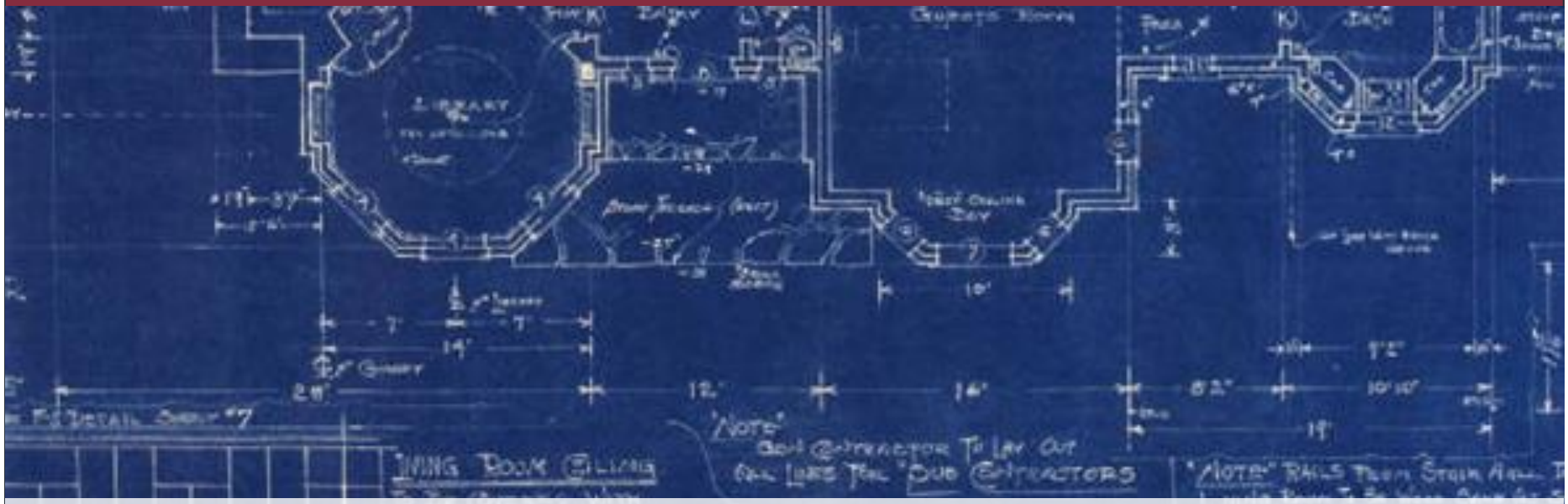
The Tax Cuts and Jobs Act & Its Impact on the Construction Industry



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AGENDA

BUSINESS TAX LAW CHANGES

Miscellaneous Business Tax Law Changes

Like-Kind Exchanges

Per Diems & Accountable Plans

Business Interest

Section 199A

INDIVIDUAL TAX LAW CHANGES

Business Tax Law Changes

Provision	Prior Law	New Law
Accounting for Long-Term Contracts	Businesses with average annual gross receipts of $10 million or less in the preceding three years were not required to use the percentage-of-completion method for long-term contracts (i.e., they are allowed to instead deduct costs associated with construction when paid and recognize income when the project is complete).	Expands the exception if the contract: (1) is expected (at the time it is entered into) to be completed within two years and (2) is performed by a taxpayer that meets the new $25 million gross receipts test (for the tax year in which the contract was entered into).

Business Tax Law Changes

Provision	Prior Law	New Law
Accounting for Inventory	Cash method of accounting could be used for certain businesses with average annual gross receipts of $10 million or less.	Increases threshold to $25 million for all taxpayers.
Section 179/Bonus Depreciation	Subject to net income limitations, the max amount a taxpayer could expense under Code Sec. 179 was $510,000 (in 2017), reduced by the amount by which the cost of such property placed in service during the tax year exceeded $2,030,000. First- year bonus depreciation deduction was allowed, equal to 50% of the adjusted basis of new qualified property.	Increases expensing limit to $1 million and the phase-out threshold to $2.5 million. Allows 100% expensing for qualified property placed in service after 9/27/17. Applies to new and used property. Expected to phase out starting in 2023 and completely eliminated by 2027.

