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Business & Finance

Experts Weigh in on Federal Tax Reform's Effects on Local Businesses and Their Employees

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Editor's Note: This is the second part of a series of articles on the effects of the new Federal Tax Law on businesses and residents of West Essex County.

WEST ESSEX AREA, NJ – It was a busy two months for West Essex accounting firms as they began grappling with the extensive changes that local businesses and their employees must deal with in the aftermath of the new federal tax reform legislation. Three tax experts at leading local accounting firms recently spoke with TAPinto about the positive and negative ramifications they envision for their business clients and the high-income employees who are most affected by this legislation.

When it comes to how the new law affects tax deductions that employees will be allowed to make, Ken Bagner, member of Livingston-based accounting firm Sobel & Co. LLC, said people should be aware that the IRS is coming out with a new withholding form for company employees.

He said that employees need to fill out this form due to changes in the way they can deduct their itemized deductions as well as changes in the tax rates, "which are going to affect how much take-home pay employees have," Bagner said. From an employer's side, Bagner said the changes differ from client to client—such as real estate brokers versus manufacturers.

According to Bagner, one of the biggest changes in the tax law is the 20-percent deduction being allowed for pass-through businesses (such as sole proprietor or LLC businesses), meaning that these entities can take a 20-percent deduction on the income that they earn in their businesses. Bagner added that there are certain limitations on this for certain service businesses, like accounting and real estate firms, but that "this will be a huge benefit for clients" overall.

Bill Schwarz, a partner in the CPA firm Meisel, Tuteur and Lewis in Roseland, said that carving out the 20-percent deduction that will not be allowed for service businesses could have a more negative effect in areas such as suburban Essex, where there are many doctors, lawyers, investment bankers and brokers who will not be able to benefit in the way that pass-through businesses will from this new tax law.

Schwarz said that one thing that service businesses like law firms are considering is breaking up their businesses to save on taxes. He said an example of this would be a law firm spinning off the part of their operation that handles billing, which he said could benefit the firm tax-wise.

He added that some high-earning employees are also beginning to strategize about ways to take advantage of the 20-percent deduction by forming their own LLC or S corporations. Schwarz cautioned that over the years, this type of strategy has not worked out well for most people, but that it could be beneficial in certain cases.

According to Bagner, another major benefit for many of his clients is the increase in the 179 deduction, which allows businesses to deduct the full purchase price of qualifying equipment.

"It's on new or used equipment, so any purchases you buy for any equipment usually had to be capitalized or written off over a period of time," he said. "Now you can basically write off all of your purchases when you buy it, which is going to be a nice boost for the manufacturers who are selling equipment and for realtors who might be selling things that are capital intensive."

Schwarz said this deduction will be a boon for construction companies, which will be able to buy a lot of equipment that can now be deducted. He added that as more companies switch over to putting more of their information in the computer cloud, they can now make the investments that they have been putting off to buy newer computers for their staff. According to Schwarz, these computers can now be written off immediately.

Under the new law, Bagner said that most people's biggest concern is that although business owners might have a 20-percent deduction, employees being paid in the highest tax bracket no longer get a state-income tax deduction.

"The highest tax rate is now 37 percent when it used to be 39.6 percent, so people who are in states like New Jersey will actually be paying more federal taxes as their income becomes higher and higher," said Bagner. "So the pretty affluent residents of a town like Livingston could find their tax bill going up if they're not a business owner and are just an employee of a company."

In the spring or early summer of 2018, after 2017 tax returns are completed, Bagner said the partners at Sobel & Co. will be running an analysis with each of their clients to make predictions on what each client's 2018 returns will look like under the new tax law based on their 2017 numbers.

Partners at Bederson LLP, an accounting firm with offices in West Orange and Fairfield and an 80-year history in Essex County, said their biggest concerns center around the elimination of deductions for entertainment expenses.

"Essex County is home to many entertainment and recreation strongholds such as golf clubs, the Prudential Center and NJPAC," said Bederson Managing Partner Mark Mazza, CPA. "The elimination of entertainment deductions may not only negatively impact these entities, but thwart continued development in Newark as well."

Schwarz also expressed concern about how the new tax law will affect Newark's Prudential Center.

"Businesses were able to buy a box at the Devils, and take a 50-percent deduction," he said. "Now it will be zero."

Within Bederson's client family, those who are negatively affected by the Tax Cuts and Job Act (TCJA) as it relates to entertainment include professional service companies, such as law firms.

According to Mazza, law firms use entertainment facilities including sports arenas, golf clubs and restaurants to build relationships with existing and potentially new clients. He said that the loss of any deduction related to these activities has a detrimental impact in combination with the fact that "these firms do not qualify for the 20 percent pass-through deduction."

On the other hand, Mazza said other types of businesses, such as construction companies, would benefit from these changes because of the more-than doubling of the domestic production activity deduction (DPAD) IRC 199, which is now at 20 percent when it was previously at 9 percent.

This is the second part of a series of articles on the effects of the new Federal Tax Law on businesses and residents of West Essex County. A third article, which focuses on changes in charitable contributions, will be published in the coming weeks.

Read the first article of the series HERE.