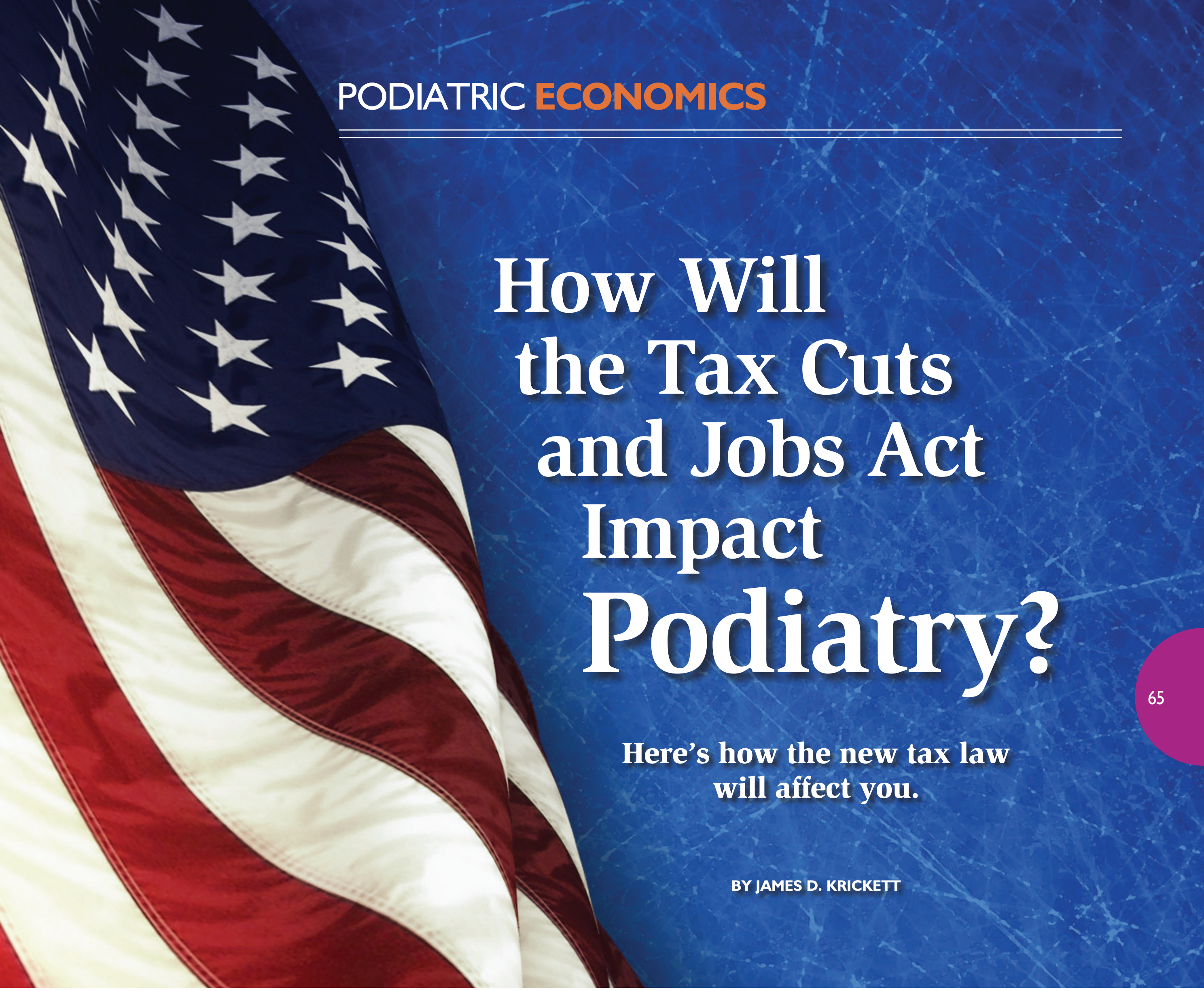

How Will the Tax Cuts and Jobs Act Impact Podiatry?

