above \$10 million.
- *Increased [Code Sec. 179](#) expensing.* The new law increases the maximum amount that may be expensed under [Code Sec. 179](#) to \$1 million. If more than \$2.5 million of property is placed in service during the year, the \$1 million limitation is reduced by the excess over \$2.5 million. Both the \$1 million and the \$2.5 million amounts are indexed for inflation after 2018.
- *Bonus depreciation.* Under the new law, a 100% first-year deduction is allowed for qualified new and used property acquired and placed in service after September 27, 2017 and before 2023. Under the new law, the 100% allowance is phased down starting after 2022. The ability to quickly write-off the cost of used business property will significantly impact the payback period associated with many asset acquisitions in the future.
- *Qualified Opportunity (QO) Funds.* The tax law changes created two new elections, one that allows for the deferral of gain from the sale of property that is reinvested into an investment in a QO Fund and another to permanently exclude gain from the sale or exchange of the investment in a QO Fund. Assets must generally be held in designated Qualified Opportunity Zones. The zones include portions of Humboldt County. A detailed map of the California zones can be located on the State of California's Department of Finance website at http://dof.ca.gov/Forecasting/Demographics/opportunity_zones/.
- *New deduction for pass-through income.* The new law provides a 20% deduction for "qualified business income (QBI)," defined as income from a trade or business conducted within the U.S. by a partnership, S corporation, LLC or sole proprietorship. There are limitations based on W-2 wages paid by the business, the basis of acquired depreciable tangible property used in the business, and service related trades or businesses, such as health, law, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners, which may cause the deduction to be reduced or eliminated. It may be beneficial to proactively calculate the estimated QBI deduction, so tax saving actions can be taken by year end to maximize it.

- *Converting a pass-through entity to a C corporation.* The best candidates for conversion don't expect losses and want to accumulate funds in the business for future use. The 21% tax rate is scheduled to expire on December 31, 2025, so another entity conversion may need to be considered for 2026, or earlier depending upon the circumstances.
- *Alternative minimum tax repealed for corporations.* The corporate alternative minimum tax (AMT) has been repealed by the new law.
- *Alternative minimum tax credit.* Corporations are allowed to offset their regular tax liability by any AMT credit that is carried forward from 2017. For tax years beginning after 2017 and before 2022, the credit is refundable up to 50% (100% for years beginning in 2021).
- *Net Operating Loss ("NOL") deduction modified.* Under the new law, generally, NOLs arising in tax years ending after 2017 can only be carried forward, not back. The general two-year carryback rule, and other special carryback provisions, have been repealed. However, a two-year carryback for certain farming losses is allowed. These NOLs can be carried forward indefinitely, rather than expiring after 20 years. Additionally, under the new law, the NOL deduction for new losses are limited to 80% of taxable income, determined without regard to the deduction. The deduction for pre-2018 NOLs can still offset 100% of taxable income.
- *Limit on business interest deduction.* Under the new law, every business with average annual gross receipts of \$25 million or more, regardless of its form, is limited to a deduction for business interest equal to 30% of its adjusted taxable income. For pass-through entities such as partnerships and S corporations, the determination is made at the entity, i.e., partnership or S corporation, level. Adjusted taxable income is computed without regard to the repealed domestic production activities deduction or to deductions for depreciation, amortization, or depletion through 2021. Any business interest disallowed under this rule is carried into the following year, and, generally, may be carried forward indefinitely. Real property trades or businesses can elect to have the rule not apply if they elect to use the alternative depreciation system for real property used in their trade or business. Certain additional rules apply to partnerships.
- *Domestic production activities deduction ("DPAD") repealed.* The new law repeals the DPAD for tax years beginning after 2017.
- *New fringe benefit rules.* The new law eliminates the 50% deduction for business-related entertainment expenses. Additionally, the deduction for transportation fringe benefits (e.g., parking and mass transit) is denied to employers, but the exclusion from income for such benefits for employees continues. However, bicycle commuting reimbursements are deductible by the employer but not excludable by the employee. Lastly, no deduction is allowed for transportation expenses that are the equivalent of commuting for employees except as provided for the employee's safety.
- *Family and medical leave credit.* A new general business credit is available only for tax years beginning in 2018 and 2019 for eligible employers equal to 12.5% of wages they pay to qualifying employees on family and medical leave if the rate of payment is 50% of wages normally paid to the employee. Paid leave provided as vacation leave, personal leave, or other medical or sick leave is not considered family and medical leave.
- *Luxury auto depreciation limits.* Under the new law, for a passenger automobile for which bonus depreciation (see above) is not claimed, the maximum depreciation allowance is increased to \$10,000 for the year it's placed in service, \$16,000 for the

