Tax Reform's Effects on Trucking and Transportation Companies

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Speaker Introductions

Andrew Bollman, CPA

Serves clients in the trucking and transportation industry group on a firmwide basis. Andy has assisted trucking companies of all sizes with financial and tax planning for the company and its owners, and other industry-specific tax, accounting, and consulting matters.

Chastity Wilson, J.D., L.L.M., CPA

Chastity is a Principal and the National Tax Office Leader at CLA. Chastity has extensive experience dealing with all facets of the IRS including exam and appeals representation, responding to IRS notices, and resolving IRA accounting issues.

Learning Objectives

- At the end of this session, you will be able to:
  - Identify the tax advantages of different entity structures
  - Evaluate per diem plans in light of the new law
  - Gain an awareness of the overall impact on your company, including accounting methods, fixed asset depreciation, employee expenses, and more
  - Consider strategies for complying with and benefiting from the law's provisions

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Tax Cuts and Jobs Act (TCJA)

Key Aspect Comparison: *Tax Rates*

Comparison of MFJ Rates: Prior 2018 Rates vs. TCJA

Income range	Scheduled 2018 rate	TCJA
$1 to $19,050	10%	10%
$19,051 to $77,400	15%	12%
$77,401 to $156,150	25%	22%
$156,150 to $165,000	28%	22%
$165,001 to $237,950	28%	24%
$237,951 to $315,000	33%	24%
$315,001 to $400,000	33%	32%
$400,001 to $424,950	33%	35%
$424,950 to $480,050	35%	35%
$480,051 to $600,000	39.6%	35%
Over $600,000	39.6%	37%

CAUTION: Taxable income measures differ; child credit rather than dependency exemption but with age differences.

Corporate Tax Rates

2017 Corporate Tax Rates (Graduated)	
Tax bracket	Taxable income
15%	50,000
25%	75,000
34%	100,000
39%	335,000
34%	10,000,000
35%	15,000000
38%	18,333,333
35%	**EXCESS**
Corporate AMT Tax Rate = 20%	

Corporate Tax Rate Under TCJA:

- **Flat 21% Rate, effective for tax years beginning after December 31, 2017***
- **20% Corporate AMT Repealed** *(Prior Alternative Minimum Tax (AMT) Credits refundable up to 50% of excess AMT credits > regular tax liability for 2018 – 2020; Remaining AMT credit refunded in 2021)*

*Blended tax rate for corporations with fiscal years beginning before 12/31/2017

Capital Gains Tax Rates

2017 Capital Gains Tax Rates (Pre-TCJA)				
Tax Bracket	Single	MFJ	H of H	Estates & Trusts
0%	37,950	75,900	50,800	2,550
15%	418,400	470,700	444,550	12,500
20%	**EXCESS**			

2018 – 2025* Capital Gains Tax Rates (Under TCJA)				
Tax Bracket	Single	MFJ	H of H	Estates & Trusts
0%	38,600	77,200	51,700	2,600
15%	425,800	479,000	452,400	12,700
20%	**EXCESS**			

- **TCJA generally retains prior law tax rates and breakpoints on capital gains and qualified dividends**
- **Ordinary income fills lower brackets first, then capital gains.**
  - *Deductions offset ordinary income*

Discussion of Entity Structure

- Individual rate structure
  - Maximum 37%
  - Business maximum 29.6% to 37% depending upon limitations
  - AMT
- Domestic
  - C corporation @ 21%, no AMT
  - S corporation (existing rules modified for business interest)
  - Partnership (existing rules modified for business interest)

Section 199A

Deduction for Qualified Business Income

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Basics of 199A, Deduction for Qualified Business Income

- 20% deduction for non-wage portion of pass-through business income
  - Includes sole proprietorships in "pass-through"
- Does not include wages
  - Not S corporation shareholder wages
  - Not guaranteed payments paid to partner
- Excludes personal service businesses
  - Health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, "any other trade or business where the principal asset … is the reputation or skill of one or more of its employees"
  - Personal service does not include architects, engineers

