

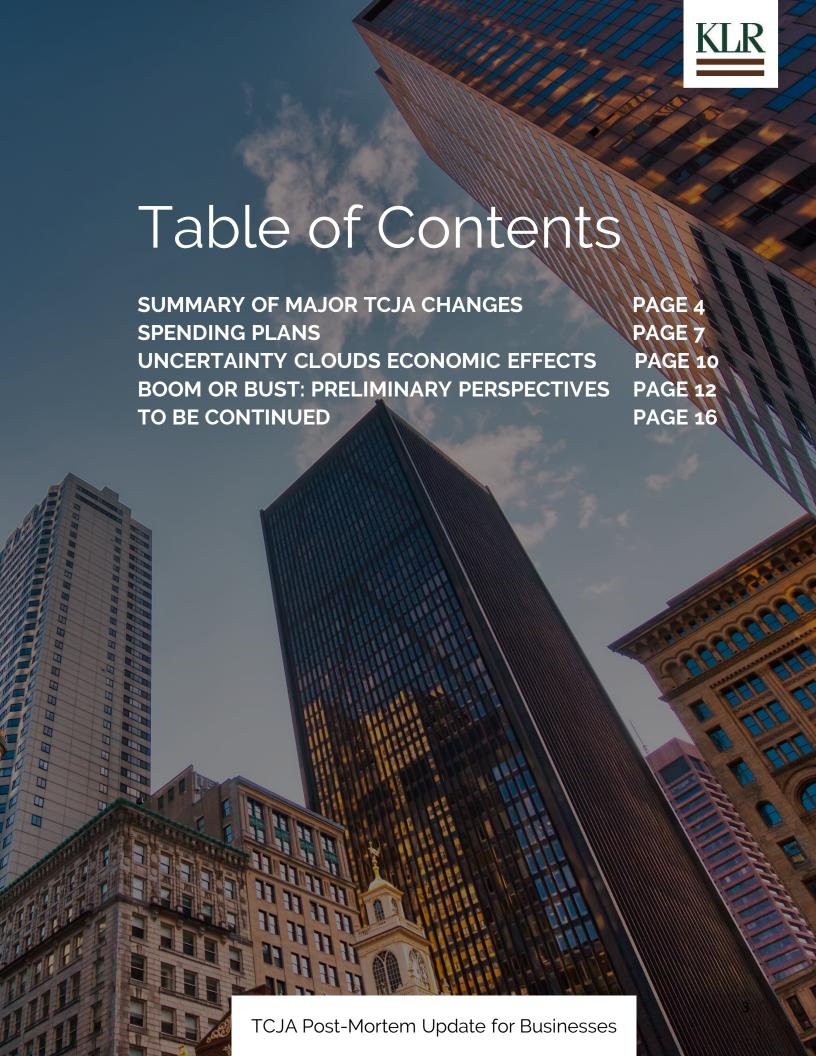


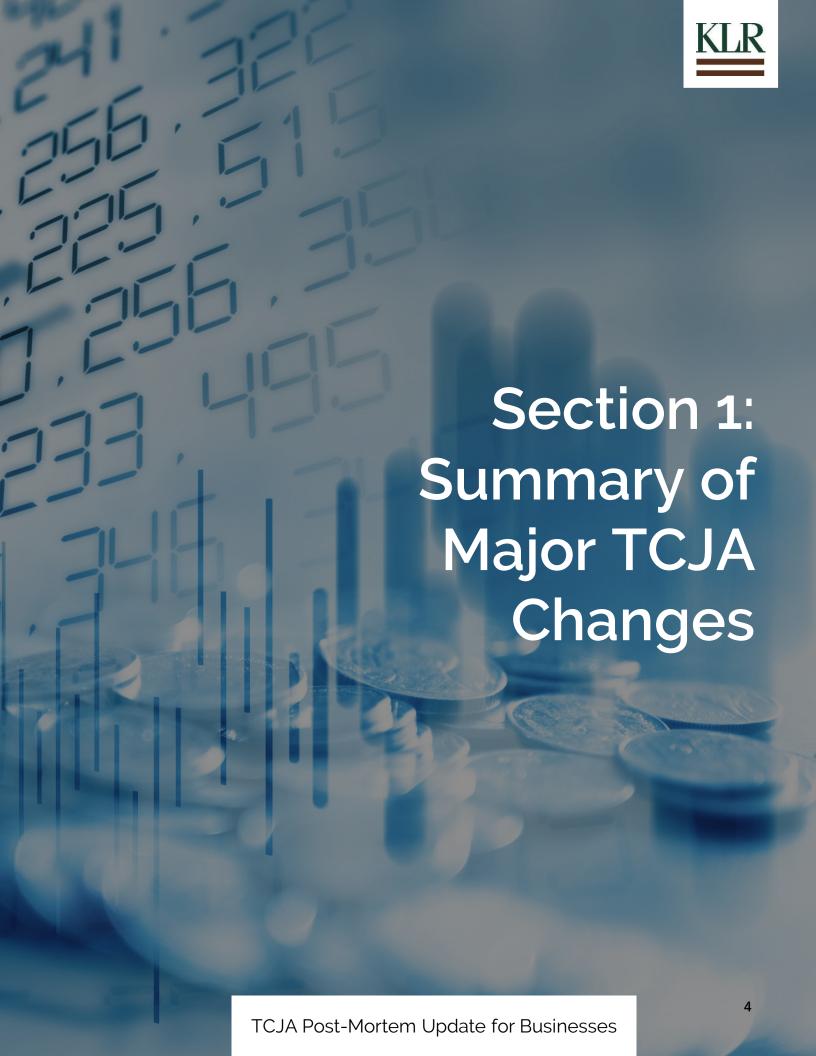
TCJA Post-Mortem Update for Businesses

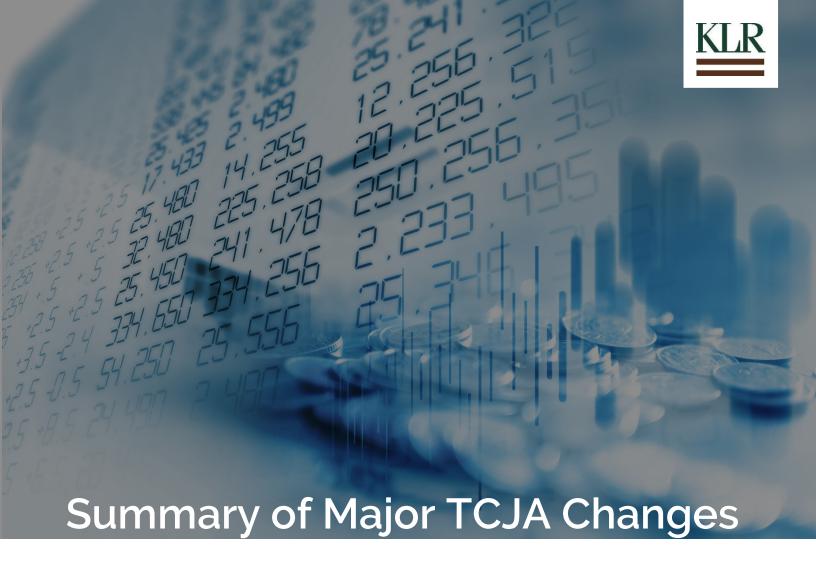


Introduction









Starting in 2018, several key TCJA provisions benefited business taxpayers, such as:

Reduced corporate tax rate. The TCJA permanently lowered the top corporate income tax rate from 35% to 21%. This is below the global average for Organization for Economic and Development (OECD) countries. The TCJA also eliminated the graduated tax rate schedule for corporations.

A new deduction for pass-through businesses. Sole proprietors, S corporation shareholders, partners and members of limited liability companies (LLCs) may be eligible for a deduction of up to 20% on qualified business income (QBI) from pass-through entities. For qualifying small business owners, this provision reduces the effective top individual income tax rate on business income from 37% to 29.6% for 2018 through 2025.