Business Tax Law Changes

Provision	Prior Law	New Law
Like-Kind Exchange	No gain or loss recognized to the extent that property held for productive use in the taxpayer's trade or business is exchanged for property of a like-kind that also is held for productive use in a trade or business.	Limited to cover only like-kind exchanges of real property not held primarily for sale. Trade-ins of equipment result in reporting gain/loss of traded asset as if it was sold. Under a transition rule, the pre-TCJA law applies to exchanges of personal property if the taxpayer has either disposed of the property given up or obtained the replacement property before 2018.

Like-Kind Exchange Example

ABC Contractor purchases a new excavator for $200,000 and trades in an old excavator with a trade-in value of $75,000. Cash difference equals $125,000. Tax basis (original cost less depreciation previously reported) on the old excavator is $0.

Prior Law		New Law	
Tax basis of old excavator	$0	Trade-in value	$75,000
Add, Cash difference	$125,000	Less, tax basis of excavator	$0
Tax basis of new excavator	$125,000	Gain recognized	$75,000
No taxable gain or losses reported related to trade-in.		Tax basis in new excavator $200,000.	

Business Tax Law Changes

Provision	Prior Law	New Law
Meals & Entertainment (M&E)	50% deductible, whether related to employees or clients.100% deductible (and tax-free to employee) if meals were provided on business premises for convenience of the employer	Entertainment expenses are disallowed. Meals provided while traveling on business and meals provided on site are considered 50% deductible. After 2025, no deduction is allowed for meals provided on site for the convenience of the employer.
Employee Achievement Awards	Deductible to employer and tax-free to recipient as long as award was tangible personal property within a dollar limit of $400/award and $1,600 for all awards to the employee for the year.	Tangible personal property has been defined and does not include cash, gift cards, coupons, certificates, tickets, meals, vacations, lodging, stocks or bonds. To be deductible and tax-free to the recipient, the award must meet this definition. Dollar limits remain unchanged.

Overview – Per Diems & Accountable Plans

What Is "Per Diem"?

- Allowance paid to employees for lodging, meals and incidental expenses incurred when traveling away from home, in lieu of paying for actual travel expenses.

What Does Per Diem Cover?

- There is a rate for combined lodging and meal costs and a rate for meal costs alone – an employer can use either.

What Are The Per Diem Reimbursement Rates (High-Low Substantiation Method)?

- Lodging, Meals & Incidentals – High = $284, Low = $191
- Meals & Incidentals Only – High = $68, Low = $57

Are Per Diems Taxable To Employees?

- If the allowance is less than or equal to the federal rate, it does not need to be reported as W-2 income to the employee, as long as the requirements of an accountable plan are met.

Overview – Per Diems & Accountable Plans

Accountable plan: Allows an employer to reimburse and deduct employee travel expense without reporting it as W-2 income to the employee.

Nonaccountable plan: Requires ALL reimbursement payments to be reported as W-2 income to the employee.

Under an accountable plan:

- Employee must provide written evidence of ALL expenses incurred, including location, date and business purpose, AND
- If employee is reimbursed amounts in excess of the substantiated expenses, excess must be returned within a reasonable time (usually 30 days).

✓ If no written evidence is obtained, the reimbursement should be included in taxable income.

✓ If amounts in excess are not returned, they should be included in taxable income.

Overview – Per Diems & Accountable Plans

Other Items of Importance:

- If a plan is later determined to be non-accountable, employer could be held liable for payroll taxes related to the previously untaxed reimbursements.
- If an assignment is considered indefinite (i.e., over 12 months), any expenses for travel away from home are no longer deductible as travel expenses by the employer and instead must be included in the employee's compensation. The employer still receives the deduction, but it is instead characterized as compensation

What does this have to do with the new tax law changes?

Provision	Prior Law	New Law
Miscellaneous Itemized Deductions	Deductible to the extent exceeds, in the aggregate, 2% of the taxpayer's adjusted gross income.	Suspended. Therefore, when employees have taxable per diems related to jobs that are considered temporary (i.e., less than 12 months), they will no longer be able to personally deduct related traveling expenses.

Business Tax Law Changes

Provision	Prior Law	New Law
Business Interest	Generally deductible, subject to certain limitations	Disallowance of deduction of business interest in excess of 30% of adjusted taxable income. For pass-through entities, disallowance is made at the entity level. Amount disallowed are carried forward indefinitely. Does not apply to taxpayers with average annual gross receipts of $25 million or less for the three-year period ending with the prior tax year. Certain additional rules apply to partnerships.