Lower Income Taxpayers

- All businesses (including personal service businesses) below taxable income threshold allowed the deduction
- Tentative taxable income threshold
  - < $315,000 jt./$157,500 single
- Net all business activity
  - Multiply by 20%
  - Subject to overall limitation of 20% of ordinary taxable income

Taxable Income Above Threshold

- Proprietor, partner or S shareholder limit on deduction, greater of:
  - 50% of wages expense from pass-throughs, or
  - Sum of 25% of wages plus 2.5% of *unadjusted basis* of qualified property
- Threshold reminder
  - < $315,000 jt./$157,500 single
  - Phase-out 20% over next $100K/$50K of taxable income

Limitations Applied

- W-2 subject to payroll taxes
  - Includes S corporation shareholder wages
  - Common law employees (Reg. 1.199-2(a)(2))?
- Qualified property
  - Depreciable tangible property on hand at end of year
  - Included in computation if held at least 10 years or cost recovery period has not expired, whichever is longer
  - Bonus depreciation does not affect the recovery period

Business-by-Business Computation

- Define "business"
  - Legal entity?
- Business-by-business computation of 20% deduction for high income taxpayers
  - Apply wages and investment limitation to each business
  - Netting of Qualified Business Income Amount (QBIA) after each business's limitation has been computed
  - Netting of negative QBIA against positives
- Overall business loss
  - Taint on next year's qualified business income

Multiple Businesses, Overall Limit

- Add together:
  - QBIA from trades or businesses plus
  - 20% of qualified REIT dividends plus
  - 20% of qualified publicly traded partnership income
- Deduction for the sum of the above is limited to
  - 20% of taxable income after subtracting net capital gain (i.e., income which is taxed using long-term capital gain rates)

Aggregation

- An individual **may** aggregate multiple trades or businesses to treat as a single trade or business for purposes of the limitations applied to the taxpayer over the taxable income threshold.
  - Each trade of business to be aggregated must itself be a "trade or business"
  - Same person or group or persons must own a majority interest in each business for a majority of the year
  - None of the aggregated businesses can be a SSTB
  - Individuals and trusts must establish they meet at least 2 of the 3 factors to demonstrate the businesses are part of a larger integrated trade or business.

Key Business Provisions

Cost recovery

Business interest expense

Losses and limitations

Methods of accounting

Bonus Depreciation

- 100% Bonus Depreciation – Allows immediate write-off of qualified property placed in service after 9/27/17 and before 2023
  – Phases-down starting in 2023 by 20 percentage points for each of the five following years (80% in 2023, 60% in 2024, 40% in 2025, 20% in 2026 and fully phased out in 2027)
  – Eliminates original use requirement, which means that **used** assets qualify for 100% bonus depreciation
  – More pressure from buyers to structure acquisitions as asset (or deemed asset) acquisitions

Section 179 Expensing

- Increased to $1 million (from $510,000)
- Phase-out threshold increased to $2.5 million
  - Dollar for dollar reduction
- Eligibility expanded to include roofs, HVAC and fire alarm/security systems
- Effective for tax years beginning after 12/31/2017

Qualified Improvement Property

- Eliminates separate definitions of 15 year property
  - Qualified leasehold improvement property
  - Qualified restaurant property
  - Qualified retail improvement property
- Focus is on qualified improvement property
  - Improvements to interior portion of building
  - Nonresidential
  - Placed in service after date building placed in service
- Technical correction needed
  - QIP is currently 39 year property

Luxury Automobile Limitation

- Maximum depreciation for passenger autos increased from $3,160 to $10,000
- Claiming bonus depreciation adds another $8,000 to the first year maximum
- “Luxury” is more than $50,000 and less than 6,000 pounds in general

Year	Depreciation Cap (Pre-TCJA)	Depreciation Cap (Under TCJA)
1	3,160	10,000
2	5,100	16,000
3	3,050	9,600
4+	1,875	5,760
Bonus Depreciation	11,160	18,000

