MHCS

THE TAX ROUTE

financial information for the long haul

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About MHCS

At MHCS, we are dedicated CPAs and Business Advisors that love nothing more than to see you succeed. We work with you to gain a deeper understanding of your current landscape and discover your short and long-term goals. We are thrilled to be your trusted advisor, offering a complete range of services including audit and assurance, tax and accounting, business advisory services, client accounting services, consulting, and financial planning to meet your unique, diversified, and sophisticated needs. We have a passionate commitment to responsive, personal service, and this is reflected in everything that we do for you.

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Our Transportation Team

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Dan joined the firm in October 1990. In addition to his daily client and firm responsibilities, Dan leads the firm's transportation market and specializes in business valuation, consulting and tax services. He is originally from Maynard, IA, and attended Hawkeye Institute of Technology, where he received his associate of applied science degree. Dan holds board of director positions with the Iowa Motor Truck Association Allied Division and the Blank Park Zoo and is a member of the American Institute of Certified Public Accounts and the Iowa Society of Certified Public Accountants. DSchwarz@MHCScpa.com

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Jenny joined MHCS in November 2009. Jenny specializes in closely-held businesses such as manufacturers, distributors, construction, and transportation. She also works with employee benefit plans, not-for-profits, and performs fraud services. Jenny is originally from Oskaloosa, Iowa and received her bachelor's degree from Iowa State University. Jenny is a board member at Hawthorn Hill and Bidwell Riverside center and is a member of Iowa Society of CPAs, American Institute of CPAs, and the Association of Certified Fraud Examiners. She is also a member of Lead like a Lady, is a 2016 graduate of the West Des Moines Leadership Academy, and a 2016 Business Record Forty Under 40 honoree. JLSmith@MHCScpa.com

ASHLEY SLY, CPA | MANAGER

Ashley joined the firm in September 2013. Ashley focuses on tax preparation and strategic planning for transportation and manufacturing clients. She also specializes in multi-state taxes and property, plant and equipment issues. Ashley grew up in Round Lake, Minnesota and received her Bachelor of Arts with a double major in Accounting and Finance at Buena Vista University. Ashley is an active member of the community through her membership with the Iowa Society of CPAs, Iowa Association of Business and Industry (ABI), and being Treasurer on the West Des Moines Library Friends Foundation Board. ASly@MHCScpa.com

LIZ KRAUSE, CPA | SUPERVISOR

Liz joined the firm in June 2016. Liz specializes in tax for closely held businesses, as well as state and local tax issues. She is originally from Carroll, Iowa, and attended Creighton University, where she received bachelor degrees in accounting and financial planning. Liz is a member of the American Institute of CPAs, the Iowa Society of CPAs, and CPAmerica International. She is involved with the Johnston Chamber of Commerce and firm-wide community and service events. LKrause@MHCScpa.com

Tax Cuts and Jobs Act Update by Ashley Sly

New Opportunities and Strategies

The Tax Cuts and Jobs Act (TCJA), the tax reform bill passed in late 2017, significantly changed tax planning strategies for entities. Some of the major changes allow entities the opportunity to take additional deductions to reduce taxable income in a given year. However, due to some other changes, entities need to not only think about the impact on the current year taxable income but how these changes may impact future years. Below we discuss some of these major changes and the future considerations that need to be made.

Section 179

Section 179 is the ability to deduct 100% of tangible and some intangible assets in the year placed in service. The TCJA increased the deduction amount allowed under Section 179 to $1 million of deduction for up to $2.5 million of fixed assets purchased. Section 179 allows a taxpayer to strategically reduce taxable income on an asset-by-asset basis and allows for some flexibility if perhaps a taxpayer is trying to fall within a specific taxable income range or maximize their qualified business income deduction (QBID). Section 179 is only allowed when there is taxable income, so it cannot be used when there is a taxable loss or to create a taxable loss. Since Section 179 deducts an assets entire cost in one year, it reduces deductions in future years since the asset is not being depreciated over several years.