Business Interest Limitation Example

ABC Contractor is a C corporation and has the following items of income and expense during the 2018 tax year:

Gross receipts	1,000
Interest income	50
Cost of goods sold	(700)
Interest expense	(150)
Depreciation	(100)
Taxable income before interest limitation	100

ABC Contractor's interest expense deduction is computed as follows:

Taxable income before interest limitation	100
Add back: net interest expense ($150-$50)	100
Add back: depreciation	100
Adjusted taxable income	300
Multiply by 30%	x30%
Business interest deduction limitation	90

Business Interest Limitation Example

ABC Contractor's deduction for net interest expense is limited to $90, resulting in disallowance of $10 of interest expense ($150 interest expense - $50 interest income = $100 net interest expense - $90 interest expense limitation = $10 disallowance).

- Limitation applies to all business entity types and is generally applied at the entity level. Any interest that is not deductible as a result of the limitation is carried forward indefinitely until it can be absorbed.

What About Pass-Throughs?

✓ S corporations - interest expense in excess of the limitation carries over at the entity level until the S corporation generates enough income to absorb the interest.
  - Shareholder does not reduce basis in the S corp stock until the interest is deducted

✓ Partnerships - interest in excess of the limitation is allocated to the partners with the excess interest carried over at the partner level until the partner is allocated excess taxable income from that entity.
  - Partner reduces basis in the partnership when interest is incurred even if not yet deductible.

Business Tax Law Changes

Provision	Prior Law	New Law
Section 199A Deduction	N/A	A non-corporate taxpayer who has qualified business income (QBI) may deduct the lesser of: • 20% of the taxpayer's combined QBI amount or • 20% of the taxable income (excluding capital gains) If taxable income exceeds $315,000: • Deduction may not exceed the greater of: • 50% of W-2 wages related to QBI • 25% of the W-2 wages plus 2.5% of the unadjusted basis of qualified property immediately after acquisition

Section 199A Deduction

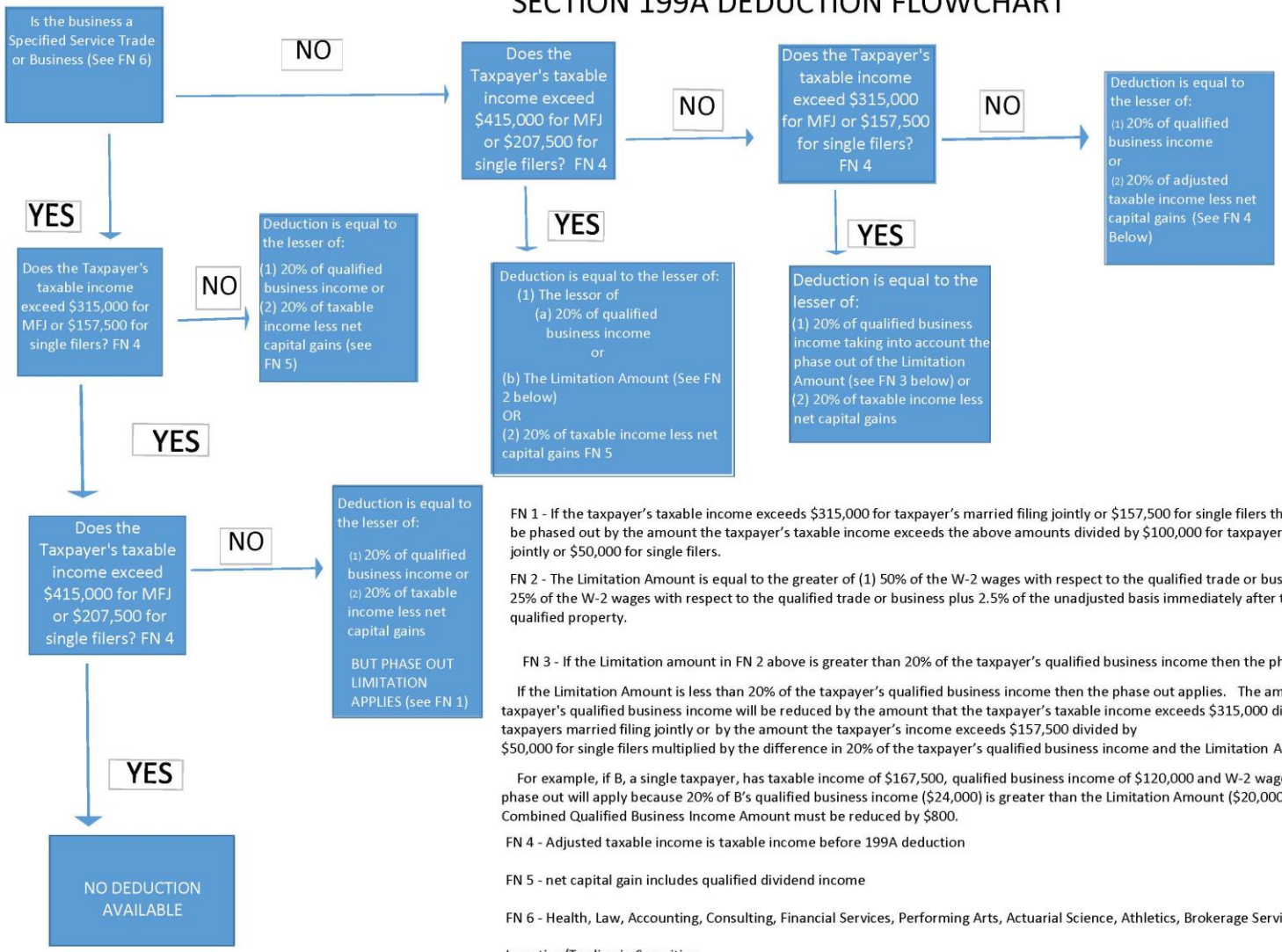
Important Definitions:

