Ep:10 New Tax Law Changes that Will Benefit YOU when Filing your Corporate Return

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PATTI BRENNAN: Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

I am so honored to have with me today Bruce Boylston. Bruce is a CPA and one of the founding partners of Rothman Boylston, located right here in West Chester. Among the many accolades that Bruce has, he is an adjunct lecturer at the University of Pennsylvania, and also at Drexel.

One of the cool things that Bruce does is, as part of his work with the people at Wharton, he does work for the Lipman Prize, which is a really neat prize that they are involved in. Bruce, why don't you do a quick overview of what that's all about?

BRUCE BOYLSTON: The Lipman Prize was founded or was created by the Lipman family, Barry Lipman and his wife. What the prize does is it goes out and tries to find socially responsible and socially innovative not for profit organizations. What they do is they review what they're doing and then they give them if they meet the criterion the prize committee says their worthy of it then they get the prize.

Our position is simply to look at the financial information of the candidates that are being presented. We then break that down for the committee as well as for the fellows that are part of the Lipman Prize and give them the financial tools that they can use to make certain decisions.

PATTI: What a privilege that is. Among all of the firms that we have here locally in Philadelphia, they chose to work with you. That just really shows the quality of the work that you guys do.

BRUCE: It certainly is an honor. It's impressive because there are days...One of them was about two Mondays ago. We're sitting on top of Huntsman Hall, which is the building for Wharton now, used to be Steinberg, now it's Huntsman Hall.

You all of a sudden you go, "Wow. Look at where I'm sitting." It's a little humbling when it all gets said and done. The Lipman Prize does great work because it gives money to the people that truly can use it and really can be innovative in what they do. Good people.

PATTI: That's terrific. Thank you so much, and thank you for your work in that.

Today, we're going to be talking about the new tax law as it relates to businesses. One of the things that you and I have been able to work on together over the 20 years that we've known each other is really helping our businesses, the businesses that we work with, structure themselves and to optimize the tax laws as they present themselves and change throughout the years.

We've got this brand new massive tax legislation that does have important implications as it relates to business owners. Let's talk about some of the highlights that you see as a result of the law. Let's really zone in on some of the opportunities that the law could also present.

BRUCE: We'll take the Mac review for a minute. What's the stuff that grabs the headlines? What was grabbing the headlines was the reduction of the corporate tax rate from 35 percent to 21. That was everybody's focus. If you remember about a year ago, all these corporations started handing out 1,000 dollar bonuses to say look, we're giving the money back to the employees, and so on.

I won't comment on that, but I will tell you that there's a significant saving that's taking place at the corporate level. In addition to that, they can also then bring their earnings from overseas back into the United States at another reduced rate.

That is giving the corporations' the ability to have more cash flow, which I'm sure is driving the market to an extent and all that you folks deal with the politics of who's going to get the money at the end of the day and so forth.

From that perspective at the C corporation level…C corporation means that's a corporation that has shareholders but the income does not flow to the shareholders. It stays in the corporation, gets taxed in the corporation. What gets taxed to the shareholders in a C corporation is dividends.

As an example, Costco is a C corporation. I was just looking at their books, and it looks like they're going to save probably $300 million in taxes in 2018 based on the new tax law.

PATTI: That's a big deal.

BRUCE: It's a significant deal. Therefore, put that [inaudible 4:18] . The question becomes what are the companies going to do with it, and that's a political question. From a practical standpoint, corporations will have more cash because of the change in the tax law.

PATTI: I just hoped that when I go to the cash register, the cost of my food is going to be lower.

BRUCE: Well, that's OK. [laughs]

PATTI: So, I'm dreaming?

BRUCE: Exactly. [laughs]

PATTI: That's interesting. One of the other things that I thought was also pretty big deal is the repeal of AMT, alternative minimum tax, for corporations. That's also pretty significant, isn't it?

BRUCE: It is pretty significant, but again that operates at a level that certainly my firm doesn't operate in. That's more in the public traded companies. C corp level was never really a big issue at our level. But certainly again, it's another benefit to large corporations that they're going to be paying less tax.

