

There's a lot to discuss, as there were significant changes impacting businesses that take effect in 2018 under the Tax Cuts and Jobs Act ("TCJA"), but please bear with us. There's a good chance that one or more of these changes will change your tax bill. The TCJA was the largest tax bill passed in the past three decades. Therefore, we have limited our discussion to some of the most significant changes impacting our business clients.

REDUCTION OF THE CORPORATE TAX RATE TO A FLAT 21%

For tax years beginning after December 31, 2017 corporations pay a flat 21% tax rate.

REPEAL OF THE ALTERNATIVE MINIMUM TAX

The alternative minimum tax is repealed for tax years beginning after December 31, 2017.

Taxpayers continue to be allowed the prior year minimum tax credit to offset the taxpayer's regular tax liability for any tax year. For tax years beginning after 2017 and before 2022, the prior year minimum tax credit is refundable in an amount equal to 50%.

CASH METHOD OF ACCOUNTING

Effective for tax years beginning after December 31, 2017, taxpayers with average gross receipts of less than \$25 million (indexed annually for inflation) for the prior three taxable years are permitted to use the cash method of accounting regardless of entity structure or industry.

Taxpayers choosing to change from the accrual to cash method of accounting to take advantage of this provision must comply with the change of method rules under IRC Section 481.

ACCOUNTING FOR INVENTORIES

Effective for tax years beginning after December 31, 2017, taxpayers with average gross receipts of less than \$25 million (indexed annually for inflation) for the prior three years are exempt from the requirement to account for inventories under IRC Section 471, regardless of entity structure or industry. Such taxpayers may either treat inventories as materials and supplies that are not incidental or conform to the taxpayer's financial accounting treatment.

Taxpayers choosing to take advantage of this provision must comply with the change of method rules under IRC Section 481.

UNICAP RULES RELAXED TO APPLY TO FEWER TAXPAYERS

Effective for tax years beginning after December 31, 2017, taxpayers with average gross receipts of less than \$25 million (indexed annually for inflation) for the three prior taxable years are exempt from the

UNICAP rules. Application of this provision is a change in method of accounting under IRC Section 481.

ACCOUNTING FOR LONG-TERM CONTRACTS

Effective for tax years beginning after December 31, 2017, taxpayers with average gross receipts of less than \$25 million (indexed annually for inflation) for the prior three years are exempt from the requirement to use the percentage-of-completion accounting method for long-term construction contracts to be completed within 2 years. Application of this provision applies on a cutoff basis and does not result in an adjustment under IRC Section 481.

SECTION 179 EXPENSING AND BONUS DEPRECIATION

The Tax Cuts and Jobs Act (TCJA) has effectively lowered the cost of acquiring capital assets by making substantial changes to the income tax rules for bonus depreciation and other "cost recovery."

Bonus depreciation - Before the TCJA, taxpayers were allowed to deduct 50% of the cost of most new tangible property (other than buildings and some building improvements) and most new computer software in the year placed in service (with adjustment of the regular depreciation deductions allowed in that year and later years). The "50% bonus depreciation" was to be phased down to 40% for property placed in service in calendar year 2018, 40% in 2019 and 0% in 2020 and afterward.

Under the TCJA, property placed in service and acquired after Sept. 27, 2017 (with no written binding contract for acquisition in effect on Sept. 27, 2017), the TCJA raised the 50% rate to 100%. (Appropriately, 100% bonus depreciation is also called "full expensing" or "100% expensing".)

Additionally, the post-Sept. 27, 2017 property eligible for bonus depreciation can be new or used. Also, certain film, television and live theatrical productions are now eligible.

On the other hand, the TCJA repealed the eligibility of "qualified improvement property" (certain improvements to buildings other than residential rental buildings). And the TCJA excluded from bonus depreciation public utility property and property owned by certain vehicle dealerships.

The 2018/2019/2020 phase down (above) doesn't apply to post-Sept 27, 2017 property. Instead, 100% depreciation is decreased to 80% for property placed in service in calendar year 2023, 60% in 2024, 40% in 2025, 20% in 2026 and 0% in 2027 and afterward.

Code Sec. 179 expensing - Before the TCJA, most smaller taxpayers could immediately deduct the entire cost of section 179 property up to an annual limit of \$500,000 adjusted for inflation. For property placed in service in tax years that begin in 2018, the inflation adjusted limit was scheduled to be \$520,000. The annual limit was reduced by one dollar for every dollar that the cost of all section 179 property placed in service by the taxpayer during the tax year exceeded a \$2 million threshold adjusted for inflation. For property placed in service in tax years that begin in 2018, the threshold was scheduled to be \$2,070,000. But for tax years beginning after 2017, the TCJA substitutes as the annual dollar limit \$1 million (inflation-adjusted for tax years beginning after 2018) and \$2.5 million as the phase down threshold (similarly inflation adjusted).

