GROWERTALKS

Features

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Wrapping Your Head Around Tax Reform

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Thanks to the just passed Tax Cuts and Jobs Act (TCJA), the tax rate for incorporated greenhouse businesses will be reduced from its current 35% to 21% for the 2018 tax year and thereafter. And, although the business tax cuts are permanent, the tax cuts for individuals are temporary, expiring in 2026.

Unfortunately, while regular "C" corporations will be taxed at a flat 21% tax rate, the majority of small businesses and professional practices doing business as pass-through businesses will face new personal tax rates higher than the corporate tax rate.

Pass-through businesses

Pass-through businesses—such as partnerships, limited liability companies (LLCs), S corporations and sole proprietorships—pass their income to their owners who pay tax at the individual rate. The TCJA created a 20% deduction that applies to the first $315,000 of income (half that for single taxpayers) earned by growers and retailers operating as S corporations, partnerships, LLCs and sole proprietorships.

All businesses under the income thresholds, regardless of whether they're service professionals or not, can take advantage of the 20% deduction. For pass-through income above this level, the new law provides a deduction for up to 20% of "business profits"—reducing the owner's effective marginal tax rate to no more than 29.6%.

In other words, the TCJA places limits on who can qualify for the 20% tax rate with strong safeguards, so that so-called "wage income" doesn't receive the lower marginal tax rates for business income. Thus, for pass-through income above the limits, the 20% deduction applies only to business income that's been reduced by the amount of "reasonable compensation" paid the owner. Reasonable compensation hasn't been defined as yet.

The corporate alternative minimum tax

Lawmakers long-ago created a unique 20% tax rate as part of a parallel tax system that limited tax benefits to prevent large-scale tax avoidance. Under this system, incorporated businesses were required to calculate both their ordinary tax and the Alternative Minimum Tax, paying whichever was higher. Fortunately, the corporate AMT has been eliminated, lowering taxes and eliminating the confusion and uncertainty that surrounded it in the past.

Cost recovery—increased expensing

Unlike in past years when businesses were required to depreciate equipment costs, spreading the recovery of those costs over a period of several years, many businesses will be able to fully and immediately deduct the cost of certain equipment. What's more, this provision has been made retroactive to September 27, 2017.

Of course, the faster write-off of equipment costs is only temporary; it's at the 100% level for expenditures between September 27, 2017 and January 1, 2023. After 2023 and before 2025, the amount deductible drops to 60% with a further decrease to 40% after 2025 and to 20% after 2026. On January 1, 2027, the equipment cost write-off disappears.

The Section 179 first-year write-off

The differences between bonus depreciation and the tax law's Section 179, first-year expensing write-off has narrowed, with both offering write-offs for both new and used property. Section 179, however, remains as an improved option, since unlike so-called "bonus" depreciation, the use of equipment doesn't have to begin with the growing business.

Section 179 allows up to $1 million (up from $500,000 in 2017) of expenditures for business equipment and property to be treated as an expense and immediately deducted. The ceiling after which the Section 179 expensing allowance must be reduced dollar-for-dollar has also been increased from $2 million to $2.5 million.

And now, improvements—including roofs, heating, ventilation, air conditioning systems, fire prevention, alarms and security systems—qualify under the new Section 179 rules, providing another opportunity for growers that actually need equipment.

Interest expenses

In the past, our tax laws have protected the ability of small businesses to write-off the interest on loans. In an attempt to "level the playing field" between businesses that capitalize through equity and those that borrow, the TCJA caps the interest deduction to 30% of the adjusted taxable income of a business. Exceptions exist for small businesses to protect their ability to write off the interest on loans that help them start or expand a business, hire workers and increase paychecks.

R&D

The frequently overlooked and often misunderstood Research & Development (R&D) Tax Credit, originally designed to encourage businesses to develop cutting edge "Made in America" products and services, has been preserved. Generally, "specified research and experimental expenditures" means, at least according to our lawmakers, research or experimental expenditures that are paid or incurred by a business.

The TCJA extended the tax credit for "increased" R&D expenditures but, for the most part, a grower's R&D expenditures are usually charged to the operation's capital account and amortized ratably over a five-year period.

Small business accounting method and simplification

The simplification of the rules governing the method of accounting that must be used for taxes is a welcome option. Businesses with average annual gross income of less than $25 million may now use the simple cash-basis accounting method.

Under this provision, the current $5 million threshold for corporations and those partnerships with a corporate partner is increased to $25 million, and the requirement that such businesses satisfy the $25 million limits for all prior years has been repealed.

For those operations that qualify as farm corporations, farm partnerships—as well as family farms—the increased $25 million threshold has been extended. Also, under the new law, the average gross receipts test will now be indexed to inflation.

With the cash method of accounting, a grower may account for inventory as non-incidental materials and supplies. Or, as an alternative, a business with inventories using the cash method of accounting and qualifies would be able to account for its inventories using the method of accounting reflected on its financial statements or its books and records.

NOLs

One of the main benefits of net operating losses (NOLs) was the fact that they could be carried back to more prosperous years, creating a refund of taxes paid in those earlier years and providing an immediate infusion of badly-needed cash. Today, the NOL deduction has been severely limited. The write-off is now limited to 80% of taxable income and only in special cases will an NOL carryback be permitted. There's no limit on how far forward NOLs may be carried.

Auto expenses

While not applying to "fleets" of five or more automobiles uses for business purposes, new limits on the write-off for the cost of so-called "luxury" automobiles and personal use property were included in the TCJA.

For passenger automobiles and light trucks placed in service after December 31, 2017, where the additional first-year depreciation deduction isn't claimed, the maximum amount of allowable depreciation is increased 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 in the recovery period.

For passenger automobiles placed in service after 2018, these dollar limits are indexed for inflation. And for those eligible for bonus first-year depreciation, the maximum first-year depreciation allowance remains at $8,000.

Like-kind exchanges, swaps and trade-ins

The tax law's Section 1031 governing like-kind exchanges currently allow growers to defer the tax bill on the built-in gains in property by exchanging it for similar property. Although more a strategy for deferring a tax bill when business assets are lost, sold, abandoned or otherwise disposed of, with multiple exchanges, gains can be deferred for decades and ultimately escape taxation entirely.

Under the TCJA, like-kind exchanges will be limited to so-called "real" property (but not for real property held primarily for sale). The provision redefines like-kind exchanges and includes language that would limit Section 1031 exchanges to exchanges of like-kind "real" property. This ensures real estate investors maintain the benefit of deferring capital gains realized on the sale of property.

Estate taxes

Although only the wealthiest 0.2% of estates owed any estate tax at last count, the TCJA provides immediate relief from the so-called "Death Tax" by doubling the exemption so it applies to even fewer estates. The higher thresholds will sunset in 2026 and be repealed entirely after six years.

More, oh, so much more

Obviously, the TCJA contains many more changes. S corporations attempting to convert to regular "C" corporations will face new rules; Section 199, the deduction for so-called "domestic production activities," has been repealed; and partnerships no longer must terminate upon the death or exit of a partner.

The TCJA also repeals the Work Opportunity Tax Credit and modifies or repeals many energy-related deductions and credits. All-in-all, however, the new law will have a significant impact on equipment acquisitions, as well as on the tax bills of many growers, retailers and other businesses.

Overall, the Tax Cuts and Jobs Act appears to favor businesses over individuals with longer-lived tax savings. Unfortunately, with few exceptions, the potential savings won't be seen until the tax bill for 2018 comes due. **GT**

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