2021 IRS Tax Reforms that Affect Businesses

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The TCJA, Tax Cuts and Jobs Act went into effect in 2018. This article will summarize the changes businesses will see when filing tax returns.

Businesses Should Recalculate Their Tax Estimates

The TCJA has made several changes to expense deductions, personal exemptions, tax rate and brackets, and increased the Child Tax Credit. This means that businesses and the self-employed will need to recalculate their tax estimates as they will likely differ from previous years'.

Use the following resources to learn more about the changes and avoid any nasty surprises come tax time:

- Visit the IRS.gov website and use the Withholding Calculator to calculate a new tax estimate
- Read Publication 505, Tax Withholding and Estimated Tax for more information about estimated tax on capital gains, dividends, or other special circumstances.
- Read Form 1040-ES Estimated Tax for Individuals for the tax changes and income tax rate schedules.
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Estimated Tax Penalty Relief

The IRS will waive the estimated tax penalty for taxpayers who have, through quarterly estimated tax payments, federal income tax withholding, or a combination of both paid 85% or more of their 2018 total tax liability. This figure is usually 90% for a taxpayer to avoid the penalty. The extra relief is intended to help taxpayers who have not adjusted their estimated tax payments for the new changes.

The new waiver computation and instructions are in Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts. For fishermen and farmers who file their returns and pay their tax by the 15th of April, the IRS will waive the estimated tax penalty. For more details, see Form 2210-F, Underpayment of Estimated Tax by Farmers and Fishermen.

Changes to Deductions for Businesses

QBI Deduction

Many individuals and businesses may be eligible for a section 199A deduction, also called a QBI deduction. Trusts and estates can directly claim the deduction.

They can deduct:

- 20% of QBI, or qualified business income
- 20% of REIT dividends
- 20% of qualified publicly traded partnership income

The section 199A deduction is implemented in tax years beginning 2018. Income earned by a C corporation or as an employee does not receive the deduction.

There are two components to the deduction.

QBI Component

A domestic business is entitled to deduct 20% of their qualified business income if the business is operated as a:

- Partnership
- Sole proprietorship
- S-Corporation
- Estate
- Trust

The qualified business income may be limited to:

- W-2 wage amounts the business or trade pays
- The type of business or trade
- The UBIA for qualified property the business or trade holds

If your taxable income falls below a certain threshold, then the limitations will not apply. The threshold is often higher for married couples. Also, if the taxpayer is a donor for a horticultural or agricultural cooperative, they may claim the patron reduction.

PTP or REIT Component

This component is 20% of the PTP income and REIT dividends and is not limited to W-2 wages or UBIA for qualified property. If the PTP is engaged in specific trades or business services, then the PTP income may be limited.

The deduction is calculated as the lesser of the following two:

- 20% of the taxable income minus the capital gain (net,) or

- QBI component plus the PTP/REIT component

Regardless of if you take a standard deduction or itemize your deductions on Schedule A.

Any section 162 business or trade is qualified, aside from these three exceptions:

1. A business or trade that operates as a C-Corporation
2. Taxpayers with a taxable income that exceeds the threshold for SSTBs.
3. Performing services as an employee.

See Publication 535, Determining Your Qualified Trades or Businesses for more information.

QBI is the total net amount of all qualified gains, income, losses, and deductions connected to U.S operations from qualified businesses and trades.

These items cannot be counted as qualified business income:

- Income from wages
- Investment items such as dividends, capital gains and losses
- Items disallowed for inclusion in income
- Interest not allocable to the business or trade
- Foreign currency losses or gains
- Commodities transactions
- Income connected to foreign business conduct
- Qualified PTP income
- Qualified REIT dividends
- Annuities unconnected to the business or trade
- Guaranteed payments from partnerships
- Reasonable compensation from an S-Corp
- Notion principal contracts deductions, losses, or income
- Payments received from a partner to pay for something other than partner services

Excess Business Losses

An excess business loss is the amount of their deductions which exceed their total gross income. At-risk and passive activity limits must be applied before calculating these excess business losses.