§1031: Like-Kind Exchanges

- 1031 Like-Kind Exchange **(Pre-TCJA)**
  - Tax-deferred exchange of like-kind property held for productive use in a business or property held for investment
  - Applies to both real estate and tangible personal property
- **1031 Like-Kind Exchange (Under TCJA)**
  - Applies to real property only
    - ➢ *<u>LKE of tangible personal property (Tractors/Trailers/Buses/Airplanes) taxable</u>*

**Commentary: provision should have little tax consequence due to 100% bonus depreciation (through 2022) and expanded §179 deduction.*

Meals and Entertainment

- Entertainment expense: Non-deductible!
  - Transportation passes and parking fringes disallowed
  - Social, athletic and sporting clubs treated as entertainment
- Employer-provided eating facility limited to 50%
  - Pre-TCJA: 100% Deductible
- Meals consumed on work travel remain 50% deductible
- Holiday parties for employees are still 100% deductible
- Business meals
  - Regulations might treat as nondeductible entertainment
- Per Diems: no change on the business level

Disallowed Business Interest Expense

- Pre-TCJA: Business interest generally allowed as a deduction
- Under TCJA: Interest expense limited to interest income + 30% of remaining adjusted taxable income
  - Remaining business adjusted taxable income
    - Determined w/o interest income, NOL, 199A, depreciation, amortization, depletion
    - Determined at tax filer level (1065, 1120-S, 1120)
  - Excess carried forward indefinitely
  - *Businesses with <$25M average annual gross receipts exempt*
  - Determined at the entity level
  - After 2021, depreciation etc. not added back

Limitation on Excess Business Losses

- Non-corporations only
- Net business loss limited to $500K jt./$250K single
- Applied at 1040 level
- Excess is treated as NOL c/o

Net Operating Losses

- Limits NOLs to 80% of taxable income for losses arising in tax years beginning after 2017
- Repeals carryback provisions for years ending in 2018 and forward
  - Allows NOLs to be carried forward indefinitely
  - *Pre-2018 NOLS retain 20-year carryover restriction*
- Two-year carryback allowed for farm losses

Business Credits

- **Retained:**
  - Employer-Provided Child Care Credit
  - Research & Development Credit
  - 20% Credit for Rehab of Certified Historic Structure
  - Work Opportunity Tax Credit (WOTC)
  - New Markets Tax Credit
  - Investment in Qualified Community Development
  - Disabled Access Credit
  - Employer Tip Credit
- Modified:
  - Orphan Drug Credit – Modified from 50% to 25% of qualified clinical testing expenses
- Repealed:
  - 10% credit for qualified rehabilitation expenditures with respect to pre-1936 buildings

Expansion of Cash Method of Accounting

- All businesses with average gross receipts < $25 million permitted to use cash method
  - But account for inventories as non-incidental supplies (hold cost until sold)
  - Exempt 263A (UNICAP), including real estate construction
  - May use completed contract method if < 2 years
  - Automatic consent accounting method change

Entity Selection

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Overview: C Corporations

	Prior Tax Law	Tax Reform
C Corporation Tax Rate	Maximum rate of 35%	Flat rate of 21%
Corporate AMT	20% Corporate AMT rate	Corporate AMT repealed
NOL Period	2 year carryback, 20 year carryforward	No carryback, unlimited carryforward
NOLs to Use	100% of Taxable Income, AMT may apply	80% of Taxable Income
Cash Basis of Accounting	< $5 million in gross receipts	<$25 million in gross receipts
Tax on dividends paid	Taxed at capital gains rates, Max of 23.8%	Taxed at capital gains rates, Max of 23.8%

Overview: Pass-Through Entities

	Prior Tax Law	Tax Reform
Pass-Through Taxes	Taxed at individual shareholder/partner tax rates	Taxed at individual shareholder/partner tax rates, Deduction of 20% of qualified domestic income. Limited to 50% of W2 wages.
Maximum Federal Tax Rate	39.60% (Plus 3.8% NIIT for Passive SHs)	37% (Plus 3.8% NIIT for Passive SHs)
Maximum Tax Rate Applies	Single >$418,400 Married >$470,700	Single >$500,000 Married >$600,000
Standard Deduction	Single = $6,350 Married = $12,700	Single = $12,000 Married = $24,000
Personal Exemption	$4,050 per person	Eliminated

C vs S Example 1

	Double taxation		S Corp. Taxation of Marginal Earnings	
	1120	1040	N/A	1040
Year 1				
Net Income (after W-2 wages and rent)	$1.00		Net Income (after W-2 wages and rent)	$1.00
Corporate Tax	(.21)		Less top 1040 rate (37%) after 20% deduction (29.6%)	(.296)
Net after-tax cash in corporation	$.79		Net after-tax cash to shareholder	$.704

This example assumes no distributions or dividends come out of the company, and earnings are reinvested into the company.

