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Tax Advice for Business Clients Closing Out 2019

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As 2019 comes to a close, many tax professionals are already providing their small business clients with tax planning advice for tax year 2019, in addition to tax compliance services. Tax reform presents a good opportunity for all practitioners to perform advisory services by looking at their clients' 2019 tax situations and identifying **tax savings opportunities**. The following article will discuss various tax law provisions and related year-end tax planning tips.

20% Qualified Business Income (QBI) Deduction

One significant change to tax law as a result of tax reform gives small business owners a **20% deduction** on pass-through income from sole proprietorships (Schedules C, E and F on Form 1040), limited liability companies, partnerships and S corporations. Small businesses qualifying for the 20% tax deduction could see their effective marginal tax rate reduced to 29.6%.

There are some comprehensive rules surrounding this, including a phase-out of the deduction for high-income earners (over $160,700 for single filers and $321,400 for joint filers). The rules associated with this provision opens the door for some planning techniques to maximize the deduction and reduce taxable income and tax liability.

Planning Tips

- If your taxable income is above these thresholds, think about deferring income and/or accelerating expenses (e.g. contribute to a retirement plan) to bring down taxable income in the current year, and thus, increase the QBI deduction.
- If you're subject to the wage / depreciable property limits, think about hiring W-2 employees instead of independent contractors to increase the QBI deduction. Remember to take into account increased payroll tax and employee benefits.
- If you're subject to the 20% taxable income limit, think about increasing taxable income, such as taking on a second job, in order to increase the QBI deduction.
- If you have a specified service trade or business and are subject to the phase-out, think about establishing a separate business, a separate entity or a C corporation. Be careful because there are rules constraining some of these tactics.
- If you have a low QBI or none at all, see if there are opportunities to become a business owner, such as an employee becoming a consultant. Remember to take into account things such as benefits packages into consideration.

Depreciation Perks under Tax Reform

Tax professionals can meet with their small business clients to see if it makes sense to invest in depreciable property before year end in an effort to reduce taxable income and save tax dollars.

Bonus Depreciation

The government increased bonus depreciation from 50% to **100%.** Generally, bonus depreciation applied to personal property, such as furniture and equipment and now, used property also qualifies. You can elect out of bonus depreciation on an asset class basis only, and you must attach an election statement.

Planning Tips

- Be careful claiming bonus depreciation when you cannot fully utilize the benefits in the current year. Net operating losses need to be carried over and the self-employment tax doesn't allow for loss carryovers.
- Bonus depreciation may reduce your 20% QBI deduction, but could also take you below the phase-out threshold and allow for a greater deduction, so plan carefully.

Section 179 Expensing

The limit has been increased to **$1,020,000** for 2019, but remember, it is limited to business income and is recaptured if the business use percentage drops below 50%.

Planning Tips

- Section 179 deduction allows for more flexibility than bonus depreciation because you're able to pick and choose the assets and amounts to expense.
- Section 179 may reduce your 20% QBI deduction, but could also take you below the phase-out threshold and allow for a greater deduction so plan carefully.

Choosing the Best Entity Type

Under the new law, the tax rate for C corporations has dropped from 35% (top marginal rate) to 21% (flat tax). To simplify things even more, Congress repealed the corporate alternative minimum tax. Reducing the corporate rate to 21% and the new 20% deduction for flow-through entities opens the door for small businesses to choose the most favorable entity type.

Planning Tip

- In addition to crunching the numbers, be sure to consider all the factors, such as administrative duties and legal liability implications.

Retirement Planning

It's always a good idea to plan for retirement early, especially with the government handing out lucrative tax incentives. There are a variety of retirement plans available for small businesses that allow the employer and employee a tax favored way to save for retirement. Contributions made by the owner for himself or herself and for employees can be deducted. Furthermore, the earnings on the contributions grow tax free until the money is distributed from the plan. Please note: with Roth type plans, you don't get a deduction for the contribution, but the earnings escape taxation (not just deferral). The small business owner is also allowed a tax credit equal to 50% of the first $1,000 incurred in starting up a plan.

Planning Tip

- Small businesses are sometimes reluctant to save for retirement because they don't have enough cash. For some plans, the rules allow you to wait until the filing deadline to contribute and still get a deduction for the previous year.

New Credit for Employer-Paid Family and Medical Leave

One nice new perk for businesses and their employees is the ability for business owners to claim a credit for wages paid to employees on family and medical leave. It starts at 12.5% for payments of 50% salary, and goes up to 25% if the leave payment rate is 100% of the normal rate. The maximum leave allowed for any employee is 12 weeks per year. To qualify, employers need to have a written policy that provides at least 2 weeks of paid leave.

Recordkeeping Tips

Businesses of all sizes and types should learn to keep good records as an integral part of being successful. Here's why recordkeeping is a key process:

- It helps monitor financial health and business progress
- Allows businesses to more easily identify sources of income and expenses
- It leads to easier financial statement and tax return preparation

For efficiency, small businesses can choose an electronic, cloud-based system such as QuickBooks Online, to record transactions and track revenue and expenses. In general, the IRS suggests that taxpayers retain their records for three years.

Wrap-up

As practitioners perform these advisory services, it's important to point out the **return on investment** to their clients so they can see the value of the services (i.e. how much they are saving versus how much it will cost them to do the extra work). It is also important to point out the fact that you're allowed to reduce their tax bill as long as you follow the law. Overall, the goal is to enhance your standing as your clients' trusted advisor to set yourself apart from the competition.

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