

Tax Reform

Key Provisions Impacting Construction Companies and their Shareholders

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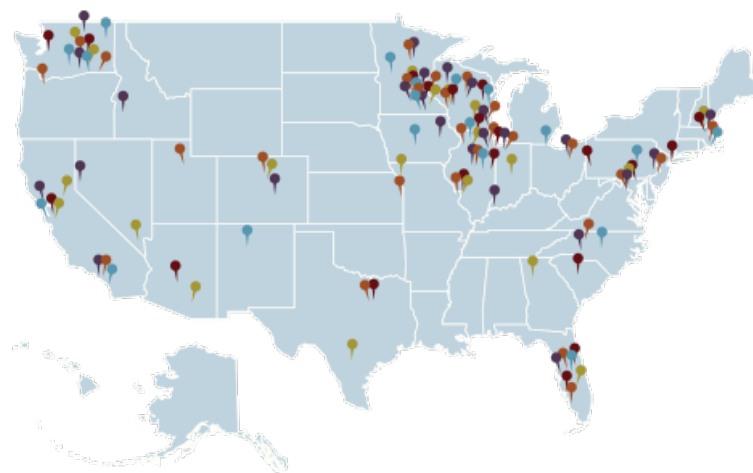


Today's Topics

- Business Provisions - Tax Cuts and Jobs Act (TCJA)
- Corporate Tax Rates
- Section 199A and Qualified Business Income (QBI)
- S vs C Corporations
- Accounting Methods

About CliftonLarsonAllen

- GALLINA LLP merged with CLA as of 1/1/2017
- A professional services firm with three distinct business lines
 - Audit, Tax and Consulting
 - Outsourcing
 - Wealth Advisory
- More than 5,000 employees
- Offices coast to coast



H.R.1 – Tax Cuts and Jobs Act (TCJA)

- **H.R.1 Official Title:** “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.”
- **December 22, 2017:** Signed into law by President Trump (Public Law No. 115-97)



Tax Cuts and Jobs Act (TCJA)

Business Provisions



Depreciation – Under TCJA

- **100% Bonus Depreciation**
 - Applied retroactively and effective for property **acquired and placed** in service after September 27, 2017
 - Phase down beginning in 2023 (fully phased out after 2026)
 - Eligibility expanded to used property
- **Section 179 Expensing Increased to \$1M**
 - Phase-out threshold increased to \$2.5M
 - Eligibility expanded to include roofs, HVAC and fire alarm/security systems.
 - Effective for tax years beginning after 12/31/2017
 - Section 179 you need net income, bonus depreciation can be taken whether you have net income or a net loss

Buildings, Equipment and Autos

- **Buildings**

- Retains 39-year and 27.5 year provisions
- Retains 15 year qualified improvement property
 - ◇ Interior portion of buildings, nonresidential

- **Like Kind Exchanges (Section 1031 Exchange)**

- No longer applies to equipment
- Applies only to real property (real estate, land, buildings, inherently permanent structures and their components)

- **Luxury Autos**

- Maximum depreciation for passenger autos increased from \$3,160 to \$10,000 (+additional \$8K bonus dep.)
 - ◇ Second year from \$5,100 to \$16,000

Disallowed Business Interest Expense

- **Pre-TCJA:** Business interest generally allowed as a deduction
- **Under TCJA: Interest expense limited to interest income + 30% of remaining adjusted taxable income**
 - Remaining business adjusted taxable income
 - Determined w/o interest income, NOL, 199A, depreciation, amortization, depletion
 - Determined at tax filer level (1065, 1120-S, 1120)
 - Excess carried forward indefinitely
 - **Businesses with <\$25M average annual gross receipts exempt**

Meals & Entertainment

- **Entertainment Expense: Non-Deductible!**
 - Transportation passes and parking fringes disallowed
 - Social, athletic and sporting clubs treated as entertainment
- **Employer-provided eating facility limited to 50%**
 - *Pre-TCJA: 100% Deductible*
 - Also repeals employer deduction for employer-provided on premises meals and employer eating facilities after 2025
- **Meals consumed on work travel remain 50% deductible**
- **Holiday parties, Company-wide events, etc. remain 100% deductible**

Business Credits

- **Research and Development Credit – Retained**
- **Work Opportunity Tax Credit (WOTC) – Retained**
- **New Credit - Employer-Paid Family and Medical Leave:**
 - Credit = 12.5% wages paid to qualifying employees during any period in which employees are on family and medical leave
 - Rate of payment must be > 50% wages normally paid
 - Credit increased 0.25% for each percentage point by which payment rate exceeds 50%, up to a Maximum credit = 25%, for Maximum 12 weeks
 - Employee wages must be less than \$72,000 annually to qualify
 - Not available to the extent that family and medical leave is mandated by state or local law
 - Available for 2018 and 2019 Only and Allowed Against AMT
- **Employee Retention Tax Credit (Not part of the TCJA)**
 - Expanded to include California wildfires (up to \$2,400 per employee)

Tax Cuts and Jobs Act (TCJA)

Corporate Tax Rates



Corporate Tax Rates

Corporate Tax Rate Under TCJA:

2017 Corporate Tax Rates (Graduated)	
Tax Bracket	Taxable Income
15%	50,000
25%	75,000
34%	100,000
39%	335,000
34%	10,000,000
35%	15,000,000
38%	18,333,333
35%	EXCESS
Corporate AMT Tax Rate = 20%	

- **Flat 21% Rate**, effective for tax years beginning after December 31, 2017*
- **20% Corporate AMT Repealed** (*Prior AMT Credits refundable up to 50% of excess AMT credits > regular tax liability for 2018 – 2020; Remaining AMT credit refunded in 2021*)
- **Net Operating Losses (NOLs)**
Maximum amount of business taxable income that can be offset with prior NOLs is reduced to 80%.