Numerous rules and restrictions apply to the QBI deduction. So, unfortunately, it's not a sure win for owners of pass-through entities.



Summary of Major TCJA Changes

Minimized exposure to the alternative minimum tax (AMT). Under the TCJA, the corporate AMT has been repealed, and fewer pass-through business owners are hit with the AMT on their personal tax returns.

Expanded first-year tax breaks for investing in fixed assets. The TCJA doubled the Section 179 expensing limit for small businesses from \$500,000 to \$1,000,000. It also increased the asset acquisition phaseout threshold from \$2 million to \$2.5 million. These amounts are indexed annually for inflation. For 2019, they're \$1.02 million and \$2.55 million, respectively.

In addition, the bonus depreciation percentage has increased from 50% to 100% of the cost of qualifying new and used assets put in service through 2022. Starting in 2023, the bonus depreciation percentage is scheduled to decrease by 20% annually, until it's fully eliminated after 2026, unless it's extended by Congress.

Tax incentives to repatriate foreign income and move foreign operations to the United States. The TCJA created a modified territorial tax system. It exempted from taxation the dividends that domestic corporations receive from foreign corporations in which they own at least a 10% stake. And it created "guardrails" — such as a minimum tax on global intangible low-taxed income (GILTI) and base erosion and anti-abuse tax (BEAT) — to prevent companies from shifting tax deductions to the United States and taxable income to low-tax jurisdictions overseas. The TCJA also created a new deemed repatriation tax for previously accumulated and untaxed earnings of foreign subsidiaries of U.S. companies.

Businesses will generally pay less federal income tax under the TCJA than under prior law. But the TCJA does contain some unfavorable provisions. For example, it limits business interest deductions, net operating losses (NOLs) and deductions for officers' compensation. The TCJA also repeals the domestic production activities deduction, certain fringe benefits and tax breaks for business entertainment (with certain exceptions). So, the amount of tax savings under the TCJA varies significantly from company to company, depending on its unique circumstances.





Tax cuts from the TCJA were intended to help pay for themselves by stimulating the U.S. economy and, in turn, generating incremental tax revenue. Specifically, businesses were expected to spend their tax savings on:

- Hiring more workers who, in turn, would earn taxable income,
- Providing incentive bonuses and profit sharing to workers, which would increase workers' productivity and taxable income,
- · Expanding benefits offered to workers, which would
 - 1) boost morale and productivity, and
 - 2) decrease workers' out-of-pocket costs and, therefore, increase their taxable income,
- Training current workers to have more advanced skills, which would lead to increased wages, higher productivity and greater long-term prosperity,



- Buying new equipment and other fixed assets, which would stimulate business-to-business (B2B) demand and boost productivity,
- Expanding and upgrading business facilities, which would stimulate (B2B) demand and boost productivity,
- Investing in research and development (R&D), which would increase wages paid to in-house R&D workers and result in more spending on external R&D consulting,
- Paying dividends to owners, which would provide returns to shareholders, including Americans who own retirement portfolios, and
- Repaying debt obligations, which would strengthen the balance sheets of U.S. businesses.