Bonus Depreciation

The TCJA increased bonus depreciation from a 50% deduction to a 100% deduction of the purchase price in 2018 with the ability to now fully depreciation both new and used tangible property with a depreciable life of 20 years or less. Bonus depreciation is applied on an asset-class-by-asset-class basis, meaning assets with the same depreciable life placed in service during the year must apply the bonus depreciation election unless the taxpayer elects out for all property or a specific asset class. Bonus depreciation can be used to create a taxable loss, however pass-through entities should strategize to try not to use these deductions against lower-tax bracket incomes. This gives the taxpayer an opportunity to use part of the depreciable deduction in future years when the taxpayer may be in a higher income bracket. The new bonus depreciation rules increase the benefit of a cost segregation study when a building or terminal is placed into service. A cost segregation study breaks down a building that would normally be depreciated at 39 years and segregates out 5, 7, and 15-year property from the building's structure. These assets with shorter lives can then utilize bonus depreciation allowing an entity to utilize deductions sooner rather than spreading it out over 39 years.

Since not all states, including Iowa, coupled with the bonus depreciation rules, it is also important to consider the state taxable income for both the current year and future years. When bonus depreciation is utilized for federal purposes in the year placed in service there is an addback adjustment for state taxable income since more expense was taken for Federal purposes than what is allowed for state purposes. However, in future years this state adjustment shifts to an additional deduction on the state return since all the deduction on the federal return was utilized in one year.

Tax Cuts and Jobs Act Update by Ashley Sly Continued

Method Changes

The TCJA changed the definition of a small business from an entity who generates average gross receipts of $5 million or less to one who generates average gross receipts of $25 million or less. In addition, the TCJA also allows these small businesses to make accounting method changes to simplify their accounting for tax purposes. Of the accounting method changes available, two may have a significant impact on transportation companies. First, the TCJA allows for small businesses to make an accounting method change from the accrual method of accounting to the cash method. Cash method accounting is often easier and cheaper to implement and maintain compared to the accrual method and it allows for greater flexibility to control the timing of income and deductions. However, the accrual method does provide a more accurate picture of financial performance since it requires income and expenses to be matched. The second accounting method that may be beneficial to transportation companies is the exemption from accounting for inventories. Instead of tracking inventory, a company would instead treat inventory as nonincidental materials and supplies and deduct when consumed. Transportation companies who are tracking small parts and equipment kept on hand for repairs may especially find this accounting method change beneficial since it is easier to implement than tracking inventory and allows for a deduction at the time of purchase. The year this accounting method change is made allows for an entity to take its entire inventory balance as a deduction, which may significantly decrease taxable income.

Net Operating Losses (NOLs)

Treatment of net operating losses (NOLs) also changed as a result of the TCJA. For tax years beginning on or before December 31, 2017, entities were allowed to carryback an NOL to the two proceeding tax years and then carryforward the remaining amount for the next 20 years. The NOL was eligible to offset up to 100% of regular taxable income. However, now for tax years beginning after December 31, 2017, the NOL can only be carried forward for an indefinite period of time and can only be applied against 80% of taxable income. Due to the 80% limitation, taxpayers may find in future profitable years paying income tax even though they have an NOL from prior years. Taxpayers need to take into consideration the new treatment of NOLs as they consider bonus depreciation and accounting method changes that may generate an NOL.

Interest Expense Deduction Limitation

Historically, business interest has been deductible in the year paid or accrued. Under the TCJA, the deductibility of business interest is now limited to 30% of a taxpayer's adjusted taxable income. Business interest expense is netted against business interest income to determine the net expense. Any amount of business interest expense exceeding 30% of the adjusted taxable income is carried forward indefinitely to future years until it can be utilized. If an entity's adjusted taxable income is $1,000,000 and interest expense is $400,000, the entity can only take $300,000 of interest expense in the current year. The remaining $100,000 is carried forward to the next year. This limitation needs to be considered when entities are considering loans and financing options.

The TCJA created a number of changes to the tax code. While these changes may have a positive impact on businesses in the current tax year, it is important to plan ahead to determine the impact these changes may have on future years. We would be happy to discuss how any of the above changes may impact your company's taxes whether for the 2018 tax year or for future years.