❖ **Blended tax rate for corporations with fiscal years beginning before 12/31/2017**



Tax Cuts and Jobs Act (TCJA)

Section 199A and QBI



Section 199: Domestic Production Activities Deduction

- **Pre-TCJA:**

- Began in 2006
- Provided a deduction of 9% of qualified income manufacturing, mining, construction, architecture, engineering, software
- Deduction could not exceed 50% of wages or 9% of AGI

- **Under TCJA: Repealed**

- Effective for taxable years beginning after 12/31/2017

Individual Qualified Business Income (QBI) Deduction

- Deduction available for noncorporate taxpayers
 - *Also referred to as the “pass-through deduction”*
- Not a deduction to arrive at AGI
 - *Does not reduce AGI for purposes of AGI thresholds*
- Intended to reduce the tax rate on QBI to a rate closer to the corporate tax rate (effective rate of 29.6%)
- 20% accuracy penalty applies when understatement exceeds 5%
 - Normally applies to understatement > 10%
- *Sunsets for tax years beginning after 12/31/2025*

Individual Qualified Business Income (QBI) Deduction

- **Deduction = 20% of the lesser of qualified business income or taxable income**
 - Sole Proprietorships (reported on Sch C)
 - Pass-through entities subject to tax at the individual owner level (from Sch K-1)
 - *Wages paid by S Corp and guaranteed payments paid by partnership not included*

Individual Qualified Business Income (QBI) Deduction

- **Limited to greater of:**
 - 50% of the taxpayer's share of allocable wages from pass-through entities
 - Sum of 25% allocable wages + 2.5% unadjusted basis of qualified property
- **Qualified Property Defined:**
 - Depreciable tangible property held by and available for use at the close of the tax year
 - Included in computation if held at least 10 years or until expiration of recovery period, whichever is longer

Individual Qualified Business Income (QBI) Deduction

- **Lower Income and Wage Limitation**
 - Wage & investment limitation does not apply for taxpayers below taxable income threshold amounts
 - <\$315,000 MFJ / \$157,500 Single
 - Phase in 20% limit over next \$100,000 MFJ / \$50,000 Single
- **Deduction Allowed Against AMTI**
- **Not Available for Purposes of Self-Employment Tax**
- **Deduction Allowed to Non-Itemizers**

Tax Cuts and Jobs Act (TCJA)

S Corporation vs. C Corporation



C Corporation Example

		C Corporation		
		Federal	CA	Total
Business income		1,000,000	1,000,000	1,000,000
CA tax deduction		(88,400)		
Net taxable income		911,600	1,000,000	
Tax rates		21.0%	8.84%	
Tax amounts		191,436	88,400	279,836



S Corporation Example

	S Corporation		
	Federal	CA	Total
Business income	1,000,000	1,000,000	
CA S corp 1.5% tax	(15,000)	-	
Subtotal	985,000	1,000,000	
QBI Deduction 20%	(197,000)		
Net taxable income	788,000	1,000,000	
Tax rates	37.0%	12.3%	
Tax amounts	291,560	123,000	414,560
CA S corp 1.5% tax			15,000
Total tax paid			429,560



S vs C Taxes Paid

	S Corporation		C Corporation		Savings	
Total Taxes Paid	429,560	42.96%	279,836	27.98%	149,724	14.97%



So What's the Catch? Capital Gains Tax

	S Corporation			C Corporation			Savings	
5 Years of Earnings	5,000,000			5,000,000			-	
Taxes Paid	2,147,800			1,399,180			748,620	14.97%
Retained Earnings	2,852,200			3,600,820			(748,620)	
Capital Gains Tax								
Federal tax (0%/20%)	-	0.00%		720,164	20.00%		(720,164)	
NIIT (0%/3.8%)	-	0.00%		136,831	3.80%		(136,831)	
CA tax (0%/12.3%)	-	0.00%		442,901	12.30%		(442,901)	
Total capital gains tax	-	0.00%		1,299,896	36.10%		(1,299,896)	
Taxes Paid over 5-years	2,147,800			1,399,180			748,620	
	2,147,800	42.96%		2,699,076	53.98%		(551,276)	-11.03%



Additional S vs C Considerations

- What could the Company do with an extra 15% cash savings?
 - Pay down debt, buy additional resources, etc.
- Inability to re-elect S Corporation status for 5 years
- Ownership transition
 - 3rd Party sale (private equity) or internal to family or key employees
- Uncertainty over the length of low corporate tax rates given the political climate
 - Built in Gains considerations
- AAA balances can be withdrawn from an S Corporation up to one year after revoking S Corporation election

Tax Cuts and Jobs Act (TCJA)

Accounting Methods



Accounting Methods

- Long-Term Contract gross receipts test increased from \$10M to \$25M (3-year average)
 - Available for Companies below \$25M
 - Cash Method
 - Completed Contract Method
 - Accrual with deferral of retentions

Many of the methods are available for Automatic Consent changes



Questions?



Thank you



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