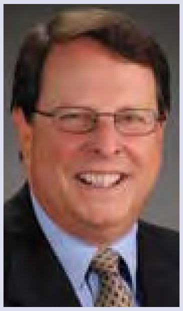
by Daniel M. Isard, MSFS



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ICCFA Magazine spotlight

➤Isard is president of The Foresight Companies LLC, a Phoenix-based business and management consulting firm specializing in mergers and acquisitions, valuations, accounting, financing and customer surveys.

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More from this author

➤Educational information, including copies of this article, can be found at ***www.theforesightcompanies.com***

➤You can follow Isard on Twitter at *@f4sight,* LinkedIn and "like" The Foresight Companies on Facebook.

Editor's note

The Cemetery Impossible column is written by the staff of The Foresight Companies. **If you have a question you want to be featured in this column, please send it to danisard@f4sight.com.** Dan Isard or a member of his staff will call you to get more information and a recommendation will be provided via this column, helping not only you but also others who are facing similar challenges.

As always when there is a change in tax law, how the Tax Cuts and Jobs Act will affect your organization depends on a number of factors and should be considered well before time to file.

A detail of the building in Washington, D.C., housing the Internal Revenue Service.

How the tax act will affect funeral homes, cemeteries

Dear Dan,
OK, how is this new tax law going to affect my funeral home or cemetery?
Wondering about TC&JA in TN

Dear Wondering,
The "Tax Cuts and Jobs Act" (TC&JA) was signed into law just before Christmas of 2017. The new tax law affects business owners in three broad ways:

1. Deductions for operations.
2. Income tax on the profits of the business.
3. Ability to transfer the business or the after-tax sale proceeds by a change in the estate tax.

Allow me to explain all three of these items.

Basic accounting and tax law is simple. Revenue, minus costs of goods, minus costs of operations, equals profit. You have to keep this operating paradigm in the back of your head at all times. Nothing has changed in a way that affects this paradigm.

For the sake of clarity, I will address some of these matters that affect both funeral homes and cemeteries (combination operations). If something affects either a funeral home or a cemetery specifically, I make it clear which entity it applies to.

Operating deductions

The single biggest change in TC&JA affecting operating deductions is the change to Section 179. Section 179 affects the ability to depreciate equipment used in the production of income in a trade or business.

The question in tax law has always been is something *deductible* or *depreciable*? The answer has been simple: If something is used up or presumed to be used within one year, it is deductible. If something is used over multiple years, it is depreciable.

For example, a business buys a pencil. It is assumed that pencil will be consumed within a year, so it is deductible. However, if that same business buys a mechanical pencil, it is assumed the mechanical pencil will last longer than a year. In theory, that mechanical pencil should be depreciated over its useful life. (Of course, the lead to refill the mechanical pencil would be

Before a taxpayer operating a funeral home or cemetery rushes out to buy equipment or vehicles to use in their business, there should be some thought and planning involved despite these changes. Remember, at best, for every piece of equipment you buy, the government might provide a tax reduction of 30-40 percent, but that means you, as the purchaser, are paying 60-70 percent.

expensed as being used up within a year).

Obviously, businesses would rather deduct than depreciate. It involves less paperwork and fewer staff resources to track deductions and gives a more cash-on-cash focused understanding of profit.

There is a great deal of debate as to what the term of a depreciation should be. The useful life of the same object could be longer or shorter depending on how or where the taxpayer uses an asset.

A car used by a mortuary could last 20 years, but that same car being used by an Uber/Lyft driver could last three years. Which period of time do you use, as both are business uses of a vehicle?

To stimulate the economy, Section 179 was added to the Internal Revenue Code. Section 179 simply states a taxpayer can elect to deduct the cost of certain types of property as an expense, rather than requiring the cost of the property to be capitalized and depreciated.

This property is generally limited to tangible, depreciable, personal property acquired by purchase for use in the active conduct of a trade or business.

Initially some real estate used in business was not included as "property" eligible for Section 179, but since the passage of the 2010 tax law, some real estate has qualified for Section 179 use.

Section 179 allows for a large deduction for property, rather than the annual depreciation of that same property. The limit of how much can qualify under Section 179 has changed over the years.

The Section 179 election is subject to three important limitations:

1. There is a dollar limitation. Under section 179(b)(1), the maximum deduction a taxpayer may elect to take in a year is $1 million. Prior to the TC&JA it was $500,000.

2. There is a total limit. This is intended to be a benefit for smaller businesses. If a taxpayer places more than $2.5 million worth of section 179 property into service during a single taxable year, the Section 179 deduction is reduced, dollar for dollar, by the amount exceeding the $2.5 million threshold.