That was the whole thrust of the law. We need to become more competitive at a global level. We had the highest corporate tax rate in the industrialized world. They certainly have made some adjustments for that.

PATTI: I thought it's also interesting you may had mentioned earlier when we were talking about the changes in the accounting methodology that is now available again for companies.

BRUCE: Let's take it down a step and get out of the publicly traded companies and come down to the privately held companies, probably more people that are your kind of client base or our kind of client base. One of the things that we always struggle, and I love talking about this in class, is what's the difference between accrual and cash?

The accrual method says you recognize income when earned and expenses when incurred. A negative side of the accrual method of accounting is you have to recognize income before you actually get the cash. In a small business, that may not work well.

Congress has always been fooling around with this and we've all been jerking around this. Now it's $25 million. You can use the cash method but you have to be in certain industries. It's an overreaching if you're under $25 million of gross receipts. You don't have to do anything, you can use cash.

You're still going to have to use certain methods. You may still end up having to use the accrual method, but it certainly expanded the opportunity for some companies to change to the cash method that may be possibly be using the accrual method at this point.

PATTI: From your perspective and from my perspective for the businesses, it's really a cash flow management issue. Is that correct?

BRUCE: Absolutely.

PATTI: It's not a tax issue, it's just how do you manage the business and make sure that you have the money for payroll and other expenses without having to allocate money for the taxes on money that you've really didn't get yet.

BRUCE: Right. Potentially maybe you don't get paid on that receivable. Now I've paid tax and I've got to wait till next year to claim it as a bad debt. In the world of taxes, we all like to be on the cash basis.

Individuals by nature, 99 and nine tenths percent are cash basis anyway, but clearly, at the corporate level and at the partnership level, business level let's say, it's clearly an opportunity that's going to present itself in more and more cases. Good thing.

PATTI: I also thought it was really interesting how they expanded the use of the bonus depreciation, the ability to do 100 percent expensing, etc. Why don't you talk a little bit about that as well?

BRUCE: There's a perfect example of where it's a wide open playing field now. If you buy something, you can write it off within one year. Let me give you a caveat on that that may take a little of the excitement away.

I go out and I borrow let's say half a million dollars to go buy a half a million dollars' worth of equipment. It's great. I get a half million dollar deduction and if you think about it, I borrowed the money. I didn't put any cash out. In 2019, the year I did that, it's a home run but what happens is you've got to pay it off.

Now you've got to generate income in the subsequent years to pay off the loan, but the deduction sits back in the year that's closed. You can somehow come up with some timing differences. You have to be careful how you do that.

PATTI: This is a perfect example of what I so appreciate about the way that you think, Bruce, because you're not just looking at it from a tax perspective. You're looking at it from a business planning perspective with the understanding that we have got to pay this thing back. What's going to make the most sense for you as the business owner, etc.?

Here's a question. I don't know the answer. Can a business choose not to do 100 percent expense?

BRUCE: Yes.

PATTI: Let's say that same example. You borrow the $500,000. Can the business say hey, I'm just going to deduct it over a period of five years?

BRUCE: There's an election you can make to get out of bonus depreciation, but usually the motivation to go do what we just talked about is because the company has profit and the company wants to get rid of that profit. Therefore, they will use after they've funded their pension plan, they've give employees their bonuses and so on, they'll go buy equipment.

I have concept here in the United States that we're the only country where we'll spend two dollars to save one dollar in tax. Sometimes it's better just to pay the tax. Therefore, in cases like this, maybe the half a million dollars of depreciation isn't really worth it when you're really...Do you really need the machine?

PATTI: That's exactly right. There is a practical aspect of all of this. Don't let the tax tail wag the dog.

I've got to tell you, Bruce, you and I do this all the time. That is a statement I must tell people at least three times a week. Let's make sure that we have our ladders on the right wall.

BRUCE: Absolutely.

PATTI: We talked a little bit about C corporations. Then we've got this whole world of other types of entities S corporations, LLCs, etc. Let's talk a little bit about that and some of the reasons why you might choose one over the other, especially as it relates to Pennsylvania State tax.