Qualified Business Income and Self-Rentals by Liz Krause

Oftentimes, taxpayers choose to own their real estate and operating companies in separate companies for a multitude of reasons. They then rent the real estate to the operating company and charge rent which is reported on their personal return. The operating company would report rent expense on their business return (Form 1065, 1120S, or 1120).

With the passage of the TCJA in December of 2017, a new question arose: does the income generated on the rental quality for the 20% pass-through deduction? As with most answers to tax questions, the answer depends. The first test that must be met is the operating company has to be a trade or business under a specific code section of the Internal Revenue Code. Basically, the activity has to be regular and continuous, and the activity must have a profit motive. Most operating companies should meet that test with no problem.

The next test that must be met deals with how the operating company is taxed. If it's a partnership (Form 1065) or S-corporation (Form 1120S), then the self-rental takes on the character of the business. For example, if the operating company is a brokerage firm who rents a building from the owners, the rental is considered a brokerage company. This means that the income from the self-rental is eligible for the 20% pass-through deduction subject to the various phase-outs and taxable income limitations.

What happens if it's a self-rental to a C-corporation (Form 1120)? For this circumstance, the rental does not take on the character of the business and is a standalone business. We then must determine whether the rental is a qualifying trade or business. Most self-rentals are set up as triple net leases which the IRS has categorized more as an investment rather than a business. Because of this, the income would not qualify for the 20% pass-through deduction. However, there are always unique circumstances where it could qualify. The self-rental rules surrounding the 20% pass-through deduction are mostly straight forward, but there are nuances to the rule that must be considered.

If you have a self-rental and am unsure of whether it qualifies for the 20% pass-through deduction, please reach out to us and we would be happy to answer your questions.

SERIES: Embracing Transition by Dan Schwarz

People tend to think of accountants as just numbers people, and boring bean counters that can't think beyond the black and white of a balance sheet or income statement. We respectively disagree. A good accountant should also be an advisor, helping a client with a variety of matters including developing and implementing their business goals.

During the life cycle of a business, goals can be drastically different. Early on the goal might be just to survive. After a while, the focus shifts to items like growth, efficiency, and better financial performance. Then one day the business owner realizes they aren't going to be around forever so the goal becomes a successful transition of business. Often time, this goal is somewhat reluctantly undertaken. Thinking of no longer owning their business just doesn't feel right. However, not embracing transition as a goal can prevent the business from a successful transition and may also limit the financial benefit to the owner.

This is the first part of a series of articles we will publish in the Tax Route about business transition. We are asked almost daily by clients about transition. It is easy to understand why. Demographically, according to Guidant Financials' 2019 Small Business Trends and Statistics, 57 percent of small business owners are over the age of 50 with 18 percent over the age of 60. These owners have spent their lives building their business, focusing on day to day operations. Now they are faced with how to successfully transition the business. They have questions such as how do I start, what am I transitioning, and how do I accomplish it. We will address these questions and more in our upcoming articles. Next up...how to start?

If you have questions and/or thoughts about transitions, please reach out to us as we would be happy to help with your situation.

Special Bulletin - February 19, 2019

Iowa Ruling Addresses State Apportionment for Transportation Brokerage Companies

The Iowa Department of Revenue issued a declaratory order on how transportation brokerage and other similar transportation service providers allocate revenues for state income tax apportionment. In this recent case, the taxpayer was a transportation brokerage specialist who connected clients needing goods transported with transportation providers. The taxpayer did not physically transport any goods, however it apportioned its revenues using the specific allocation rules allowed for transportation service companies, which based the allocation on miles in a state compared to total miles. The Director of the Iowa Department of Revenue concluded that since the taxpayer did not physically move the goods, the allocation should be based on the service provider rules. Under these rules, the revenue should be allocated based on where the benefit of the service was received, which in this case was the location of where the delivery was received. For example, if the delivery of goods the brokerage company coordinated was made to an Iowa location, the revenue from that delivery would be allocated to Iowa and therefore be considered Iowa revenue for the brokerage company.