second year, \$9,000 for the third year, and \$5,760 for the fourth and later years in the recovery period. These amounts are indexed for inflation after 2018. For passenger autos eligible for bonus first year depreciation, the maximum additional first year depreciation allowance remains at \$8,000 as under pre-Act law.

- *Computers and peripheral equipment.* The new law removes computers and peripheral equipment from the definition of listed property. Thus, the heightened substantiation requirements and possibly slower cost recovery for listed property no longer apply. Many of these items can be deducted in the year of acquisition based on the de minimis supplies rules that were recently enacted.
- *Like-kind exchange treatment limited.* Under the new law, the rule allowing the deferral of gain on like-kind exchanges of property held for productive use in a taxpayer's trade or business or for investment purposes is limited to cover only like-kind exchanges of real property not held primarily for sale. Under a transition rule, the pre-TCJA law applies to exchanges of personal property if the taxpayer has either disposed of the property given up or obtained the replacement property before 2018.
- *Employee achievement awards clarified.* An employee achievement award is tax free to the extent the employer can deduct its cost, generally limited to \$400 for one employee or \$1,600 for a qualified plan award. An employee achievement award is an item of tangible personal property given to an employee in recognition of length of service or a safety achievement and presented as part of a meaningful presentation. The new law defines "tangible personal property" to exclude cash, cash equivalents, gift cards, gift coupons, gift certificates (other than from an employer pre-selected limited list), vacations, meals, lodging, theater or sports tickets, stocks, bonds, or similar items, and other non-tangible personal property.
- *Partnership "technical termination" rule repealed.* A partnership termination is no longer triggered if, within a 12-month period, there is a sale or exchange of 50% or more of total partnership capital and profits interests. A partnership termination will only occur if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.
- *Partnership loss limitation rule.* This rule for flow through entities limits the total deductible loss to \$500,000 with the remaining balance carried forward as a net operating loss. A partner can only deduct his share of partnership loss to the extent of his basis in his partnership interest as of the end of the partnership tax year in which the loss occurred. IRS has ruled, however, that this loss limitation rule should not apply to limit a partner's deduction for his share of partnership charitable contributions. Additionally, taxpayers may elect the foreign tax credit instead of deducting foreign taxes, thus avoiding a basis adjustment.
- *Look-through rule on sale of partnership interest.* This rule applies to transfers on or after 11/27/2017 and will cause gain or loss on the sale of an interest in a partnership engaged in a U.S. trade or business by a foreign person to be foreign source.

Please note that the changes in tax law will take time to implement for financial institutions, federal and state governments, businesses and accountants. We feel that most K-1's issued to owners of partnerships, LLC's, and S Corporations will take longer to prepare this year. The new reporting requirements for the qualified business income deduction are complex, so the filing of your tax returns may be delayed as a result. Please be patient if your tax return must go on extension.

As you can see from this overview, the new law affects many areas of taxation. For many taxpayers, federal tax will be reduced in 2018, but taxpayers with significant assets and income may face an unwelcome surprise on their next tax return. We welcome the opportunity to help you navigate these major changes in tax law and take advantage of the new benefits available to you. If you have any questions or concerns, please give us a call or schedule an appointment at 707-476-0674.

Very truly yours,

The Hunter, Hunter & Hunt Team