BRUCE: The one thing with Pennsylvania State tax, I don't know if I said this before, but if you're looking at a lower marginal rate for corporations at 21 percent...Excuse me, not a marginal rate. It's a flat rate at 21 percent. Pennsylvania's corporate tax rate is 9.9 percent. So, it's 31 percent. Is the bargain really sitting there in the C corp? Not so sure.

Then we take the next option, which is to say let's go to what we call pass through entity. The pass through entity is an S corporation. It's a corporation, you get all the legal protection, but the income passes out to you as the shareholder.

Then we can go one step further and we use an LSA. Go ahead.

PATTI: Let me stop you right there. Let's give people an understanding of what that really means to them. When it passes through you as the shareholder, you're taxed personally instead of into the company. Therefore, you pay taxes theoretically one time. We'll get into that in a minute. The most important concept is it flows through to your personal tax return.

BRUCE: It flows through your personal tax return, so you've escaped the corporate level tax. It mixes up with the rest of your income and potentially there's some savings there. We like pass through entities because it lets us manage the tax liability sometimes as best we can.

You have the S corporation. Then you have the LLC, which is Limited Liability Company. The limited liability company can elect to be an S corporation if it wants to, but its default it will be treated as a partnership if there's more than one owner or it will be considered a Schedule C or sole proprietorship if there's only one owner.

It gives us a flexibility of moving income around within the corporate structure to the parties potentially. If we use an LLC as a partnership, we can maximize depreciation and so on. In my perfect world, we like an LLC as a partnership versus sole proprietorship. However, that all came to an end in 2018 with the invention of Code Section 199A.

PATTI: That's interesting. Tell us more about 199A.

BRUCE: 199A is the one when Congress is putting this together, the issue was we're going to give these corporations a 21 percent tax rate. Everybody raised, what about the S corporation? Why does the C corporation get the benefit, not the S corporation?

Congress came up with 199A which says, at the very macro level, that a business will only pay tax on 80 percent of its net income that flows through to the shareholders. That sounds like a great deal. I get a 20 percent deduction of net income.

But, like all things good in Congress, there's always a but and maybe and a comma after everything that goes on. 199A has several restrictions that are difficult to deal with sometimes. One of them is the fact that if you are, say you're filing a married joint return, the 199A deduction begins to phase out between taxable income of 315 to 415.

One of the things that you'll have to watch out for is, once your income goes above…Taxable income. I have to keep emphasizing that because it's taxable income. Goes above $315,000 if you're filing a married joint return and you are an SSTB my suggestion is…I can't remember what all the acronyms are, so look it up.

An SSTB is basically a doctor, a lawyer, accountant, potentially an investment advisor. These are all companies, professional companies is really what they're looking for. They're saying once you get above 315 and then at 415, forget it. You're not going to get the 20 percent at all. It phases out.

The interesting thing in all of that surprisingly is architects and engineers were not included in the profession.

PATTI: That's an interesting carve out. What about real estate professionals? Didn't they get a break on that as well?

BRUCE: They got an interesting break. This was, I believe, don't quote me on this, but I believe it was Senator Corker from Tennessee that sat there and held his breath and said look, unless you put something in for rental properties, the way the law was written, they weren't going to get any benefits.

Rental properties got thrown in because what's usual with most rental properties? They don't have salaries. Once you get above that 315 mark, all of a sudden we have to start using salaries as a fraction of something. It goes away.

If you have a real estate company, you can use two and a half percent of the unadjusted basis of the property. Let's say you have a building for $100,000 and its land is 50, you can't use the land but you can take two and a half percent of the building cost. It's not the depreciable value. It's the actual cost of the building.

There's all sorts of other caveats that go with this, but that becomes the basis for your 20 percent deduction. Not that you'll get 20 percent. You may only end up with two and a half percent of the basis. It was something that was thrown in there to give real estate people a benefit.

