WHAT TAX REFORM MEANS FOR FRANCHISEES

THE BOTTOM LINE

These are the highlights of the tax law changes that will have an impact on your future. With so many changes, tax planning is now more important than ever.

The most sweeping tax legislation since 1986 was signed into law in December of 2017. Changes in both business and individual taxation will impact most taxpayers in 2018 and beyond creating opportunities to reduce taxes significantly. With proper planning, these tax savings can create more wealth for business owners and make growth more feasible due to more available cash flow. Having advisors who understand the new legislation and how to navigate it for best results will be crucial to reaping all of the available benefits.

Business provisions include both rate reductions and income deductions depending on how your business is structured. C-corporations will now pay a flat 21% on profits compared to marginal rates in 2017 as high as 38%. However, most small businesses, including most franchisees, operate as "pass through" entities – meaning their income flows to the individual owners and the tax is paid at the individual level. In order to provide benefits to these "pass through" entities, a new "pass through" deduction has been created for S-corporations, partnerships and sole proprietorships. While entity selection is not as cut and dry going forward, C-corporations will continue to have double taxation issues and "pass through" entities will continue to be popular options.

The new IRS code section 199A deduction, or "pass through" deduction, is probably the single largest benefit in the new tax legislation for franchisees. This code section allows individuals to deduct up to 20% of domestic qualified business income from partnerships, S-corporations, or sole proprietorships with certain conditions and limitations. The deduction makes a distinction between qualified businesses and specified service trades or businesses. Specified service trades or businesses are businesses involving the performance of services in the fields of health, law, accounting, consulting, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees. Qualified businesses are businesses that are not service trades or businesses.

Specified service trades or businesses can still qualify for the deduction, but there are income limitations which phase out the deductions available to this group. Qualified businesses must meet some additional conditions beyond these income limitations, specifically, the deduction is limited to the higher of 50% of wages or 25% of wages plus 2.5 % of unadjusted basis in qualified property. Because many franchise brands rely heavily on labor to accomplish their mission, they will often still qualify for the deduction at even the highest income levels.

Depreciation is another area changing in a big way. Bonus depreciation is increased to 100% beginning September 27th, 2017 through 2022, and is now available on used assets as well as new – as long as they are new to you. Section 179 depreciation has also been enhanced. These increased depreciation deductions mean immediate savings (and increased cash flow) to you in years where you expand or grow your business through asset acquisitions.

Like kind exchanges under code section 1031 are now limited to exchanges of real estate. Trades of personal property where you were allowed to defer gain (for example – trades of vehicles) will now trigger recognizable gain.

Interest expense limitations now apply for businesses with gross receipts over $25 million. These limits limit the deduction to 30% of adjusted taxable income at the entity level. For tax years 2018-2021, adjusted taxable income equals income before interest, taxes, depreciation, and amortization (EBITDA). After 2021, adjusted taxable income equals earnings before interest and taxes (EBIT). Any disallowed interest generally may be carried forward indefinitely.

Net operating loss rules have also changed. The losses are now limited to 80% of taxable income for losses arising in years beginning after December 31, 2017 for business losses. Net operating loss carry backs for losses arising in years ending after December 31, 2017 are eliminated and carry forwards are allowed indefinitely.

Individual provisions include changes in tax rates and brackets. The top rate is reduced from 39.6% to 35%. The tax brackets have also expanded so that more income is subjected to the lower rates. These lower rates combine with the business deductions to provide significant savings for many taxpayers.

Personal exemptions for taxpayers/spouses/dependents are repealed; however, the standard deduction is increased to $24,000 for married filing joint, $18,000 for head of household and $12,000 for single filers. Child tax credits are increased from $1,000 to $2,000 per child under 17 with the first $1,400 refundable. Phase out begins at adjusted gross income levels of $400K for married filing joint and $200K for other taxpayers.

Property tax deductions combined with state and local income tax deductions and sales tax deductions are now limited to $10,000 in total for those taxpayers who still itemize on schedule A.

CONNECT WITH US TO GET STARTED.

These are the highlights of the tax law changes that will have an impact on your future – there are many more provisions and details that may or may not apply to your tax situation. With so many changes, tax planning is now more important than ever. We would love to have the opportunity to help you save your hard earned dollars!