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Tax Reform Means Changes and Opportunities for Small Business Owners and Employees

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On December 22, 2017, President Trump signed into law the most sweeping changes to the United States' tax code in over 30 years. The biggest change for corporations which took effect on January 1, 2018, is a reduction in the federal U.S. corporate tax rate from 35% to 21%. It also temporarily lowers the top individual income tax rate from 39.6% to 37% and revises other income tax rates and brackets. Globally, it moves the U.S. from a worldwide system to a territorial system. Importantly, the new law makes several changes affecting businesses, especially small businesses, and individuals. For small businesses, this includes changes to the tax treatment of pass-through income and several longstanding business operational items and benefits.

Pass-Through Tax Provisions:

About 75% of small business employers organize as pass-through entities, according to the National Federation of Independent Businesses (NFIB). The new law includes a deduction for owners of sole proprietorships, partnerships, and S-corporations generally equal to 20% of qualified business income, subject to additional exceptions. For a service business, the deduction phases out for taxpayers with income above $157,000 or $315,000 for joint returns.

Major Employee Benefit Changes:

- The new law would generally disallow any deduction for entertainment, amusement, recreation activities, or facilities, even if the expenses are directly related to or associated with the active conduct of trade or business. This includes meals, food, or beverages to the extent the expenses are related to entertainment, amusement or recreation.
- Deductions for qualified transportation fringe benefits are also generally disallowed.
- There are new restrictions on the deduction of employee achievement awards.
- The deduction for qualified moving expenses and reimbursements is repealed through the end of 2025.
- The law creates a new tax credit for employers (subject to certain rules) that pay employees while on family and medical leave covered under the Family and Medical Leave Act (FMLA).
- Employer-sponsored dependent care, flexible spending arrangements, and tuition reimbursement programs remain unchanged under the new law.

Retirement and Education Savings:

Retirement and education savings provisions remain largely unchanged. Section 529 savings plans can now be used for elementary or high school enrollment expenses, up to $10,000, and extra time is provided to roll-over 401(k) loans at the termination of employment.

Estate and Gift Tax Exclusion:

The estate and gift tax basic exclusion amount are doubled to $10 million and indexed for inflation. The increased exclusion sunsets after 2025.

Non-Qualified Deferred Compensation:

No changes were made to deferred compensation rules.

Observations:

Many small businesses should feel the impact of the lower corporate rate, or the adjusted individual income tax rates with the new pass-through deduction. Although several categories of previously tax-advantaged employer-provided fringe benefits no longer provide the same tax treatment for employers, it does provide employers with an opportunity to think about their existing employee benefits portfolios. More traditional employee benefits such as dental and vision insurance, disability insurance, life insurance, hospital indemnity insurance, critical illness insurance, accident insurance, or cancer insurance could see new value-propositions as employers take stock of the new tax law and seek to attract and retain employees.

Tax results may vary depending on the taxpayer's own facts and circumstances. Tax laws are subject to change. The new tax legislation is still being interpreted and some provisions are awaiting further guidance by the Internal Revenue Service. Guardian, its employees, representatives, and agents cannot give legal or tax advice. Each taxpayer must consult with and rely on their own independent tax and legal counsel.