Key tax reform takeaways for construction contractors and real estate businesses

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Takeaways specific to real estate businesses

> The pass-through 20 percent deduction provides opportunity for real estate rental and development entities. Service-oriented businesses may require operational and branding changes to take advantage of the 20 percent pass-through deduction for business income.

> Limitations on the deduction of business interest expense require real property trades or businesses to consider electing out of the 30 percent limitation. The corresponding trade-off is no bonus depreciation and longer depreciable lives for certain assets. Making appropriate elections will mitigate lost deductions.

> 100 percent bonus depreciation drastically changes the landscape for operating businesses. Proactively working with a tax advisor to determine if immediate expensing is to your benefit enables you to add real value to your bottom line.

> Tax deferral for governmental incentives such as tax incremental financing or other location incentives have been limited, and receipt of such funds requires preparation to achieve the best tax results.

> To receive favorable long-term capital gains treatment for carried interests, any gain allocable to the carried interest must be attributable to assets held for more than three years.

> Cash-basis accounting and percentage of completion method are more readily available since thresholds have increased. Consider whether these accounting method changes are beneficial to your business.

> The limitations imposed on deducting state and local real property taxes and personal property taxes do not apply to taxes that are paid or accrued in carrying on a trade or business; they are in limitations on individual itemized deductions.

> Like-kind exchanges of real estate are preserved but equipment exchanges, such as vehicle trade-ins, are no longer tax-free events. Consider and negotiate trade-in values on your commercial and executive fleets.

Takeaways specific to construction contractors

> Pass-through 20 percent deduction rules await clarification from IRS. Operational and branding changes may be necessary for contractors to take advantage of the 20 percent pass-through deduction for business income.

> Limitations on the deduction of business interest expense require contractors to consider an election out of the 30 percent limitation. Making appropriate elections will mitigate lost deductions.

> 100 percent bonus depreciation drastically changes the landscape for contractors and your clients. Proactively working with your client on project design enables you to add value to your client relationship. This can be a key area of differentiation for any contractor.

> Vehicle trade-ins are no longer tax-free events. Consider and negotiate trade-in values on your commercial and executive fleets. 100 percent bonus is available on vehicles in excess of 6,000 pounds.

> Cash-basis accounting and percentage of completion method now available since thresholds for “small” contractors have increased. Consider whether these accounting method changes are beneficial to your business.

> Flow-through entities need to track tax basis for their owners. Changes in tax law effective Jan. 1, 2018 make this especially important for any owner considering a liquidation event in the next five to seven years.

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Takeaways for both real estate businesses and construction contractors

- Business entertainment expenses are no longer deductible. Changes to the law require modifications to your expense reporting and reimbursement procedures. Review expense reporting policies and procedures to avoid lost deductions. Business meals with clients or customers should be 50 percent deductible as long as the meeting is business-related.
- Business net operating losses can no longer be applied to prior years and losses are limited in the current year to 80 percent of the business's taxable income. Deductible losses of non-corporate taxpayers are limited as well. Review loss potential and any limitations that may apply currently and in future years.
- C corporation? S corporation? LLC? What form is your business and is it the right choice under new law? You have options and should be working through scenarios now to mitigate unnecessary exposure.
- The domestic production activities deduction (DPAD) is repealed, but the research and development (R&D) credit is retained. R&D modifications require capitalization and amortization of the credit over a five-year period beginning in 2022. Limitation on business losses may make the R&D credit a consideration.
- There are new tax incentives for energy-efficient construction that are applied retroactively for 2017. Qualifying units can get a $2,000 tax credit per residential unit as well as a deduction based on the square footage of the qualifying building. Multifamily and single-home builders qualify.
- Federal tax law changes may not have a corresponding and proportionate state impact. Work with your tax advisor to review changes at the federal and state level.
- New IRS exam procedures significantly affect entities taxed as partnerships. Work with legal and accounting advisors to review and revise all governing documents.