C vs S Example 1

	Double taxation		S Corp. Taxation of Marginal Earnings	
	1120	1040	N/A	1040
Year 2				
Redemption or dividend to shareholder		$.79		
Less: 23.8% LTCG/dividend		(.19)		
Net After-tax cash to shareholder		$.60	Net after-tax cash to shareholder (from previous slide)	$.704

This example assumes the remaining earnings after taxes are distributed to the shareholders.

Comparison of Corporate and Pass-Through Rates

	C corporation	Pass-through (Active)	Pass-through (Passive)
Taxable income	$100.00	$100.00	$100.00
Entity level tax	($21.00)	($0.00)	($0.00)
Net distribution	$79.00	$100.00	$100.00
20% deduction		($20.00)	($20.00)
Individual tax	($18.80)	($29.60)	($33.40)
After-tax cash	$60.20	$70.40	$66.60
Effective tax rate	39.8%	29.6%	33.4%

Traps for the Unwary in Switching to C Corporation

- How long 21% rate will last
- Accumulated earnings tax
- Conversion back from C corporation to partnership subject to double tax

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Accounting Method Changes

Accounting Methods

- Cash Method of Accounting (Pre-TCJA)
  - C corporations and partnerships with C corporations as a partner with gross receipts < $5M.
  - Small businesses with gross receipts < $1M
  - Certain industries with gross receipts < $10M
  - Inventory costs may not be deducted until sold
  - Certain industries without inventory (such as transportation companies)
- Cash Method of Accounting (Under TCJA)
  - Permitted for all businesses with average annual gross receipts < $25M
  - Inventory accounted for as non-incidental supplies (i.e. hold cost until sold) or by conforming to method reflected on financial statements
  - *Automatic Consent Accounting Method Change*

Changing to the overall cash method

- Filing an automatic accounting method change
  - DCN #32 – overall cash method (under $1 million)
  - DCN #33 – overall cash method (between $1–10 million of average annual gross receipts)
  - DCN #126 – overall cash method (between $10–50 million of average annual gross receipts)
    - This is for transportation companies ONLY
- Creating a new entity (holding company for example)
  - New entities get to make new elections

Example – Accrual to Cash Impact

ABC Trucking Company		
Assets	**12/31/2016**	**12/31/2017**
Cash	31,000	74,000
Accounts Receivable, Net	**736,000**	**789,000**
Inventory – Materials and Supplies	100,000	91,000
Prepaid Expenses	**75,000**	**71,000**
Property, Plant, and Equipment, Net	2,450,000	2,800,000
Total Assets	**$3,392,000**	**$3,825,000**
Liabilities and Equity		
Accounts Payable	**303,000**	**268,000**
Mortgage Payable	1,290,000	1,170,000
Accrued Payroll	**150,000**	**170,000**
Customer Deposits	300,000	290,000
Capital Stock	200,000	200,000
Retained Earnings	1,149,000	1,727,000
Total Liabilities and Equity	**$3,392,000**	**$3,825,000**
***No prepaid election was previously made		

Example – Accrual to Cash Impact

§481(a) Calculation	
Deduct Assets:	
Accounts Receivable, Net	(736,000)
Prepaid Expenses	(75,000)
Addback Accrued Liabilities:	
Accounts Payable	303,000
Accrued Payroll	150,000
Net §481(a) adjustment	**(358,000)**

Since the §481(a) adjustment is negative, it can be taken in 2017 (a 3115 would be required to be filed)