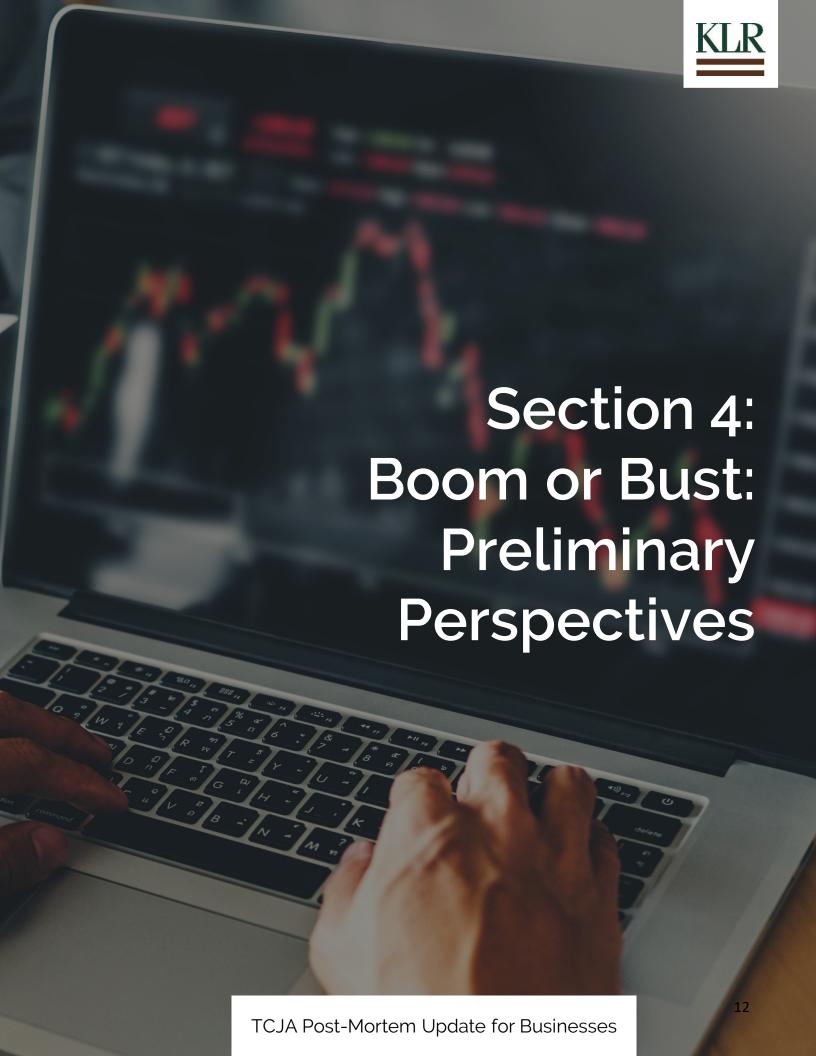
Section 3: Uncertainty Clouds Economic Effects



Is there any evidence over the last two years that tax savings from the TCJA has led to economic growth? In such a short period of time, it's hard to say whether the tax cuts have generated the intended economic effect.

To complicate matters, the IRS continues to dribble out guidance to clarify some of the more complex provisions of the law, such as the QBI deduction, the limitation on business interest deductions and the provisions related to foreign operations and assets. In addition, the TCJA changes affected state tax returns in various ways, depending on whether the state conformed to federal changes or not. As a result, a record number of business owners filed extensions for the 2018 tax year, making it harder for analysts to evaluate the effects of the TCJA in a timely manner.

Moreover, the TCJA has created an atmosphere of uncertainty: The tax cuts vary from business to business. And complexity over how the law will affect each business could make management hesitant to spend savings that could be temporary or haven't yet materialized. In general, an uncertain business environment tends to stifle economic activity.





To date, the TCJA has received mixed reviews. Over the last two years, there have been several positive indicators of economic growth. In December 2019, the White House published an article, <u>"Two Years On, Tax Cuts Continue Boosting the United States Economy,"</u> which reports that:

- Wages have increased, especially for blue collar workers. Blue collar wages rose at a 3.0% annual rate from January 2017 through November 2019. The annual growth rate was 2.4% from July 2009 through December 2016. The nominal wage growth for the lowest wage earners has been 10.6% since the TCJA was signed.
- Unemployment rates dropped to 3.5% in 2019, the lowest rate in a half-century. Likewise, job openings are at historic highs.
- Investment into qualified opportunity zones (QOZs) has helped revitalize lowincome communities.



Boom or Bust: Preliminary Perspectives

- Investment in equipment has increased across all asset classes. In 2018, investment levels were 4.5% higher than projections made by the U.S. Council of Economic Advisers (CEA) during TCJA negotiations. In 2019, investment levels exceeded CEA projections by 3.3%.
- Corporations have repatriated \$1 trillion in profits to the United States that were previously invested abroad. Likewise, corporate inversions are down.