Maybe I should explain how tax law is structured. Congress passes a law, then they empower the Internal Revenue Service to write regulations. The regulations just came out for this 199A cap as it relates specifically to this issue with regard to real estate.

The regulation now says that for you to qualify as a real estate company that can take advantage of this 199A, you have to show 250 hours of services. They don't have to be services from the owner standpoint.

It can be the person that cuts your grass, the person that paints the house, whatever. If you can combine all those and they said there's at least 250 hours being spent on this property, then you can get the 199A deduction.

PATTI: It's so interesting because I will tell you, I was out at the National Conference for the AICPA. I'm a member of it just because that I think your industry is phenomenal as it relates to helping us talk about tax planning.

This time last year was all the rage. Gee, is there a way that we can create real estate entities for those people who would otherwise not be able to take advantage of that 20 percent tax deduction? It's so interesting that it took like a year for them to come out and say before you do that, here's what you need to do in order to actually be able to qualify.

BRUCE: Taking the IRS for what they are, the other issue is they've now said for 2018, as long as you can demonstrate somehow that you've got the 250 hours, we'll let you go. Going forward, you have to keep contemporaneous records. That means that you have to write down that on

March 4th, John Smith came to our place and shoveled snow for an hour and a half.

Again, that's what the regulations say, that's what we have to do and that's what we have to abide by. It is going to become somewhat onerous for the real estate people that maybe only have one or two properties to have to keep track of all this stuff.

PATTI: Let's talk about some of the deductions that were retained and some of the deductions that were eliminated. We can do some brainstorming also about what do you think Congress was thinking when they actually passed this? For example, we can talk about the entertainment deduction.

BRUCE: The other thing you have to look at when a bill goes through Congress is what they call scored. It's scored for its revenue gain or its revenue loss. Through the scoring process, what you end up with is them having to take away some things to offset some revenue losses on the other side.

Entertainment was one that came off the table. Therefore, no entertainment. Although entertainment by itself was somewhat limited anyway, but now entertainment in no way, shape or form is deductible.

One of the other things and this goes to the individual level, is the fact that, let's say a transit pass. It's still tax free for the employee but no longer deductible for the employer. What's that all about? Again, we're trying to score the bill.

Same thing with home equity interest. Trying to score the bill. Where can we take? We're going to take it from here and hopefully, nobody will complain. Salt is another perfect example of that.

PATTI: It's just so interesting. The bottom line to this for businesses is it basically means you can deduct the cost of the hot dog but you can't deduct the ball game tickets?

BRUCE: Correct.

PATTI: It does have interesting implications. You think about the concept of the transit pass that you're using as an example. Employers and employees like that perk. That's a really important perk. Does the employer now, because they can't deduct it, do they take away that perk? What does that do to morale? What does that do to the ability to retain the talent?

Again, getting back to something we talked about earlier, you want to look at these things and make good sound business decisions irrespective of the tax implications. You've got to keep good people. That's one of the ways that you can do that.

BRUCE: Absolutely. If there's one complaint that clients have over and over and over again at the business level is we'll accept whatever the law says, but hey, can you give me a break and keep it consistent.

If you think about it, we do probably within every three to four years, we're changing something else. Something that was deductible is no longer deductible. That piece of equipment is now only deductible 50 percent, not 100 percent. To run a business, you need to know what's coming down the pike, and tax laws don't give you that option.

PATTI: On a bigger level, we're not going to talk about it right now, but think about that on a global basis and the impact of these potential tariffs. You're running the company in Apple and there's a possibility of a new law that will completely change the operations of your business.

Same thing on our level with small businesses, you come out with a wonderful employee benefit for your employees, it works from a cash flow basis. The employees love it. They love working for you. Then all of a sudden it's taken away. Now you have to make a different, maybe a new business decision. It's one thing to give something to people. It's another thing to take it away.

BRUCE: That's what a lot of our clients are trying to decide. Is this something we really want to take away? We'll forego the deduction. From the employee's standpoint, it's still tax free. There's really no harm, no foul there. Again, it starts to create other issues in the corporate level that they have to think about.

