Top Tax Changes and Updates for RTO Dealers

BY KIMBERLY CARDENAS, CPA

2023 brought some significant changes to tax rules, many of which have a specific impact on the Rent to Own (RTO) Industry. Below is a summary of the most significant changes that RTO owners should be aware of.

Depreciation Updates

In 2017, Congress passed the Tax Cuts and Jobs Act, which allowed businesses to write off 100% of the cost of qualified property placed into service after September 27, 2017, but before January 1, 2023, under IRC Sec. 168(k). Unfortunately, this 100% bonus depreciation write-off was temporary. For property placed in service from January 1, 2023, through December 31, 2023, bonus depreciation phases down to 80%. The law currently states that bonus depreciation will go down to 60% in 2024, 40% in 2025, then 20% in 2026. For those taxpayers who have taken advantage of the 100% bonus expensing on rental unit purchases, this tax change may come with a potential taxable income increase over the next several tax years. That's because the bonus depreciation deductions will have decreased while still writing off fully expensed property for tax purposes.

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Section 179 expensing on qualified assets is still available. However, there could be limitations on the total expenses available, with the first limitation based on the cost of property placed in service, which was $1,160,000 in 2023 and will be $1,200,000 in 2024. There also must be taxable income for the entity to be able to utilize the expensing in that current tax year. Section 179 expensing will reduce taxable income to zero but cannot create a tax loss (with some exceptions). Rent-to-own dealers will need to contact their tax advisors to determine if certain property placed in service is eligible for Section 179 expensing, where normally property that qualifies for Section 179 expenses is used in the ordinary course of trade or business. Vehicles that qualify under the 'heavy' category have a Section 179 tax expense limit of $28,900, so a comparison between what's the most beneficial tax expense between bonus depreciation and 179 will be essential.

Deductible Meals

The Consolidated Appropriations Act (CAA), signed into law on December 27, 2020, temporarily allowed a 100% business deduction for certain restaurant food and beverages purchased during 2021 and 2022. For tax year 2023, these business deductions are back to pre-CAA rules, meaning that most business meals are only 50% deductible. The IRS provides a thorough list of deductibility by purchase type to review.

Pass-through Entity Tax

The Tax Cuts and Jobs Act created a change in allowable itemized deductions that affected many taxpayers with high state and local taxes. The new ruling capped the SALT deduction to $10,000 a year. For taxpayers with high real estate taxes and state income tax, a $10,000 deduction would potentially disallow a large amount of state or local tax payments to be used as itemized deductions. Those deductions could have been utilized on their federal tax return to lessen their tax burden. To mitigate this change, many state departments have created a workaround in the form of a pass-through entity tax. For these states that have passed new laws, business entities can now pay state income tax on the pass-through entity level and then take a federal deduction for those tax payments in

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the year paid. Although some of these changes were implemented before 2023, many taxpayers were unaware of the benefit, and most states that planned to enact new legislation have done so. There will still be an addback on the state tax return level, but at least taxpayers will not lose out on the full deduction over the SALT limit as enacted under the TCJA. Be mindful that there are specific rules on a state-by-state basis for which types of shareholders or partners qualify depending on the entity structure. Another note to add: these PTE tax payments are taxed at the highest tax rate, so this might not benefit every taxpayer. Running an analysis to see if this could positively affect your business and personal taxes might help save taxpayers cash while under this IRS Act.

Inflationary Adjustments

To offset inflation, the IRS has adjusted certain deductions, tax brackets, and contribution limits affecting most taxpayers. The 2023 Marginal Income Tax Rates and Brackets have increased, along with a higher standard deduction for all taxpayers. Please check out this IRS link for the updated figures: https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2023. Taxpayers wishing to contribute pre-tax dollars to a 401(k) or 403(b) can now contribute up to $22,500 a year, up from the 2022 limit of $20,500, with a $7,500 catch up for taxpayers 50 years or older. IRA contributions are up to $6,500 for each taxpayer (when eligible), with a $1,000 catch up payment for taxpayers 50 years or older. The threshold limits for deductible traditional IRA contributions, as well as Roth IRA contributions by taxpayer type, have increased as well (when eligible). Health savings account contribution limits for taxpayers with high deductible health plans have increased to $3,850 for self-only coverage and $7,750 for family coverage with a $1,000 catch up payment for taxpayers 50 years or older. The annual gift tax exclusion for 2023 increased to $17,000 for each recipient.

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Conclusion

Rivero, Gordimer & Company, P.A. (RGCO) works with numerous franchisors, franchisees, and small-to-larger-sized independents that represent hundreds of RTO storefronts. We understand the RTO industry from start-up and financing to specific tax and accounting rules through success and merger or sale transactions, including valuation. While we have provided several changes for 2023, we encourage you to check back for guidance on IRS changes that will affect the 2024 tax year.

About the Author

Kimberly Cardenas joined Rivero, Gordimer & Company and began practicing public accounting in 2013. Ms. Cardenas' areas of concentration include tax preparation, tax review, tax planning, QuickBooks setup and cleanup, and other services. Ms. Cardenas works on clients over various industries, one specialty being in the Rent-To-Own industry.

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