Crowe

Tax Reform: Construction Highlights

President Donald Trump signed H.R. 1, known as the *Tax Cuts and Jobs Act*, on Dec. 22, 2017. The following is a summary of the key provisions of the bill that could have the most impact on construction companies. Most provisions are applicable starting in 2018 (for calendar year taxpayers), unless otherwise noted. (Because of varying effective dates, some new provisions – for example, interest expense limitation – will not apply to fiscal years ending in 2018 but will apply to fiscal years ending in 2019 and later.)

	PREVIOUS LAW	NEW LAW	COMMENTS/OBSERVATIONS
Corporate Tax Rates	Top rate of 35%. Corporate alternative minimum tax (AMT) rate 20%.	Reduces corporate tax rate from 35% to 21%. Repeals corporate AMT.	CCs may want to evaluate changing to a C corporation depending on their circumstances and should discuss such a change with their tax advisers. With potential conversion to a C-corp, CCs need to consider double tax of dividends and any potential state tax implications. Benefits of such a conversion might apply only in limited circumstances.
Pass-Through Entity Provisions	Income included at ordinary rates.	Deduction for 20% of pass-through income is not to exceed the greater of the following: • 50% of wages paid by the business • 25% of wages paid by the business plus 2.5% of the original tax basis of certain tangible property 20% deduction is from taxable income rather than adjusted gross income (AGI), so it does not affect various AGI limitations. Trusts and estates also are eligible for the 20% deduction. Service business income for high-income taxpayers (other than architects and engineers) is not eligible for the deduction.	The effective top marginal rate for most pass-through CC ordinary income would be approximately 29.6%. Multientity structures should consider the impact of the wage limitation as this likely will be applied on an entity-by-entity basis. Such structures may need to consider restructuring due to this limitation. High-margin, low-wage CCs may run into the wage limitation, creating an effective rate in excess of 29.6%.

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Interest Expense	Generally deductible when incurred without limitation.	Limits deduction to 30% of adjusted taxable income. Adjusted taxable income is earnings before interest, taxes, depreciation, and amortization through 2021 and earnings before interest and taxes in subsequent taxable years. Applies to real estate businesses unless they elect to use the alternative depreciation system (ADS) in lieu of the modified accelerated cost recovery system and 100% expensing. Generally applies on an entity-by-entity basis. Special rules apply to pass-through entities. Includes unlimited carryforward of disallowed amounts. Taxpayers with average gross receipts of $25 million or less would not be subject to interest expense limitation.	Leveraged entities should consider the impact of this limitation and the use of debt to finance operations. The small-business exceptions are subject to controlled group attribution. These thresholds are likely not helpful to most CCs on a stand-alone basis. For real estate and other entities, if the gross receipts must be added together for related ownership entities, most will be excluded.
Cash Basis and Completed Contract Methods	Generally limited to taxpayers with three-year gross receipts averaging less than $10 million.	Increases average gross receipts test limit from $10 million to $25 million. Related-party receipts test remains.	Taxpayers with average gross receipts of less than $25 million should consider the impact of the completed contract method. This method would be available to contracts entered into after Dec. 31, 2017. Taxpayers with gross receipts of less than $25 million who are generally underbilled should consider the impact of the cash method.
Domestic Production Activities Deduction (DPAD)	Deduction of up to 9% of taxable income.	Repealed.	New lower C-corp and qualified flow-through income tax rates generally exceed the loss of the DPAD.

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Depreciation and Amortization	50% bonus depreciation.	Allows 100% expensing for new and used equipment acquired after Sept. 27, 2017, unless purchased pursuant to a binding contract entered into prior to that date; no immediate expensing for buildings. Real estate businesses may elect out of interest limit in exchange for 100% expensing on qualified improvement property. Electing real estate entities will depreciate real property using 40 years for buildings and 20 years for qualified improvement property versus their general depreciation system recovery periods of 39 years and 15 years, respectively.	CC equipment acquired and placed in service between Sept. 27, 2017, and Jan. 1, 2018, is eligible for the new 100% bonus depreciation. State conformity will be key. Many states likely will not allow bonus depreciation, creating large state tax adjustments. Any new property acquired and placed in service prior to Sept. 28, 2017, is allowed the 50% bonus depreciation under previous law. Adopting real estate companies depreciate their real property using ADS – 40 years versus 39 years for buildings, 20 years versus 15 years for qualified improvement property. They also lose bonus depreciation on qualified improvement property. Electing real estate businesses still get bonus depreciation on personal property and land improvements.
Section 179 Expense	$500,000 with phaseout at $2 million.	Increases business expensing to $1 million with phaseout amount starting at $2.5 million. Qualifying property now includes roofs, heating, ventilation, air-conditioning, fire protection, and alarm and security systems.	
Depreciation Limits for Luxury Automobiles	Depreciation limited to $3,160 for year one, $5,100 for year two, $3,050 for year three, and $1,875 for year four and following years.	Increases depreciation limits to $10,000 for year one, $16,000 for year two, $9,600 for year three, and $5,750 for year four and following years.	The depreciation limit is increased without regard to bonus depreciation eligibility.
Like-Kind Exchanges	Generally allowed.	Repeals like-kind exchanges except for investments held in real estate.	Deferred exchanges (forward and reverse) in progress as of Dec. 31, 2017, can be completed as like-kind exchanges. Loss of like-kind exchanges for equipment may not negatively affect taxpayers due to 100% bonus depreciation provisions.