PATTI: Another thing as it relates…We'll talk about this in the next podcast as it relates to planning from an individual perspective. Those employees who have miscellaneous expenses related to their job are no longer going to be able to deduct them. It's an interesting dilemma for salespeople who buy trinkets to give to their customers. That creates a little bit of an issue too.

BRUCE: Sure. Again, there's caveats to everything. There's no such thing as an absolute statement that I can make. Under the new law, the home office deduction is gone if you're an employee. If you're not an employee, it still exists for sole proprietors and things like that.

The other thing that I have to tell your audience too is the fact that although it's gone for federal purposes if you meet the criteria, it's still there for Pennsylvania and local. Just because you can't take it doesn't mean you shouldn't look at it because it can work on your state and your local return as well.

PATTI: That's a really good point. That is a really, really good point. We're talking about the federal law, but there are state income tax implications as well.

You talked about the home office deduction. This is something that I talk with people all about. I'd like to hear your thoughts about the home office deduction, whether people should be really worried about an audit if they take a home office deduction.

BRUCE: No, not at all. In fact, actually, the IRS made it easier. They came up with what they call the simplified method. Let's say your office is 100 square feet. I believe it's five dollars per foot. Your home office deduction is $500 and we're finished.

The IRS doesn't look a this because, again, as an employee's perspective, home office was difficult to get because the business expenses had to exceed two percent of adjusted gross income. Very hard to get.

At the Schedule C level, it's easier to get because there is no limitation, but it's just not a big number. Everybody should also remember it's not just your office. If we're using your house for storage, things like that, make sure you include that square footage as well.

PATTI: Great point. Thank you so much. That's a great, great point.

Let's go back to the corporations. One thing that has changed relates to this concept that I know you've done it for our mutual clients, and that's related to net operating losses. We can no longer carry them backwards in order to get the tax benefits. You can still carry them forward, but you can't get the backward benefit that we used to be able to get.

BRUCE: The carryback period, if memory serves, was two years. I would have to say, in most cases that never came up. I think we maybe do two or three carrybacks a year. The fact that you've lost the carryback, I don't think is super critical.

However, you do have the carryforward going forward, which comes in handy. The mutual client we were talking about before with regard to real estate losses. We've been able to carry those losses forward. This is the year they have income. Now they have income but they don't have to pay any tax. The carryforward of those losses are helpful. There's no doubt.

PATTI: Isn't that a beautiful thing?

BRUCE: It is when it works.

PATTI: Having income and you don't have to pay taxes on it. It sounds like an incredible deal.

BRUCE: Yeah, but here we go back to the same issue. You had to spend money to lose it. At the end of the day, if you can break even, we'll call it square. Again, it serves itself well in the year that you can actually use it because it's somewhat of a relief rather than just continuing to dig a deeper hole.

PATTI: Let's talk strategically now. We've got this new tax law. You might have someone who is above that $415,000 limit, not able to take the 20 percent deduction. What do you think, from a practical perspective? When do you think, if at all, would it make sense for those people to think about changing the entity and going to the C corporation where they get that 21 percent rate?

BRUCE: That, I'm going to say is probably a hard push. I haven't seen anything in our analysis yet, but what we have done, I think we've done four or five this year if memory serves, is we've taken people that are in partnerships, specifically LLCs that are taxed as partnerships, and converted them to S corporations.

The short end of that story is once you get above 315, the formula changes with respect to the 20 percent and you have to start using 50 percent of the wages as one of your measurement points. If you're a sole proprietor or you're a partner with not a whole lot of payroll, you're going to lose that deduction.

If we create an S corporation and we take some of which you're taking out and call it compensation, which we have to in an S corp, now we've brought up the 199A deduction back up to where it has some benefit. It's one of those things that's a case by case basis, but that's one of the conversion points we've been looking at, which is to say go from the partnership, sole proprietor to an S corp.

PATTI: Bruce, it really is a good example of, especially during tax season when you're sitting down with your CPA, with you, really these conversations have to come up and early in the year so that you're able to take advantage of it.