The following things may be included in calculations:

- Being an employee
- Gains and losses reported on Forms 8949 and 4797
- Pass-through income and losses for a business or trade
- Farming losses due to drought, disease, or casualty

For further details and instructions, read Form 461

Net Operating Losses

The TCJA means that most taxpayers can no longer carry back a net operating loss for anything prior to 2017. There are some exceptions for insurance companies (other than life insurance) and certain farming losses.

Meal and Entertainment Expenses

The new laws have almost entirely eliminated amusement, entertainment, and recreation expenses. Meal expenses can still be deducted (50% of the cost) for non-extravagant meals where the taxpayer or one of their employees are present. This includes meals with clients, potential clients, business contacts, or consultants. Meals during entertainment events must be billed separately to the entertainment event to be claimed.

Fines and Penalties

Penalties and fines for breaking the law are not able to be deducted.

Payments in sexual abuse or harassment cases

Certain payments made in sexual abuse or sexual harassment cases cannot be claimed as tax deductions. However, Section 162(q) does not prevent settlement recipients from deducting attorney's fees for the case.

Payments Under State or Local Tax Credit Programs

Businesses that make payments to government entities or charities may deduct any payments that allow them tax credit.

- Revenue Procedure 2019-12 states in its safe harbors section that any payments made in exchange for a tax credit may be treated as normal business expenses in section 162(a).

Changes to Fringe Benefit Deductions

The changes to fringe benefits deductions may impact employees' deductions and a business's bottom line.

Transportation Fringe Benefits

Under the new laws, employees can no longer claim transportation fringe benefits for commuting.

Bicycle Commuting Reimbursements

Employers can deduct qualified reimbursements for bicycle commuting until 2025. These reimbursements must also now be included in employees' wages.

Moving Expenses

Moving expense reimbursements must now be included in employees' wages. The exception is US Armed Forces in Active Duty; they may exclude moving expenses from their income.

Achievement Awards

If an achievement award is not tangible personal property, then it may be excluded from employee wages. If the award is tangible personal property then it is subject to certain deduction limits.

Changes to Depreciation and Expensing for Businesses

The TCJA changed expensing and depreciation laws:

- Businesses can expense more things
- Depreciation limitations have changed for personal-use property and luxury automobiles
- Certain farm property will be treated differently
- Farming businesses will use an alternative depreciation system
- Temporary 100% expensing for qualified business assets in the first year
- Applicable recovery period for real property

For passenger automobiles, taxpayers may use the safe harbor method so they qualify for the 100% first-year depreciation limitations. This allows taxpayers to deduct depreciation from the excess amount. Read more about the safe harbor method in Publication 946, How to Depreciate Property. This method is not applicable to passenger vehicles if the taxpayer elected to expense the cost of the vehicle or elected out of the 100% additional first-year depreciation deduction.

Additional Resources:

- FS-2018-9
- Additional First-Year Depreciation Deduction (Bonus) – FAQ

New and Revised Tax Credits for Businesses

New Employer Credit for Paid Family and Medical Leave

Employers can claim a percentage of their employee's paid family and medical leave as a tax credit. Read Notice 2018-71 for more information.

Rehabilitation Tax Credit

The new law has removed the 10% tax credit for rehabilitation buildings older than 1936. The 20% credit for rehabilitation to certified historic structures remains, but the taxpayer must prorate the credit over 5 years.

Accounting Methods

Small Businesses

Under TCJA, businesses that over the last three years have averaged $25 million or less in gross revenue may use cash accounting methods. This allows more businesses to change to cash accounting.

S-Corp to C-Corp

An S corporation which has changed to a C corporation must use IRC Section 481(a)'s 6 year adjustment period to change from cash method to accrual method. Read Revenue Procedure 2018-44 for more information.

Like-Kind Exchanges

Deferral of gain or loss will no longer apply to exchanges of intangible or personal property, it will only apply to real property. Real property must be held in as an investment or for productive use in a business or trade if it is to qualify as a like-kind exchange. See the IRS document Like-Kind Exchanges – Real Estate Tax Tips for more information.