



The Tax Reform Act: An Overview of Provisions Affecting Contractors

The Tax Cuts and Jobs Act signed into law in late December has been described as the most sweeping tax overhaul in more than 30 years. But the effects go far beyond taxes alone. Many of the new law's provisions could also affect how you organize and manage your construction-related business in the years to come.

Plan on spending some time with your accounting team soon to discuss steps you should take in response to the changes. It's impossible to foresee all the specific issues you might encounter, but here is a quick overview of some provisions that are most likely to affect construction businesses.

Personal Tax Provisions

One of the most talked-about changes in the new law is a reduction in individual income tax rates. Like most of the individual income tax provisions, these cuts are scheduled to expire in 2026 unless Congress takes additional action before then.

Another important provision for many contractors is a 20 percent deduction on pass-through income from S corporations and LLCs. This deduction is subject to some complex limitations, however, so be sure to ask your tax professional about it.

For higher-income taxpayers, the Alternative Minimum Tax (AMT) is still in place, but the exemption levels have been increased so fewer taxpayers will be affected. The new law also puts a \$10,000 limit on state and local tax deductions and lowers the cap on the mortgage interest deduction to the first \$750,000 of principal value.

The 40 percent estate tax also remains in place, but the exemption level has been doubled to \$11.2 million, so fewer estates will be subject to it. This provision is scheduled to expire in 2026, so keep this in mind as you consider your long-term estate planning.

Business Tax Provisions

Unlike the changes to personal income taxes, the changes to business income taxes are permanent. The largest and most far-reaching of these is a major cut in the corporate income tax rate.

Starting in 2018, corporations will be taxed at a flat rate of 21 percent, instead of the previous graduated rate structure that topped out at 35 percent. The new law also repeals the corporate AMT.

While these changes are good news for most contractors, some of the other changes are likely to have mixed effects. For example, there are new limits on the amount of net operating losses (NOLs) your company can apply to other years' taxes. Starting with your 2018 return, NOL carrybacks to prior years have been eliminated, and NOL carryforwards will be limited to 80 percent of your company's taxable income.

The new law also limits the deductibility of net interest expense to 30 percent of earnings before interest, taxes, depreciation and amortization (EBITDA). Starting in 2022, interest expense deductions will be limited to 30 percent of earnings before interest and taxes (EBIT).

Another change that will affect many construction businesses is the repeal of the domestic production activities deduction under Section 199 of the Internal Revenue Code. The new law

also increases the Section 179 expensing limit and makes changes to the research and development (R&D) tax credit – two more provisions that are often used by contractors.

Starting in 2018, the new law will allow certain small contractors with less than \$25 million in gross receipts to choose the cash method of accounting rather than the accrual method. Some might also be able to choose something other than the percentage-of-completion method to account for revenue from long-term contracts.

But remember that such choices would have a significant impact on numerous other tax and accounting questions. We encourage you to talk with your accounting professionals first, before you start considering any such changes.

Stay Tuned

In addition to the points mentioned here, there are many other provisions of the Tax Cuts and Jobs Act that are likely to affect both your business and personal tax situations.

We will keep you updated on the new tax law as these issues become clearer in the months to come. In the meantime, for more information, please contact [Jason DaPonte](#) at 401-752-0558.