Example – Accrual to Cash Impact

This example would result in a deduction of $422,000 in 2017 for the client

- *$358k in §481(a) adjustment and $64k deduction in CY Accrual to Cash adjustment*
- *A second 3115 would be required to make the prepaid election since it is not already in place in this example.*

Current Year Accrual to Cash Calculation	
Plus PY Receivables:	
Accounts Receivable, Net	736,000
Prepaid Expenses	75,000
Plus CY Payables:	
Accounts Payable	268,000
Accrued Payroll	170,000
Less CY Receivables:	
Accounts Receivable, Net	(789,000)
Prepaid Expenses	(71,000)
Less PY Payables:	
Accounts Payable	(303,000)
Accrued Payroll	(150,000)
CY Accrual to Cash adjustment	**(64,000)**

Cost Segregation Benefits

- Purchases of property
  - Shorter lives, bonus depreciation
- Section 179D energy efficient buildings
- Great opportunity for trucking companies
  - Additional concrete used on the floor
  - Specialty plumbing with shops and wash bays
  - Equipment like cranes or lifts

Accounting Methods – Cost Segregation

Cost Segregation Analysis – 2017 vs. 2018 Benefit				
Tax Year	481(a) Adjustment	Total Additional Current Year Tax Deduction	Tax Rate	Additional Current Year Cash Flow
2017	$236,486	$242,823	X 40%	= $97,129
2018	$236,486	$242,823	X 26%	= $63,134

Key Individual Provisions

Individual Tax Deductions

Tax Bracket	Pre-TCJA	Under TCJA
Standard Deduction	Single: 6,350 MFJ: 12,700 HoH: 9,350	Single: 12,000 MFJ: 24,000 HoH: 18,000
Personal Exemption	$4,050 per Individual **Subject to AGI Phase-out*	*Repealed*
Mortgage Interest	Debt Limit: $1.1M 2nd Home Allowed: Yes Home Equity Interest Allowed: Yes	Debt Limit: $750,000 2nd Home Allowed: Yes Home Equity Interest Allowed: No
Taxes	<u>Itemized Deduction Allowed for:</u> • Real Estate Tax (U.S. Property Only) • Personal Property Tax • State/Local Income Tax (or sales tax) **Subject to AGI Phase-out*	Itemized Deduction **Limited to $10,000** for the *Aggregate* of State & Local Property and Income Taxes
Charitable Deductions	Limited to 50% AGI	Limited to 60% AGI **80% Deduction for Athletic Tickets Repealed*
Miscellaneous Deductions	Itemized Deduction Subject to 2% AGI Floor (includes employee business expense [DRIVER PER DIEMS], investment expenses, tax prep fees, professional dues, etc.)	*Repealed*
Medical Expenses	Subject to 10% AGI Floor	Subject to 7.5% AGI Floor **Retroactive to 2017*
AGI Phase-out	Phase-out begins at $313,800 (MFJ)	*Repealed*

Standard Deduction and Personal Exemptions

- Standard deductions almost doubled
  - MFJ = $24,000
  - MFS = $12,000
  - Single = $12,000
  - H of H = $18,000
- Personal exemptions were repealed

Standard Deduction – Example

- Matthew and Lisa file a joint return and expect to have the following expenses for 2018 and 2019:

	2018	2019
State income taxes	5,000	5,000
Real property taxes	3,000	3,000
Mortgage interest	10,000	10,000
Charitable contributions	6,000	6,000
Total itemized deductions	24,000	24,000
Standard deduction	24,000	24,000
Benefit from itemizing	None	None

Standard Deduction - Example

- Matthew and Lisa talk with their CPA and adopt a bunching strategy, altering the timing of the payments:

	2018	2019
State income taxes	5,000	5,000
Real property taxes	4,500	1,500
Mortgage interest	10,000	10,000
Charitable contributions	12,000	0
Total itemized deductions	31,500	16,500
Standard deduction	24,000	24,000
Benefit from itemizing	7,500	None