Here's how the new tax law will affect you.

BY JAMES D. KRICKETT

Are you ready for tax "reform?" Thanks to the just passed Tax Cuts and Jobs Act (TCJA), the tax rate for incorporated podiatry practices and businesses will be reduced from its current 35 percent to 21 percent—for the 2018 tax year and thereafter. And, although the business tax cuts are for the most part permanent, the tax cuts for individuals are temporary, expiring in 2026.

Unfortunately, while regular 'C' corporations will be taxed at a flat 21 percent tax rate, the majority of small businesses and professional practices operating as pass-through entities will face new personal tax rates that may be higher than the corporate tax rate.

Pass-Through Businesses

Whether it is two professionals working to run a more profitable enterprise, podiatrists and podiatry practices in a joint venture, a syndicate, group or pool with others, pass-through entities are an increasingly popular option. In fact, many podiatrists operate as or are involved in pass-through practices such as partnerships, limited liability companies (LLCs), S corporations, and sole proprietorships, where income is passed to their principals who pay tax at the individual rate.

The TCJA created a 20-percent deduction that applies to the first $315,000 of income (half that for single taxpayers) passed-through from an S corporation, partnership, LLC, or a sole proprietorship. All practice entities meeting the income thresholds, regardless of whether they're service professionals or not, can take advantage of the 20 percent deduction.

The tax rate for incorporated podiatry practices and businesses will be reduced from its current 35-percent to 21-percent.

The TCJA does place limits on who can qualify for the pass-through deduction, with strong safeguards to ensure that so-called "wage income" does not receive the lower marginal

Continued on page 66

Tax Cuts (from page 65)

tax rates. For pass-through income above the threshhold level, the new law allows that 20 percent deduction, but only for "business profits," reducing the podiatrist's effective marginal tax rate to no more than 29.6 percent.

In other words, that 20-percent deduction applies only to business income that has been reduced by the amount of "reasonable compensation" paid the practice's principal. "Reasonable" compensation has not been defined as yet.

Fringe Benefit Limits

Further limiting the options of podiatrists working for their practice, the new law "disallows" deductions for entertainment expenses, eliminating the necessity of attempting to prove whether such expenses are sufficiently business or practice-related. The 50 percent limit on the deductibility of business meals has been expanded to include meals provided through an in-house cafeteria or a location otherwise on the premises of the podiatry practice.

A practice's deduction for fringe benefits such as transportation (e.g., parking and mass transit) is no more, although such benefits received by an employee, even the practice's principal/employee, can continue to be excluded from the recipient's income.

The Corporate Alternative Minimum Tax

Too many deductions and too many otherwise legitimate tax "preferences" shouldn't, at least according to our lawmakers, mean escaping taxes. Lawmakers long ago created a unique 20 percent tax rate as part of a parallel tax system that limited tax benefits to prevent large-scale tax avoidance. Under the Alternative Minimum Tax (AMT) system, incorporated practices were required to calculate both their ordinary tax and the AMT, paying whichever was higher. Fortunately, the corporate AMT has been eliminated, lowering taxes and eliminating the confusion and uncertainty that surrounded it in the past.

Cost Recovery—Increased Expensing

Unlike in past years when a podiatry practice was required to claim depreciation, spreading the recovery of their equipment costs over several years, many podiatrists will be able to fully and immediately deduct the cost of certain equipment. Used equipment will now qualify for the first time.

While the 100 percent write-off has been made retroactive to September 27, 2017, the faster write-off of equipment costs is only temporary. It is at the 100 percent level for expenditures between September 27, 2017 and January 1, 2023. After 2023 and before 2025, the amount deductible drops to 60 percent with a further decrease to 40 percent after 2025 and to 20 percent after 2026. On January 1, 2027, the equipment cost write-off disappears.

Many podiatrists will be able to fully and immediately deduct the cost of certain equipment. Used equipment will now qualify for the first time.

