How Does the Tax Cuts and Jobs Act Impact Rent-To-Own Businesses? It Depends on Your State.

The Tax Cuts and Jobs Act ("TCJA") made significant changes to the federal tax code, leaving many taxpayers wondering what that means for state tax purposes. The short answer is, it depends on your state. Federal conformity varies from state to state, and some states are selective as to which specific code sections to follow. These changes will impact how rent-to-own dealers, as well as their families, make business and personal decisions that could have a huge impact on their tax planning. Here's a summary across the key tax areas of bonus depreciation, net operating losses, qualified business income, business interest deductions, and deduction caps.

Bonus Depreciation

The TCJA increased bonus depreciation allowable from 50 percent to 100 percent for both new and used qualified property placed in service after September 27, 2017, and before January 1, 2023. Note that numerous states do not conform to federal bonus depreciation.

There will be an addback for bonus depreciation taken over regular MACRS depreciation. Future tax years will have a subtraction for a fraction of the disallowed bonus depreciation or a subtraction for the difference in the net value of the assets when sold or written off.

For the RTO industry, this change means that rental units purchased and placed in service qualify for 100 percent expensing for federal tax purposes. These purchases could add up to a significant cost, especially for taxpayers who own multiple stores. Since the difference between taking 100 percent bonus depreciation or no bonus with the 3-year MACRS depreciation will be substantial, it's important to know which option is appropriate for your business. There are two potential implications to consider further:

- It will first create large book-to-taxable income differences that will have to be factored in when looking at yearly financials.
- This could create situations where there is a taxable loss for federal tax purposes but taxable income and tax due for the states that do not conform to bonus depreciation. For business owners that own stores across multiple states, it is important to determine the individual state rules as some states will have state depreciation addbacks while others might not.

Net Operating Losses

Prior to the TCJA, federal net operating losses ("NOL") could be carried back two years and then carried forward for up to twenty years. After the TCJA, the carryback period was eliminated. However, carryforward of the NOLS is indefinite, but not to exceed 80 percent of taxable income. Many states already did not allow for a carryback of NOLs, and most do not conform to the federal changes as well. The federal NOL is added back and a separate state NOL is calculated. It will be important to plan for the difference between the federal loss that could be the result of a bonus depreciation or Section 179 expense, and the state loss or income for that matter. The large NOL for federal tax purposes may not be the same for state purposes.

Qualified Business Income

The 199A deduction on qualified business income ("QBI") is a cashless 20 percent deduction available to owners of pass-through entities when all qualifications apply. The 199A amounts are calculated on business returns and passed through to Form 1040. This is a below-the-line deduction taken after the adjusted gross income is calculated.

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The RTO industry meets the requirements for QBI and the 20 percent deduction when applicable. However, most states do not allow for 199A. Just because a state conforms to federal tax law does not necessarily mean that the state conforms to the QBI deduction. These questions will need to be asked and not assumed while planning.

Business Interest Deductions

One of the biggest changes from the TCJA is the restriction of business interest. Business interest deduction is limited to 30 percent of the adjusted taxable income and it's possible to carry the remainder of the deduction forward to future tax years.

Adjusted taxable income is defined as earnings before interest, taxes, depreciation, and amortization for the first four years following the TCJA, with a more restrictive definition (depreciation not added back) afterward. This limitation affects the pass-through income and expenses that flow through on Schedule K-1 to each shareholder or partner. This change will affect taxpayers with average gross receipts of $25 million or greater, including combined revenue through common ownership of entities. For larger entities or ones that leverage their purchases, this law may cause controversy. The large tax swings from taking advantage of the depreciation rules would need to be reconsidered after factoring in the limited business interest those deductions could create if losses are created.

Many states are still working through newly-enacted laws regarding the business interest deduction limitation, especially for states that conform to federal law. For the states that haven't passed new legislation, this limitation can affect the state level as well.

Deduction Caps After the TCJA

After the TCJA, the total taxes paid that can be deducted on Schedule A for a taxpayer is now capped at $10,000 or $5,000 for married filing separate status. Taxpayers must plan accordingly especially when operating in taxable states that are impacted by this cap on the real estate and income tax deduction on Schedule A.

Taxpayers will have to consider if their respective state conforms to the TCJA provisions, especially taxpayers who own stores across multiple states. More states have been passing new rules regarding nexus which includes requirements to file in those states so staying up to date with the changing regulations is as important as ever.

Partner with an Expert to Know Your Options

The TCJA is the largest overhaul of the tax code in more than 30 years and while this article represents highlights for rent-to-own businesses, individual circumstances will vary. That's why you should consider partnering with a CPA firm who specializes in the rent-to-own industry.

Rivero, Gordimer & Company, P.A. works with numerous franchisors, franchisees, and small- to larger-sized independents who represent hundreds of storefronts. We understand the RTO industry from start-up and financing to specific tax and accounting rules through succession and merger or sale transactions.

Questions or comments?

If you have any questions regarding the Tax Cuts and Jobs Act or any other rent-to-own industry topic, contact Kimberly Cardenas at KCardenas@rgcocpa.com or any other member of the Rivero, Gordimer & Company Rent-To-Own Committee at 813-875-7774.

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, and specializes in the rent-to-own industry.

Contact Ms. Cardenas at 813-875-7774 or KCardenas@rgcocpa.com.

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by calling 813-875-7774 or visiting our website at www.rgcocpa.com.