- ✓ **Qualified Business Income (QBI)** includes net amount of domestic qualified items of income, gain, deduction, and loss with respect to the taxpayer's qualified trade or businesses

- ✓ **Qualified Trades or Businesses** include any trade or business except a "specified services" trade or business

- ✓ **Specified Services Trade or Business** means any trade or business involving the performance of services in the fields of:
  - Health, law, accounting, actuarial sciences, performing arts, consulting, athletics, financial services, brokerage services,
  - Any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners

SECTION 199A DEDUCTION FLOWCHART



FN 1 - If the taxpayer's taxable income exceeds $315,000 for taxpayer's married filing jointly or $157,500 for single filers then the deduction will be phased out by the amount the taxpayer's taxable income exceeds the above amounts divided by $100,000 for taxpayer's married filing jointly or $50,000 for single filers.

FN 2 - The Limitation Amount is equal to the greater of (1) 50% of the W-2 wages with respect to the qualified trade or business or (2) the sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis immediately after the acquisition of all qualified property.

FN 3 - If the Limitation amount in FN 2 above is greater than 20% of the taxpayer's qualified business income then the phase out will not apply.

If the Limitation Amount is less than 20% of the taxpayer's qualified business income then the phase out applies. The amount equal to 20% of the taxpayer's qualified business income will be reduced by the amount that the taxpayer's taxable income exceeds $315,000 divided by $100,000 for taxpayers married filing jointly or by the amount the taxpayer's income exceeds $157,500 divided by $50,000 for single filers multiplied by the difference in 20% of the taxpayer's qualified business income and the Limitation Amount.

For example, if B, a single taxpayer, has taxable income of $167,500, qualified business income of $120,000 and W-2 wages of $40,000 then the phase out will apply because 20% of B's qualified business income ($24,000) is greater than the Limitation Amount ($20,000). Therefore B's Combined Qualified Business Income Amount must be reduced by $800.

FN 4 - Adjusted taxable income is taxable income before 199A deduction

FN 5 - net capital gain includes qualified dividend income

FN 6 - Health, Law, Accounting, Consulting, Financial Services, Performing Arts, Actuarial Science, Athletics, Brokerage Services,

Investing/Trading in Securities

Section 199A Deduction

Items to Note:

- ✓ Construction companies are unlikely to be subjected to limitations due to significant wages
- ✓ The deduction <u>does not</u> offset self-employment income or state taxes

Section 199A Example

FACTS

- Adjusted Gross Income (AGI) = $600,000
- Taxable Income = $576,000 before 199A
- Net Taxable Income from Construction Flow-Through = $505,000
- Capital Gains and Dividends from Construction Flow-Through = $5,000
- Qualified Business Income = $500,000
- W-2 Wages = $4,000,000
- Qualified Property = $500,000