BRUCE: The conversion is a perfect point. Again, and this is not to toot our own horn, but we're always in contact with our clients because it's not a static issue with respect to tax planning. It's constant throughout the year. If [indecipherable 26:17] comes to us as a partnership and they say, it'd really be great if you were a partnership, well the door is closed for 2018. It becomes a looking forward issue.

People have to be proactive if they're not hearing from their firm. They have to be proactive and say am I in a situation where I could take benefits that I'm not looking at right now.

PATTI: That goes with all aspects of this planning. Basically, we talked about the carryback. We talked about the income threshold. The ability to convert from different entities, etc. Here's a question. I know the answer, but just for our listeners.

Let's say that you're located in Pennsylvania. If it doesn't work because of the 9.9 state income tax, would it ever make sense for a business to move to, for example, Delaware and incorporate in Delaware? Does moving the business entity to a different state that might have a lower tax bracket, does that make it look more favorable in your eyes?

BRUCE: Possibly, but I'm going to have to cite the recent Supreme Court ruling with Wayfair. I think it was Justice Kennedy said guess what, this whole nexus nexus is physical location it's not working in today's world. Therefore, we're not going to be so much concerned about where you're physically located, we're going to be more concerned about where your company is actually doing business.

Let's take the State of California as an example. If you have $500,000 or more of sales to people in California, you are subject to California income tax. They just came out with a recent ruling that said if you have sales of over $100,000, you have to start collecting sales tax for us.

If you think about California, which I believe is the fifth or sixth largest economy in the world. Everybody's doing business in California. You'd say, OK, that kind of makes sense but we live in a world where we have 50 states. None of them do things exactly the same.

We had a situation last year where we had a client who tripped the half a million dollar rule for California. So I called Pennsylvania and I said, excuse us but what are we going to do? We're not going to pay tax in two states. Pennsylvania's attitude was, well, our provisions don't work that way. Tough, you're going to have to deal with it.

These are the things that we have to watch out. It's just not as easy as moving to another state because you can still get trapped pulling that income right back to where you were.

PATTI: Very interesting, Bruce. Really good points. Let's summarize this in terms of takeaway for our listeners. What I'm hearing from you, and I'm going to paraphrase it, and fill in as you wish. Takeaway number one is look at your business structure. Make sure that you're talking with your CPA early in the year as it relates to should you be a C corporation, LLC, Sub S LLC, etc.

BRUCE: Correct. Status quo is no longer acceptable.

PATTI: Boy, that is the takeaway. The status quo is never really acceptable because things change so much.

Number two, understand the deductions that were enhanced, for example, the depreciation deduction, things of that nature. Also, understand that there are some deductions that have been taken away. Very important to know going into this year what you can and cannot do.

The third one, most important, is don't let the tax tail wag the dog. As it relates to running your company, run your company from a practical perspective doing the right thing for your employees and the customers that you serve. If we all do that in what we do for the people that we serve, you're going to win no matter what.

BRUCE: That's true. The tax you have to look at as it's a cost of doing business. It's probably the worst cost that anybody wants to deal with, but it is the cost of doing business. Therefore, you have to keep it in control from the standpoint that you're not going to try to eliminate it at the expense of something else.

PATTI: Exactly.

BRUCE: That's what you need to do.

PATTI: Excellent. Bruce, thank you so much for joining me today.

BRUCE: My pleasure.

PATTI: This was terrific. I think our listeners got so much out of this today. That's it for today's show. Thank you so much for spending time with us. If you want to learn more about business tax planning, just head over to our website at keyfinancialinc.com, where you can schedule a call with me. I can introduce you to Bruce. You can learn more about what you can do for your business.

Also, make sure you hit the subscribe button if you like today's episode. Be sure to turn on notifications so you don't miss a single episode.

Bruce is going to be joining me again. He's going to be talking with us about the individual tax benefits. You really want to hear that because there's a lot of juicy stuff in that show, as well. Please leave us your comments on the show. Tell us what you liked or didn't like. We would just love to hear from you.

Until next time, I'm Patti Brennan. I will see you in the next episode. Thanks so much for joining us.