Section 179 Expensing

The differences between bonus depreciation and the tax law's Section 179, first-year expensing, have narrowed with both offering 100-percent write-offs for both new and used property. The immediate write-off, or "expensing" of capital asset costs under Section 179, remains appealing because, unlike so-called "bonus" depreciation, the use of equipment doesn't have to begin with the practice.

Section 179 allows up to $1 million (up from $500,000 in 2017) of equipment expenditures to be treated as an expense and immediately deducted. The ceiling after which the Section 179 expensing allowance must be reduced dollar-for-dollar has also been increased from $2 million to $2.5 million.

And now, improvements including roofs, heating, ventilation, air conditioning systems, fire prevention, alarms and security systems qualify under the new Section 179 rules, providing another opportunity for practices that actually need equipment.

Qualified Property Write-Offs Gone

While additional improvements to the practice's offices may now qualify for the Section 179 expensing allowance, the unique write-offs for the cost of improving a practice's leased offices, clinic or other business property has been eliminated by the TCJA. In fact, separate definition of qualified leasehold improvements, and qualified restaurant and qualified retail improvement property, have been eliminated along with the 15-year recovery period and the use of straight-line depreciation for qualified improvement property.

Today, qualified improvement property is generally depreciable over 15 years using the straight-line method and the half-year convention, whether the improvements are property subject to a lease, placed in service more than three years after the date the building was first placed in service, or made to a restaurant building.

Interest Expenses

In the past, our tax laws protected the ability of podiatrists and their practices to write off the interest on loans. In an attempt to "level the playing field" between practices and businesses that capitalize through equity and those that borrow, the TCJA caps the interest deduction to 30-percent of the practice's adjusted taxable income. Exceptions exist for smaller practices to protect their ability to write off the interest on loans that help them start or expand, hire workers, and increase paychecks.

Leases are Another Story

Despite the massive reforms under the TCJA, in many cases, leas-

Continued on page 68

Tax Cuts (from page 66)

es remain far more favorable than a loan for acquiring equipment. Under new U.S. accounting rules, a podiatry practice with an operating lease will find the capitalized asset cost is lower when compared to borrowed money or a cash purchase. The reason? Operating leases reflect only the present value of the rents and, as a result, it is still partially off the balance sheet.

Although leases are currently treated as off-balance sheet transactions, newly adopted international accounting standards will soon require those leases to be reported on a practice's balance sheets as a front-end-loaded expense. Surprisingly, however, the result under both standards is that leasing—compared to borrowing to purchase—will be more favorably reflected on many practice's books.

A podiatry practice can, of course, continue to deduct the cost of leased assets while the tax benefits inherent in tax-advantaged leases can be passed on or continue to benefit lessees through lower pricing. Lessees will also enjoy lower tax rates.

Like-Kind Exchanges, Swaps, and Trade-Ins

The tax law's Section 1031 governing like-kind exchanges currently allow podiatrists and their practices to defer the tax bill on the built-in gains in property by exchanging it for similar property. Although more a strategy for deferring a tax bill when business assets are lost, sold, abandoned or otherwise disposed of, in fact, with multiple exchanges, gains can be deferred for decades and ultimately escape taxation entirely.

Under the TCJA, like-kind exchanges will be limited to so-called "real" property (but not for real property held primarily for sale). The provision re-defines like-kind exchanges and includes language that will limit Section 1031 exchanges to exchanges of like-kind "real" property. This ensures real estate investors maintain the benefit of deferring capital gains realized on the sale of property.

Small Business Accounting Method and Simplification

Simplification of the method of accounting required to be used by the practice is a nice option to have. Businesses and professional practices with average annual gross income of less than $25 million may now use the simple cash-basis accounting method. Yes, the current $5 million threshold for corporations and those partnerships with a corporate partner is increased to $25 million, and the requirement that such operations satisfy the $25 million requirement for all prior years has been repealed.