BUSINESS DEDUCTION = $100,000

Since AGI is above $415,000, wages and capital limitation do apply (AGI between $315,000-$415,000 adds another calculation)

- Take the greater of the following, not to exceed $100,000 (20% x $500,000):
  - ✓ 50% x $4,000,000 = $2,000,000
  - ✓ (25% x $4,000,000) + ($500,000 x 2.5%) = $1,012,500

NET TAXABLE INCOME = $476,000

Section 199A Example

FACTS

- Adjusted Gross Income (AGI) = $400,000
- Taxable Income = $376,000 before 199A (assume other losses from separate entities)
- Net Taxable Income from Construction Flow-Through = $505,000
- Capital Gains and Dividends from Construction Flow-Through = $5,000
- Qualified Business Income = $500,000
- W-2 Wages = $4,000,000
- Qualified Property = $500,000

BUSINESS DEDUCTION = $74,200

- Taxable Income - Net Capital Gains * 20% ($376,000-$5,000=$371,000*.2=$74,200)

NET TAXABLE INCOME = $301,800

Business Tax Law Changes

Provision	Prior Law	New Law
Domestic Production Activities Deduction (DPAD)	Deduction equal to 9% of the lesser of qualified production activities income or taxable income for the tax year Limited to 50% of the W-2 wages paid during the calendar year.	Repealed
Corporate Tax Rate	Graduated rates, starting at 15% for taxable income up to $50,000, with rates at 25% for income between 50,001 and $75,000, 34% for income between $75,001 and $10 million, and 35% for income above $10 million. Personal service corporations taxed at 35% flat rate.	Flat rate of 21%. Personal service corporations are taxed at the same rate as other C corporations.

Individual Tax Law Changes

Married Filing Joint			
2017		2018	
Tax Rate	Tax Bracket	Tax Rate	Tax Bracket
10%	$0-$18,650	10%	$0-$19,050
15%	18,650-75,900	12%	19,050-77,400
25%	75,900-153,100	22%	77,400-165,000
28%	153,100-233,350	24%	165,000-315,000
33%	233,350-416,700	32%	315,000-400,000
35%	416,700-470,700	35%	400,000-600,000
39.6%	over 470,700	37%	over 600,000

Single			
2017		2018	
Tax Rate	Tax Bracket	Tax Rate	Tax Bracket
10%	$0-$9,325	10%	$0-$9,525
15%	9,325-37,950	12%	9,525-38,700
25%	37,950-91,900	22%	38,700-82,500
28%	91,900-191,650	24%	82,500-157,500
33%	191,650-416,700	32%	157,500-200,000
35%	416,700-418,400	35%	200,000-500,000
39.6%	over 418,400	37%	over 500,000

Note: Individual Tax Reform is temporary. The provisions are generally effective January 1, 2018, and expire on December 31, 2025.

Individual Tax Law Changes

Provision	Prior Law	New Law
Standard Deduction	$12,700 for joint filers, $9,350 for head-of-household filers, and $6,350 for single filers.	$24,000 for joint filers, $18,000 for head-of-household filers, and $12,000 for all other taxpayers, adjusted for inflation in tax years beginning after 2018.
Personal Exemptions	$4,050	Reduced to zero
State & Local Tax Deduction	Generally deductible as an itemized deduction.	Limited to $10,000
Child Tax Credit	$1,000 per qualifying child, phasing out when AGI exceeds $110,000 for joint filers, $75,000 for single filers.	Increased to $2,000, phasing out when AGI exceeds $400,000 for joint filers, $200,000 for all other taxpayers.
Alternative Minimum Tax (AMT)	Exemption amounts were $54,300 for single, $84,500 for joint filers, $42,250 for married filing separately. Reduced (not below zero) to 25% of AMT income exceeding the following phase-out thresholds: • For single filers, $120,700 • For joint returns, $160,900 • For married filing separately, $80,450	Exemption amounts increased to $70,300 for single, $109,400 for joint filers, $54,700 for married filing separately. Reduce (not below zero) to 25% of AMT income exceeding the following phase-out thresholds: • For joint returns, $1 million • For all other taxpayers (other than estates and trust), $500,000

Questions?

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