Tax Law Alert

Tax Cuts and Jobs Act:

Every Business Has Important Choices to Make

By the Tax Law Practice Group

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Businesses should promptly and carefully consider the effects of the Tax Cuts and Jobs Act, enacted December 22, 2017 (the "Act"), on how they are organized and classified for federal tax purposes.

The Act made extremely important and history-making changes in federal tax law. The changes can result in substantial tax savings for many businesses and owners of them.

The Act changed the federal income tax rate on taxable income of corporations from a maximum rate of 35% in 2017, to a *flat rate of 21%* in 2018 and later years.

The Act changed the Internal Revenue Code by adding Section 199A to allow owners of a pass-through entity, such as partnerships, LLCs, S corporations and sole proprietors, a *deduction of up to 20% of the qualified business income ("QBI")* of the entity. The deduction will be allowed in 2018 through 2025. It can reduce the effective tax rate for an owner of a qualifying business by as much as 7.4% every year, *e.g.* from up to 37% down to 29.6%. The provisions of Section 199A are complex and include requirements and exceptions that may limit qualification for the deduction.

The size of this corporate income tax rate reduction, from 35% to 21%, and the allowance of the new and extremely generous 20% QBI pass-through entity deduction, makes it advisable that every business and its owners learn as much as possible about how the Act affects the business and owners, and if any steps should be taken to get the very best result possible. The Internal Revenue Service is expected to publish regulations interpreting Section 199A and the new 20% QBI deduction for pass-through entities that will need to be considered.

The potentially huge year-after-year financial impact of these changes means almost every new and existing business should consider obtaining legal advice about correct interpretation and the meaning of the Act and its specific effect on the business entity and its owners in 2018 and in the future.

Key tax-saving legal questions that should be addressed include:

1. New Business, Pass-Through Entity. If you are starting a new business, can the owner(s) qualify for the 20% QBI deduction by being organized and classified as a pass-through entity?

2. New Business; Corporation. If you are starting a new business, would being formed and classified as a corporation for federal tax purposes to take full advantage of the flat 21% tax rate on corporate income be the most advantageous choice?

3. Existing Business; Pass-Through Entity. If you are an existing business presently organized and classified as a pass-through entity, will the owner(s) qualify for the 20% QBI deduction? And if not, what steps, if any, can be taken to qualify for the deduction? Should the business change to be organized and classified as a corporation to be taxed at the low 21% rate?

4. Existing Business; Corporation. If you are an existing business presently organized and classified as a corporation, should you consider changing the classification of the business to a pass-through entity, and would owner(s) then qualify for the 20% QBI deduction? Are there other significant tax advantages of being a pass-through entity that do not presently apply to the business as a corporation? Would there be any disadvantages or adverse tax consequences from making the change?

GableGotwals is able to answer these very important tax questions about the effects of the Act for you and your business.

Please contact any attorney of GableGotwals you know or our Tax Law Practice Group.

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