This is an important ruling because often times transportation companies automatically use the transportation service company rules, apportioning revenues based on mileage in a state even though they are not actually moving goods. For the 2018 tax year, transportation companies providing brokerage services should revisit how revenue is apportioned and determine whether the mileage apportionment rules apply, or if, like the case of the transportation brokerage company, the service provider apportionment rules apply. It should be noted that this does not impact the apportionment for transportation companies who physically haul goods. MHCS has an experienced transportation team along with a knowledgeable state and local tax team who are closely watching this development. Please reach out to discuss how this new ruling may apply to your specific situation.

To stay up-to-date on any updates, please follow our blog at MHCScpa.wordpress.com.

State Tax Alerts

North Carolina

The North Carolina Department of Revenue updated its income tax code to conform with the Internal Revenue Code as of February 9, 2018 for both corporations and individuals. Several modifications and revisions were made relating to additions and subtractions from federal taxable income and sales apportionment.

Wisconsin

On December 14, 2018, Wisconsin's governor signed into law provisions that allows some pass-through entities to be taxed at the entity level rather than the individual partner and/or shareholder level. This change taxes net income reportable to Wisconsin at a 7.9% rate. This provision generally applies to taxable years beginning on or after January 1, 2019.

New Jersey

The New Jersey Division of Tax released a bulletin summarizing the various corporation business tax changes for the state. The bulletin highlights changes effective beginning on and after January 1, 2018 including no deduction under IRC Sec. 199A (also referred to as the Qualified Business Income Deduction) and a limitation on the 30% business interest expense deduction based on related and unrelated party interest expense.

Colorado

Colorado Department of Revenue proposes permanent rules for market-based sourcing for sales of services and intangible property when calculating the state apportionment factor. This new apportionment method will replace the cost of performance methodology previously used.

Iowa

The Iowa Department of Revenue has released guidance clarifying Iowa Section 179 expense. The Department confirmed that Section 179 expensing for the 2018 tax year will vary depending on the type of entity. C-corporations and s-corporations are limited to $25,000 with a limitation of $200,000. However, partnerships and individuals can expense up to $70,000 with a limitation of $280,000.

The Iowa House and Senate are currently moving forward with a bill that will allow for s-corporations to be subject to the $70,000 limitation instead of the $25,000 limitation. It is unclear when this bill will be finalized and if it will be retroactively applied to the 2018 tax year. S-corporations with Section 179 may want to consider extending their Iowa returns until more information is available.

California

The California Franchise Tax Board requires partnerships subject to the new centralized federal partnership audit regime to report federal audit adjustments to the state. The partnership is eligible to pay any California deficiencies at the partnership level or at the individual partner level.

Ohio

Effective for the 2019 tax year, Ohio allows for businesses to "opt-in" for centralized filing of the municipal net profit tax. The entity must register with the Ohio Business Gateway by March 1, 2019 to use this option for quarterly estimated returns and payments and also the annual return.

MHCS Leading The Way News | Find Out More + Stay Connected

Want to stay up-to-date with the most recent Leading The Way News? Check out our blogs and vlogs on MHCScpa.wordpress.com.

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Upcoming Event

You are welcome to join us on May Day, Wednesday, May 1, for our #ShredItOnMayDay event. This event will help you to protect your identity by securely shredding and recycling your outdated personal and/or business documents. We'll have activities and giveaways throughout the day including ice cream and wildflower seeds. Event details can be found on our Facebook page. We look forward to seeing you. If you have questions, please let us know.

In Transportation Territory This Quarter

L to R: Brenda Neville, Dan Schwarz, Jenny Smith, Liz Krause, Ashley Sly, Gina David

- January 28 | Brenda Neville, IMTA President, joined the MHCS Transportation Team at the West Des Moines Office to talk "trucking".
- December 2018 | Ashley Sly, Jenny Smith, and Liz Krause attended the annual holiday party at the IMTA headquarters.

We Want To Hear From You!

- How can we help you?
- What do you want to learn about?
- What trends are you noticing in your business?
- Anything else you want to share with us!

Your feedback will help us make sure we are providing you with information and support that you and your company needs. Please feel free to reach out to us with any comments or questions you have. We are always happy to help!