However, many changes appear consistent with pre-TCJA trends. In 2019, the New York Times reported that June marked the tenth anniversary of the end of the Great Recession, and workers are benefiting from "the longest economic expansion on record." So, the uptick in economic condition began long before the TCJA was signed.

It's also hard to find a direct correlation between these changes and the TCJA. For example, increasing wages also could be linked to job market competition and recent changes to the wage-and-pay regulations at the state and federal levels.

The American Enterprise Institute, a public policy think tank, reports that gross domestic product (GDP) grew at an annualized rate of 2.5% in the 18 months after the TCJA was passed. But the GDP growth rate was 2.6% in the 18 months prior to the TCJA. These statistics suggest that, over the short run, there hasn't been much change in macroeconomic growth before and after the TCJA.

There have also been warning signs that economic growth may be slowing, despite tax reform legislation. In September 2019, Federal Reserve Chairman Jay Powell pointed to the "continued softness" in business investment and declining output in the manufacturing sector as reasons for lowering the federal funds rate. In addition, 52% of U.S. CFOs believe that the United States will be in recession by the fourth quarter of 2020, and 76% believe that a recession will have begun by the second quarter of 2021, according to the fourth quarter 2019 Duke University / CFO Magazine Global Business Outlook survey.



Boom or Bust: Preliminary Perspectives

Rather than hire new workers or invest in equipment, many businesses have reportedly used their tax savings to repurchase outstanding shares of stock and pay dividends to shareholders, according to <u>"The Economic Effects of the 2017 Tax Revision: Preliminary Observations,"</u> a paper by the Congressional Research Service (CRS).

The CRS estimates that about \$1 trillion was spent on stock buybacks in 2018. Critics argue that stock buybacks enrich current owners and do little to encourage business or consumer spending.

In addition, shortly after the TCJA was enacted, some businesses paid substantial year-end bonuses to share their tax savings with workers. In hindsight, critics argue that the bonuses were used to reduce taxable income in 2017 and shift income to 2018, in anticipation of lower tax rates starting in 2018. Essentially, the TCJA created an incentive for businesses to pay bonuses earlier — and the generous bonuses weren't continued in 2018 and 2019 when tax rates were lower.

Finally, the tax cuts under the TCJA has reportedly added to the federal deficit over the last two years. Corporate tax revenues fell by an estimated 40% from 2017 to 2018, according to the Congressional Budget Office (CBO). The CBO expects corporate tax revenues to bounce back slightly for the 2019 tax year. But the CBO also expects the primary federal deficit to increase \$1.3 trillion over 10 years and the overall debt (counting interest payments) to increase by \$1.9 trillion.

The mounting federal deficit can't be attributed solely to the TCJA, however. Other factors, such as government spending and the balance of global trade, also may be at play.



Section 5: To Be Continued



Economists generally agree that it will take years to fully evaluate the effectiveness of the TCJA, and that evaluation will be complicated by forces outside of the tax law. Plus, depending on the results of the 2020 election, the pro-business provisions of the TCJA could be altered or reversed in the near future — possibly even retroactively for 2020. So, the changes to the tax law might not remain in place long enough for economists to evaluate their full effects.



Right for You?

LET'S TALK

For better or worse, today's tax rules provide numerous tax-saving opportunities for businesses. Our tax professionals can help you take advantage of the pro-business TCJA provisions — while they last.

<u>Contact our tax team</u> to set up a meeting to brainstorm financial planning strategies to help your business succeed in the future.

ABOUT THE AUTHOR

Ms. Loree B. Dubois, CPA, MBA is a Partner at KLR and joined the firm in 2003. She has been providing tax advisory services to closely held, medium sized and publicly held businesses for over 20 years. She assists clients with a variety of tax issues including tax compliance, tax accounting assistance, financial statement reporting under ASC 740, multi-state tax planning, and other general tax consulting.

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