3. The Section 179 deduction for any taxable year may not exceed the taxpayer's aggregate income from the active conduct of trade or business by the taxpayer for that year.

If, for example, the taxpayer's net trade or business income from active conduct of trade or business was $100,000 in 2018, then the taxpayer's Section 179 deduction cannot exceed $100,000 for 2018. However, any Section 179 deduction not allowed for in a year because of this limitation can be carried over to the next year.

The TC&JA also includes an increase for bonus depreciation. The mechanical and personal property used in operating a cemetery as well as a funeral home will all qualify under this new law.

There are new limits on new vehicles and new trucks. The 2018 vehicle depreciation caps will increase. IRC Sec. 280F calls for use of the "new cars" and "new trucks" components to once again increase slightly from the previous year. From 2012 through 2017, depreciation levels for new cars and trucks remained the same.

The first-year allowance for bonus depreciation is 100 percent up to a limit of $8,000 starting in 2018 for all qualifying vehicles.

The luxury auto depreciation limits under Code Sec. 280F for passenger automobiles placed in service in 2018 are:

- $10,000 for the first year (if bonus depreciation is not elected)
- $16,000 for the second tax year
- $9,600 for the third year
- $5,760 for each tax year thereafter

Section 162 of the IRC covers the deduction of business expenses. Any question about whether the auto deduction would qualify should be viewed by tax practitioners from a Section 162 perspective. If it qualifies under Section 162, then it will probably qualify under the Section 280F perspective.

The projected maximum depreciation limits for trucks and vans first placed in service during the 2018 calendar year most likely will be accounted for under the bonus depreciation provisions of section 168. This will allow the business to take a 100 percent deduction for the cost of the vehicle that weighs in excess of 6,000 pounds.

Before a taxpayer operating a funeral home or cemetery rushes out to buy equipment or vehicles to use in their business, there should be some thought and planning involved despite these changes. Remember, at best, for every piece of equipment you buy, the government might provide a tax reduction of 30-40 percent, but that means you, as the purchaser, are paying 60-70 percent.

Rather than buying new equipment to lower tax bills, pay the tax on your existing, still perfectly fine vehicles and keep the difference in your pocket.

Tax rates

All the headlines focus on the change in the tax rates. In simple, after reading this over from every angle, it appears to reduce the tax rates of the highest income earners about 2.5 percent. However, there are other tax traps that will reclaim this benefit for most.

The law sought to bring some equality for business owners, whether C corporations or pass-through entities such as sole proprietorships, S corporations and partnerships.

By my estimate, most cemeteries that are taxable entities are S corporations or partnerships, therefore they are pass-through entities. Only about 25 percent of funeral homes are C corporations. Income from pass-through business entities are taxed at the shareholder's income tax rate, whatever rate that might be, based upon the amount of other income that taxpayer has.

C corporations have always had their own tax rate, and therefore pay income tax at the corporate level. That income tax rate progressed up from 15 percent to 39.6 percent for most small businesses. The taxpayer got to choose which type of entity they wanted to operate as, with the associated income tax being just one factor to consider.

➤to page 108

➤*from page 107*

The objective of the TC&JA was to provide pass-through entities an additional reduction to bring their taxes more in line with the lower corporate rate for C corporations. Section 199A of the TC&JA has created the qualified business income (QBI) provisions. In basic terms, the QBI qualification will provide a 20 percent deduction of pass-through income on the owner's income tax returns. This new rule is subject to certain limitations for wages and other items.

To define QBI requires us to split out salary for the owner doing services and the qualifying profits. Salary is taxed as salary and QBI as pass-through income. Remember, as an employee you get some benefits such as half of the payroll taxes, health insurance, Social Security and Medicare tax up to $128,400 and inclusion in retirement plans sponsored by the company.

QBI is only on the excess distributed from your business, not on wages or capital gains or losses, dividend income or interest income.

For example, suppose your funeral home pays you a salary of $100,000. It is a pass-through business and earns $50,000 as business profit. You are the only owner. Therefore the $100,000 would be taxed as wages, subject to that tax rate. The $50,000 would be QBI and you would receive a $10,000 deduction against the $50,000 on your personal return.

Should you try and claim it all as QBI, omitting a salary? No, because you would then not be entitled to the deduction because it is limited to 50 percent of the company's wages, including the owners.

Estate tax

The good news is, only those people with a net worth of more than $11,200,000 ($22,400,000 for married folks) will have to do tax-focused planning. This change in the federal estate tax will not change any state transfer taxes, but they have never been very large as a percentage of an estate.

This is not to say that estates don't require good planning. They will continue to need it if only because you just can't drop a seven-figure check into the hands of most children. We need to protect this wealth, but that is a different topic and involves different methodology than protecting it from taxation. ❐