WHAT CONTRACTORS NEED TO KNOW ABOUT THE NEW TAX REFORM

As the new tax reform took shape in late 2017 and then was approved just a few days before Christmas, our contractor services team were examining what elements could have the most impact on contractors and small business owners. Now, what is commonly being called the Tax Cut and Jobs Act (TCJA) of 2017 has caused a lot of discussion on whether companies will come out as winners or losers in 2018. While it has enhanced some tax breaks for contractors, it has also reduced or eliminated others.

Let's start with the good news first. Here are some of the positive outcomes we think may be coming contractors' way with the new law.

Expanded Use of Cash Basis Accounting Method

Many contractors with average receipts over $10,000,000 have been required to use the percentage of completion method for tax purposes. The TCJA provides that, for tax years beginning after December 31, 2017, taxpayers that have average annual gross receipts of $25 million or less during the preceding three years are not required to report on the percentage of completion method and can elect to be treated on the cash basis of accounting. The cash basis of accounting should present a more favorable deferral of income for a contractor.

Favorable Depreciation Rules - Bonus depreciation, Section 179 and Vehicles

The IRS has effectively lowered the cost of acquiring capital assets by making substantial changes to the income tax rules for bonus depreciation, Section 179 expensing, and depreciation on passenger automobiles, small vans, and trucks. The two big changes with bonus depreciation are the deduction is raised to 100 percent of the purchase price from 50 percent and bonus depreciation is available on new and used purchases where in the past it was limited to new equipment. Code Section 179 expensing limits were raised from $500,000 to $1,000,000 in 2018, and the new law allows for $2,500,000 in total qualified purchases before the deduction is phased out while prior to the new law the phase out threshold was $2,000,000. The new law triples the annual dollar caps on depreciation of passenger automobiles, small vans, and trucks.

New Deduction on Pass-through income

Many contractors have set-up S-Corporations or partnerships (LLCs) which "pass-thru" income to its shareholders / partners. The new law provides a 20 percent deduction for "qualified business income," defined as income from a trade or business conducted within the U.S. by a partnership, S-Corporation, or sole proprietorship. Investment items, reasonable compensation paid by an S-Corporation, and guaranteed payments by a partnership (LLC) are excluded. There are some limitations on taxpayers with taxable income over $157,500 for single and $315,000 for joint filer. Limitations will be calculated based on W-2 wages paid by the businesses and basis of acquired depreciable tangible property used in the business. The deduction is phased out for certain service related trades or businesses for tax payers over the income levels, such as health, law, consulting, financial or brokerage services, *and unfairly, accountants.* The reason being that with these types of businesses the principle asset is the reputation or skill of one or more employees or its owners.

Personal income tax rates: 2017 vs. 2018

2017	2018
10%	10%
15%	12%
25%	22%
28%	24%
33%	32%
35%	35%
39.6%	37%

Along with the rates, the brackets in the upper limits improved slightly.

Meet the TBC Construction Services Team *TBC has professionals on staff that devote a substantial portion of their time serving contractors of all sizes and entity structure.*

C-Corporation Tax Rates and Corporate AMT

The new law will change the rates of C-Corporations from graduated tax rates to a flat tax rate. The new law has a flat tax rate of 21 percent when prior law had graduated tax rates of 15 percent on income up to $50,000, 25 percent on income between $50,000 and $75,000 and 34 percent on income between $75,000 and $10,000,000. The law also eliminates corporate AMT which could help contractors (C-Corporations) who were on cash basis but had to record a long-term contract adjustment for AMT purposes.

Personal Income Tax Rates

Personally, business owners and their employees will receive a break on the rates they are taxed at. Rates have been dropped between 0 percent and 4 percent based on each bracket. The tax rates were adjusted as follows: 10 percent stayed the same, 15 percent was dropped to 12 percent, 25 percent was dropped to 22 percent, 28 percent to 24 percent, 33 percent to 32 percent, 35 percent stayed the same, and 39.6 percent was dropped to 37 percent. Along with the rates, the brackets in the upper limits improved slightly (continued on other side).

CONTINUED FROM PAGE 1

Here are the changes within the new tax code that may negatively impact contractors:

Domestic Production Activities Deductions

Most of the contractors have been receiving a nine percent deduction of their qualified income for the DPAD deduction. Moving forward, the deduction will be lost after December 31, 2017. On the plus side, pass-thrus should get 20 percent deduction on qualified income so the net change is a positive 11 percent deduction.

Like Kind-Exchanges on Non-Real Estate Properties

The Section 1031 exchange rules that allowed tax-deferred exchanges of appreciated like-kind property is only allowed for real estate after December 31, 2017 There will be no more like-kind exchanges for personal property assets like contractors' vehicles and equipment. To offset this issue, the depreciation rules have improved on expensing so if you have to pick up a gain on the trade-in, you should be able to depreciate (write off the purchase). We work with several contractors that switched from C-Corporations to a S-Corporation with built-in gains. These particular contractors will need to monitor these transactions so they don't trigger the built-in gains tax during the recognition period.

Reduced or Eliminated Travel and Entertainment Deductions

The new law now limits some of the travel and entertainment deductions which were allowed in the past. After December 31, 2017, entertainment deductions are disallowed and there are reduced deductions for meals. Meals provided out of town could still count, but meals on the employers' premise could be excluded.

Eliminated Unreimbursed Employee Expenses - Itemized Deduction

An item that might affect contractors' employees more than the owners is the deduction for unreimbursed business expenses. The new law has eliminated this itemized deductions for unreimbursed business expenses over two percent of their adjusted gross income. Items like unreimbursed mileage, tools, and union dues are items commonly deducted by construction employees.

Limits on Interest Deductions

Subject to some restrictions and exceptions, prior law stated that interest paid or accrued by a business generally is fully deductible. Under the new law, corporate and non-corporate businesses generally cannot deduct interest expenses in excess of 30 percent of "adjustable taxable income" starting in 2018. For S-corps, partnerships, and LLCs the limit is applied at the entity level rather than the owner level. Between 2018 and 2021, "adjustable taxable income" is calculated by adding back depreciation and amortization.

This article is general in nature. The reader should contact their tax advisor for additional information or for clarification on how this will affect their personal situation. For more information or a question specific to your entity, please contact us at 518-456-6663 and a member of our construction services team can help you navigate the new tax law.