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Ouch! Some business owners may be shocked by lost tax breaks

As small business owners compile their income tax returns, they'll confront some of their losses from the new tax law: popular deductions that have disappeared or been reduced

By JOYCE M. ROSENBERG AP Business WriterNEW YORK — Feb 6, 2019 1:13 PM ET

As small business owners compile their income tax returns, they may have an unpleasant surprise — some popular business deductions have disappeared or been reduced under the new tax law.

While the law gave small business owners new tax breaks including a 20 percent deduction in income for many sole proprietors, partners and owners of S corporations, Congress took back deductions for entertainment expenses, employee transit benefits and what are called net operating loss carrybacks. It also put ceilings on interest deductions for some businesses. Accountants and tax attorneys suspect small business clients to especially miss the break for entertaining clients and customers.

"I think they're going to be shocked at how much more they didn't get as a deduction," says Joseph Perry, a certified public accountant with Marcum in Melville, New York.

A look at the disappearing deductions:

INTEREST

There is now a limit on how much interest businesses can deduct on their loans and credit lines. While the smallest businesses, those with up to $25 million in average annual revenue over the previous three years, have no ceiling on the interest they can deduct, there are many small businesses above that threshold that are being affected. IRS regulations limit the deduction to 30 percent of a company's adjusted taxable income plus its interest income, if it has any. A motor vehicle dealer can also deduct its borrowing costs for the vehicles it buys and then sells — what's known as floor plan financing interest.

But interest expenses that are above the limit can be carried over and deducted the next year; they will count toward that year's ceiling. And real property businesses including landlords,

developers and real estate managers and brokers can choose to be exempt from the deduction if they follow rules on depreciation of their property.

ENTERTAINMENT

Owners who take customers to sporting events or the theater or treat them to a round of golf will have to foot the entire bill for those activities. The new law has done away with the entertainment deduction for businesses. Many owners use entertainment as a key part of building and maintaining relationships with clients.

But owners can still deduct the cost of taking a client out for breakfast, lunch or dinner; half the amount spent for a business meal is deductible. The IRS also says owners can buy food for a customer at an entertainment event as long as the food is paid for separately. In a notice about meals and entertainment expenses issued in October, the agency used hot dogs at a baseball game as an example. The food is deductible; the tickets are not.

Owners can also deduct 100 percent of the cost of food at parties or picnics for employees.

While the loss of the entertainment deduction may discourage some owners from treating customers to tickets or a golf game, others will decide that paying for entertainment is a worthwhile investment in their companies' future because of the goodwill it creates. That's good business sense, says Ken Rubin, a CPA with Rubin Brown in St. Louis.

"Normally, our general statement is, don't let tax considerations drive the business decisions," Rubin says. Or, as tax advisers sometimes tell their clients: Don't let the tax tail wag the dog.

EMPLOYEE EXPENSES

The law also eliminated the deduction owners could take for subsidizing their employees' commuting costs. Similar to their decisions about entertainment expenses, owners must decide whether they want to continue giving employees money toward their mass transit fares or parking tabs; given the tight labor market, owners might want to continue providing the benefits to make their companies better able to compete for talented workers. And taking the benefit away could be a morale-buster, says Leon Dutkiewicz, a CPA with Citrin Cooperman in Philadelphia.

"When you run the math, you're going to lose more in goodwill than you would from losing the deduction," he says.

Employees also lost a popular deduction — for job-related expenses like the cost of tools, uniforms and publications related to their work. Owners who want to give their staffers a break might want to take on those expenses and deduct the costs.

NET OPERATING LOSSES

Businesses that lose money no longer have the ability to "carry back" their losses to offset earnings in previous years and get refunds on taxes they paid. The law does allow companies to carry losses forward to an unlimited number of future years, helping them reduce taxes during profitable times.

Although the absence of carrybacks takes away some flexibility for businesses, it isn't likely to be an issue for companies in a strong economy when businesses are doing well, Rubin says. It can, however, be an issue for companies like restaurants and retailers.

"It's a bigger deal for cyclical-type businesses that will make money one year, lose money the next," Rubin says.

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