Home Mortgage Interest

- Residential acquisition debt: grandfathered if incurred prior to 12-15-17
  - Home acquisition debt limit of $1,100,000 before
- For new debt incurred after 12-14-17:
  - Home acquisition debt limit of $750,000 ($375,000 MFS)
  - Retains provisions for second home
- Repeal home equity interest starting in 2018
- Acquisition debt: incurred to acquire, build, or substantially improve a residence

SALT Deduction Limitation

- Itemized deduction for taxes limited to $10k ($5k MFS)
  - State and local income tax (or sales tax)
  - U.S. real property tax,
  - U.S. personal property tax
- Applies to trusts and estates as well

Other Itemized Deductions

- Charitable contributions
  - Now limited to 60% of AGI
- Medical expenses
  - Subject to 7.5% AGI floor in 2018, 10% in 2019
- Miscellaneous deductions subject to 2%
  - REPEALED
  - Included things like unreimbursed employee expense, professional dues, tax prep fees, investment fees/expenses
  - This includes driver per diems (if a company driver was not getting per diems from their employer)

Planning Opportunities

- "Bunching" itemized deductions into one year can maximize benefit from itemized deductions
  - Prepay property tax (subject to AMT and SALT limit)
  - Make charitable contributions in one year rather than over time
    - ◊ Donor advised fund?
  - If possible time medical, dental, and vision costs to occur in same year
- Phase out on itemized deductions repealed

Other Individual Provisions

- Child Tax Credit Increased from $1,000 to $2,000
- American Opportunity Tax Credit <u>Retained</u>
- Alimony changes:
  - No longer deductible by payor
  - No longer included in income by payee
  - Applies to divorce/separation agreements executed after 12/31/2018
- Exclusion for Moving Expense Reimbursements Suspended Until 2026
  - Does not apply to members of the Armed Forces on active duty who moved pursuant to military order
  - *Moving Expense Deduction – <u>Suspended Until 2026</u>*
- Individual Mandate Under ACA <u>Repealed</u>
- Individual AMT Retained – Exemptions Increased

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Other Trucking Topics

Driver Per Diems

- Three ways to pay per diem:
  1. Common carrier pays a company driver per diem = 80% deduction for Carrier
  2. Common carrier DOES NOT pay a company driver per diem = driver claims (typically $63 per day) on Sch A, subject to 2% of AGI
  3. Independent contractor or owner operator = claims (typically $63 per day) as a business expense
- New tax bill changes:
  - No affect on #1 or #3 scenarios, only #2 scenario
    - ◊ Schedule A deduction will no longer be available

Per Diems for Drivers

- No change on the corporate side
  - Companies are still allowed to pay drivers per diems
  - Companies still get a 80% tax deduction for per diems paid
- Is your company maximizing the per diems paid to drivers?

Nexus – State Income/Franchise Tax

- General Standard is substantial presence
- De minimis threshold - MTC rule
  - Companies must meet all five of the following criteria:
    - ◊ Does not own/rent any real or tangible personal property in the state, other than mobile property
    - ◊ Does not make any pick-ups or deliveries in the state
    - ◊ Does not travel more than 25,000 miles in the state
    - ◊ Does not travel more than 3% of total miles in the state
    - ◊ Does not make more than twelve trips into the state

Nexus – State Income/Franchise Tax

- Ways to get compliant with state taxes
  - Just start filing
    - ◊ Still has past exposure as statute of limitations hasn't started
  - Voluntary disclosure agreements
    - ◊ File a certain number of years returns
    - ◊ State typically agrees to waive penalties and not go after past exposure
    - ◊ Typically still subject to tax and interest
  - Create a new holding company
    - ◊ Filing in states in the first year
    - ◊ Still has some past exposure but harder for states to find

Federal Fuel Tax Refunds

- Common fuel tax credits
  - Refrigerated units
  - APU units (prorated as no separate tank)
  - Propane used in forklifts
  - Non-propulsion motors
- Federal refunds
  - 24.3 cents for diesel
  - 50 cents for propane
- State refunds opportunities vary

Reverse Sales Tax Audits

- This is where someone comes in and audits your company to look for refund opportunities
- Most states have some sort of exemptions for transportation companies (repair parts, truck/trailer purchases, etc.)

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Questions?

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