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Individual Tax Rates and Itemized Deductions	Top rate of 39.6% beginning at $480,050 for married filers and $426,700 for single filers. Standard deduction of $12,700 for married filers and $6,350 for single filers. Allows these personal deductions: • Moving expenses if incurred in connection with work-related relocation • Itemized deduction for casualty losses • Miscellaneous deductions as an itemized deduction subject to the 2% floor • Alimony (deductible to payer, taxable income to the recipient) • Medical expenses if in excess of 10% of AGI • Charitable contributions (cash contributions limited to 50% of AGI) • State and local taxes • Mortgage interest (deductible up to $1 million of acquisition indebtedness on primary residence plus one additional residence and $100,000 of home equity indebtedness) $4,050 personal exemption per individual and dependent.	Includes seven brackets with a top rate of 37% at $600,000 for married taxpayers filing jointly or $500,000 for single or head of household taxable income. Generally retains current laws on capital gains and qualified dividends rates. Provides standard deduction of $24,000 for married filers and $12,000 for single filers. Eliminates these personal deductions: • Moving expenses except for certain armed forces • Interest on home equity loans • Casualty losses except for disaster areas • All miscellaneous deductions currently subject to the 2% floor • Alimony on new or modified divorces (also not taxed as income) Retains these personal deductions with changes: • Medical expenses over 7.5% of income • Charitable contributions with new 60% limit • State and local taxes including income, property, and sales taxes (up to $10,000 total) • Mortgage interest (capped at $750,000 for married taxpayers filing jointly or $375,000 for all other taxpayers) on acquisition indebtedness after Dec. 31, 2017 (retains the $1 million limitation on acquisition indebtedness incurred prior to Dec. 15, 2017) Repeals limitation on itemized deductions until Dec. 31, 2025. Eliminates personal exemptions.	Most individual provisions expire Dec. 31, 2025. Note: Personal deductions are modified/repealed, but businesses still may deduct property taxes, etc.
Limitation on Losses for Taxpayers Other Than Corporations	Unlimited use of trade or business losses (after application of passive loss rules) to offset other income.	Disallows an excess business loss (trade or business deductions in excess of trade or business gross income or gain plus $500,000 for married taxpayers filing jointly or $250,000 for all other taxpayers) of taxpayers other than a C corporation. Treats disallowed business loss as a net operating loss to be carried forward. For S corporations and partnerships, the limitation is applied at the individual level and is applied after any passive loss limitations. Trade or business deductions include income and deductions from pass-through entities.	The loss limitation will be in effect for tax years beginning in 2018 and expires after Dec. 31, 2025. An individual's total trade or business losses generally are limited to $500,000 for married filers and $250,000 for single filers. Excess losses will be carried over to the subsequent tax year as a net operating loss.

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Alternative Minimum Tax	Corporate AMT rate of 20%. 28% rate applies if AMT exceeds regular tax liability.	Repeals the corporate AMT after Dec. 31, 2017. Keeps personal AMT, but increases exemptions and phaseout thresholds from 2018 through 2025.	Personal AMT exemption is raised to $109,400 for married filers and $70,300 for single filers. Exemption does not phase out until income subject to AMT is $1 million for married filers and $500,000 for single filers.
Estate Tax	$5 million per person.	Doubles estate tax exemption from $5.6 million to $11.2 million (indexed for inflation) for estates or gifts made after Dec. 31, 2017, and before Jan. 1, 2026.	Review of estate plans should be considered due to increased exemption.
Net Operating Loss (NOL) Deductions	Can offset 100% of income. Can offset 90% of AMT income. Two-year carryback and 20-year carryforward of NOLs.	Generally limits the NOL deduction to 80% of taxable income for losses incurred in 2018 or later years. Repeals the two-year carryback provision and allows for indefinite carryforward provision.	NOLs will have no immediate tax benefit due to loss carryback.
Entertainment Expenses	Deduction allowed for 50% of entertainment expenses.	No deduction is allowed.	
***Family and Medical Leave Act* (FMLA)**	No credit for wages paid to employees under FMLA.	Allows credit for up to 25% of wages paid under FMLA.	No credit if payment required under state or local law.

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