Before the TCJA, section 179 property included most tangible personal property as well non-customized

("off-the-shelf") computer software. Generally, only buildings or other land improvements that qualified were restaurant buildings and certain improvements to leased space, retail space or restaurant space that were treated as section 179 property under an election. The TCJA, for tax years beginning after 2017, eliminated these categories and substituted as an elective category the much broader qualified improvement property category (that is no longer eligible for bonus depreciation, see above). Also, taxpayers can, for buildings other than rental real estate buildings, elect to treat as section 179 property previously ineligible building components that are roofs, heating, ventilation and air conditioning property, fire protection and alarm systems, or security systems.

And items (for example refrigerators) used in connection with residential buildings (though not the buildings themselves) are eligible to be section 179 property.

Other rules for real property depreciation - If placed in service after 2017, qualified improvement property, in addition to no longer qualifying for bonus depreciation and being newly eligible as section 179 property, has a 15-year depreciation period (rather than the usual 39-year period for non-residential buildings).

Apartment buildings and other residential rental buildings placed in service after 2017 generally continue to be depreciated over a 27.5 period, but should the alternative depreciation system (ADS) apply to a building either under an election or because the building is subject to one of the conditions (for example, tax-exempt financing) that make ADS mandatory, the ADS depreciation period is 30 years instead of the pre-TCJA 40 years.

For tax years beginning after 2017, if a taxpayer in a real property trade or business "elects out" of the TCJA's limits on business interest deductions, the taxpayer must depreciate all buildings and qualified improvement property under the ADS.

COMPUTERS AND PERIPHERAL EQUIPMENT

Under the TCJA, computer or peripheral equipment placed in service after 2017 isn't treated as "listed property" whether or not used in a business establishment (or home office) and whether or not an employee's use is for employer convenience. So an item doesn't have to pass a more-than-50%-qualified-business-use test to be eligible for Code Sec. 179 expensing and to avoid mandatory use of the ADS depreciation method.

BUSINESS USE OF LUXURY AUTOMOBILES

The TCJA increases depreciation limitations for passenger automobiles placed in service after December 31, 2017, to \$10,000 for the year in which the vehicle is placed in service, \$16,000 for the second year, \$9,600 for the third year, and \$5,760 for the fourth and later years. These amounts will be indexed for inflation for automobiles placed in service after 2018.

LIKE KIND EXCHANGES

The TCJA limits the nonrecognition of gain for like-kind exchanges to real property that is not held

primarily for sale. Personal property will no longer be eligible for like-kind exchange treatment. The change applies to exchanges completed after December 31, 2017.

ENTERTAINMENT EXPENSES

For expenses incurred after December 31, 2017, no deduction is allowed for entertainment expenses or club dues. The deduction for 50% of food and beverage expenses is retained. The 50% limit rule will also apply to food and beverages provided to employees through an eating facility meeting. The Act also disallows employer deductions for expenses associated with meals provided for the employer's convenience on, or near, the business premises.

LIMITATION ON BUSINESS INTEREST EXPENSE DEDUCTION

The TCJA limits the deduction for interest expense to 30% of the businesses adjusted gross income.

REPEAL OF DOMESTIC PRODUCTION ACTIVITIES DEDUCTION ("DPAD")

Taxpayers may no longer claim a DPAD deduction for tax years beginning after December 31, 2017.

NOL DEDUCTION

The TCJA limits the NOL deduction to 80% of taxable income for losses arising in tax years beginning after December 31, 2017. Carrybacks are no longer (except for farming NOLs, which are permitted to a two-year carryback) but unused NOLs may be carried forward indefinitely.

Losses incurred for tax years ended December 31, 2017 and before are not subject to the 80% limitation. NOLs of property and casualty insurance companies may be carried back 2 years and carried forward 20 years to offset 100% of taxable income in such years.

As you can see, there is a lot to talk about in 2018 related to tax planning and compliance. Gordon Advisors has contributed significant resources to understanding the new tax laws so we can provide you with the most up to date information possible.

We anticipate many of our clients will benefit from many of these changes; in particular, the more lenient cost recovery rules and the availability of the cash method of accounting. Please call us if you would like to discuss how the TCJA will benefit your company.

Very truly yours,

Gordon Advisors, P.C.
Certified Public Accountants