With the cash method of accounting, a podiatry practice may account for inventory as non-incidental materials and supplies. Or, as an alternative, a podiatry practice with inventories using the cash method of accounting will be able to account for its inventories using the method of accounting reflected on its financial statements or in its books and records. Also, under the new law, the average gross receipts test will now be indexed to inflation.

Businesses and professional practices with average annual gross income of less than $25 million may now use the simple cash-basis accounting method.

Rehabilitation And Disabled Access Credits Repealed

The TCJA repeals the tax credit so many podiatrists and their practices claimed when retrofiting or fixing their premises to be handicapped-friendly. On a related note, the Disabled Access Credit that has helped make so many offices, clinics, laboratories, and other business premises become ADA compliant, has also been repealed.

Losing With NOLs

One of the main benefits of net operating losses (NOLs) was the fact that they could be carried back to more prosperous years creating a refund of taxes paid in those earlier years and providing an immediate infusion of badly-needed cash. Today, the NOL deduction has been severely limited. The write-off is now limited to 80 percent of taxable income and only in special cases will a NOL carryback be permitted. There is no limit on how far forward NOLs may be carried.

Auto Expenses

Automobiles or other vehicles used in the podiatry practice or provided by the practice to its principals face new write-off limits for the cost of those so-called "luxury" automobiles and other personal use property. For passenger automobiles and light trucks placed in service after December 31, 2017, where the additional first-year depreciation deduction is not claimed, the maximum amount of allowable depreciation is increased to $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year and $5,760 for the fourth and later years in the recovery period.

For passenger automobiles placed in service after 2018, these dollar limits are indexed for inflation. And for those eligible for bonus first-year depreciation, the maximum first-year depreciation allowance remains at $8,000.

Similar rules apply to not only passenger automobiles, but to any property used as a means of transportation—or so-called "listed" property used for purposes of entertainment, recreation, or amusement. Computers and peripheral equipment have been removed from the definition of listed property and are no longer subject to the increased substantiation requirements applying to listed property.

Capital Contributions

Capital contributed or invested in a podiatry practice, not only by

Continued on page 70

Tax Cuts *(from page 68)*

its principals, but also contributions made by others, even that contributed by a patient or potential supplier, was not considered to be income. However, the new law now clearly states that "contributions to capital" does not include any contribution in aid of construction, any other contribution by a patient/supplier or any contribution by any governmental entity or civic group, and must be treated as "income."

If property is acquired by an incorporated practice as a contribution to capital and is not contributed by a shareholder, the adjusted basis or book value of the property is zero. If the contribution to capital consists of money, the new rules require the incorporated practice to first reduce the basis or book value of any property acquired with the contributed money within the next 12 months and then reduce the basis of other property held by the practice.

Estate Taxes

Ranking high on many podiatrists' lists of concerns, the tax law applies a 40 percent levy on estates worth more than $5.49 million for individuals and $10.98-million for couples. The newly passed law provides immediate relief from the so-called "Death Tax" by doubling the exemption so it applies to fewer estates. The higher thresholds would sunset in 2026 and be repealed entirely after six years.

In a related area, the credit for estate, gift, and generation-skipping transfer taxes has been increased to $10,000,000 for decedents dying and gifts made after December 31, 2017.

More, Oh, So Much More

Obviously, there are many more changes contained in the massive Tax Cuts and Jobs Act. S corporations attempting to convert to regular 'C' corporations will face tougher new rules; Section 199, the deduction for so-called "domestic production activities," has been repealed; and partnerships will no longer automatically terminate upon the death or exit of a partner.

All-in-all, however, the Tax Cuts and Jobs Act appears to favor professional practices and businesses over individuals with longer-lived tax savings. Unfortunately, with few exceptions, the potential savings won't be seen by podiatrists or their practices until the tax bill for 2018 comes due. **PM**

James D. Krickett is a well-known tax and financial adviser whose columns are syndicated to more than 65 publications each week. His features routinely appear in the pages of leading trade magazines and professional journals.