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**BUSINESS & FINANCIAL ADVISORS**

# Memo

**To:** **All Clients - Merry Christmas and Happy New Year!**

**From:** Gregory Barford

**Date:** 12/3/18

**Subject**: ***Business*** Income Tax Planning for 2018 (See the enclosed for Individual Income Tax Planning for 2018)

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The "Tax Cuts and Jobs Act", also known as the Trump tax plan, is a major watershed event for small business that will put more cash into the bank for just about all small businesses. We will provide an overview of major changes and what are the planning opportunities.

## Overview-Major Changes for Small Businesses

### Cash Method of Accounting

Business that have sales of less than $25 million will be able to use the cash method of accounting. Taxpayers who were required to use the accrual method can switch to the cash method of accounting, effective for the 2018 tax year. We will probably switch most of our accrual-based taxpayers to the cash method for 2018. The key factor in determining to switch to the cash method of accounting is whether the accounts receivable is greater than the accounts payable and accrued expenses.
The table below illustrates which taxpayers will benefit from the methods.

| Receivables and Payables and Accrued Expenses | Method to Use |
|---|---|
| Accounts receivables >Accounts payable and accrued expenses | Cash |
| Accounts receivables <Accounts payable and accrued expenses | Accrual |

The table is a guideline and is not absolute; each taxpayer has unique circumstances. A quick look at the table indicates the cash method is the one to use; however, the accounts payable and accrued expenses may go up significantly in 2019, and the accrual method will be better. We will consult with each of our clients in 2019 as to what the right accounting method to use for 2018.

### Qualified Business Income Deduction of 20%

Effective in 2018, this is a deduction of 20% of a business's qualified income that will reduce a business's income taxes. For example, a business that has income after expenses of $200,000 will only pay income on $160,000. Thus, this $40,000 will generate cash flow savings of $14,000 at a 35% combined federal and state income rate. This deduction is available to all businesses. However, there is a limitation on service businesses (healthcare, law, consulting, financial services, brokerage services, sales, performing arts) that can be deducted. These service businesses 20% deduction phases out for married taxpayers with taxable income of $315,000 and $157,500 for single taxpayers. Once a married taxpayer exceeds $385,000 in taxable income, there is no deduction at all for the 20%.

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*Con't from page 1 – Qualified Business Income Deduction of 20%*

It is possible that the 20% deduction may apply to service businesses that have retail sales greater than 5%. Therefore, if a service business has 60% service and 40% retail, based on sales, and the net income is $200K; a 20% deduction for retail would be $16K deducted on the tax return. This is a simplified example. <u>We are waiting for the IRS to issue more guidance on this issue.</u> Moreover, there may be a safe harbor that says the 20% deduction could be valid for a service business that has a retail component as long as the following three factors are met: the service and retail business have a separate set of books, each is a separate tax entity, and each business has separate employees.

<u>Fixed Asset Write-Off</u>

Beginning in 2018 taxpayers can expense 100% of most of their fixed asset purchases using bonus depreciation. Section 179 allows us to expense fixed assets too; however, there is a limit of $1 million dollars for 2018. A problem with the Section 179 is the deduction can only be taken when a business has enough net income to cover the amount of the deduction. Accordingly, if the Section 179 cannot be used in the current year because of income limitation, it will carry over to the next year. Therefore, in most cases we will use the bonus depreciation.

## <u>Key Actions to Take Before 2018 Year End to Lower Income Taxes</u>

1. <u>Fixed Assets</u>- Be sure to purchase machinery, equipment, furniture, fixtures, etc. before year end. Do not make over purchases of fixed assets to lower income taxes; purchase what you need only.

2. <u>Pay Expenses and Defer Collections of Receivables</u>- Pay where you can, before the end of 2018, money owed to vendors that you would normally pay to vendors in 2019. Defer collections of receivables to 2019 where you can.

3. <u>Retirement Plans</u>- Maximize simple IRA and 401 K deductions for yourself, spouse and where applicable your children.

| Employer Plan Type | Under Age 50 | Age 50 and Over |
|---|---|---|
| **Simple IRA** | $12,500 | $15,500 |
| **401K and 403B** | $18,500 | $24,500 |

4. <u>Children on Payroll</u>- Put children on your payroll to shift income to lower tax brackets; contact my office for further details. In addition, it is also possible to pay children $599, and you do not have to report on a 1099, and the child may not have to pick this up as income on their tax return.

5. <u>Make Loans to the Business to Deduct Business Losses</u>-When you have business losses, we have to make sure you have basis to deduct these losses. Therefore, we may have you make a short-term loan to the business by year end so we can deduct these losses.

***<u>Contact our office for further details: 301-865-4648 or gab@gabcpa.com</u>***