Tax Reform:

WHAT IT MEANS FOR CONTRACTORS AND REAL ESTATE EXECUTIVES

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Agenda

We will cover:

- Review Corporate Tax Changes
- Business Deduction Changes
- Depreciation Changes
- Accounting Methods for “Small” Businesses
- Section 199A Deduction for Pass-through Entities and Sole Proprietorships
- Opportunity Zone Tax Incentives

CORPORATE TAX CHANGES

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Corporate Tax Changes

- Elimination of multi-bracket corporate tax rate structure
- Replaced with a 21% flat corporate tax for tax years ending after 12/31/2017
- A blended rate applies for fiscal years ending 2018

Corporate Tax Changes

Corporate Alternative Minimum Tax (AMT)

- Repealed for tax years ending after 12/31/2017
- AMT credit carryovers to tax years after that date generally can be utilized to offset the corporations regular tax liability
- For tax years beginning in 2018 through 2020, to the extent AMT credit carryforwards exceed the regular tax liability, 50% of the excess AMT credit carryforward will be refundable
- Any amount leftover in 2021 will be fully refundable

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Corporate Tax Changes

Net Operating Loss Changes

- NOL's arising **before** 1/1/2018 follow the "old" rules, subject to a 2 year carryback and a 20 year carryforward
- NOL's arising **after** 1/1/2018 are subject to the new rule of no carryback and are carried forward indefinitely
- Fiscal year entities with NOL's arising for the tax year that spans 1/1/2018 will be subject to the new rule – no carryback and indefinite carryforward

Corporate Tax Changes

Net Operating Loss Limitations

- NOL's arising in during tax years beginning 1/1/2018 will have future utilization limited to 80% of that years taxable income
  - Fiscal year end entities with a 2018 year-ending date will follow the old utilization rule and can offset income up to the amount of the NOL as the tax year began prior to 1/1/2018
  - NOL's arising from 2018 calendar tax years or fiscal years ending in 2019 will be subject to the 80% limitation

BUSINESS DEDUCTION CHANGES

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Business Deduction Changes

Repeal of DPAD – Section 199

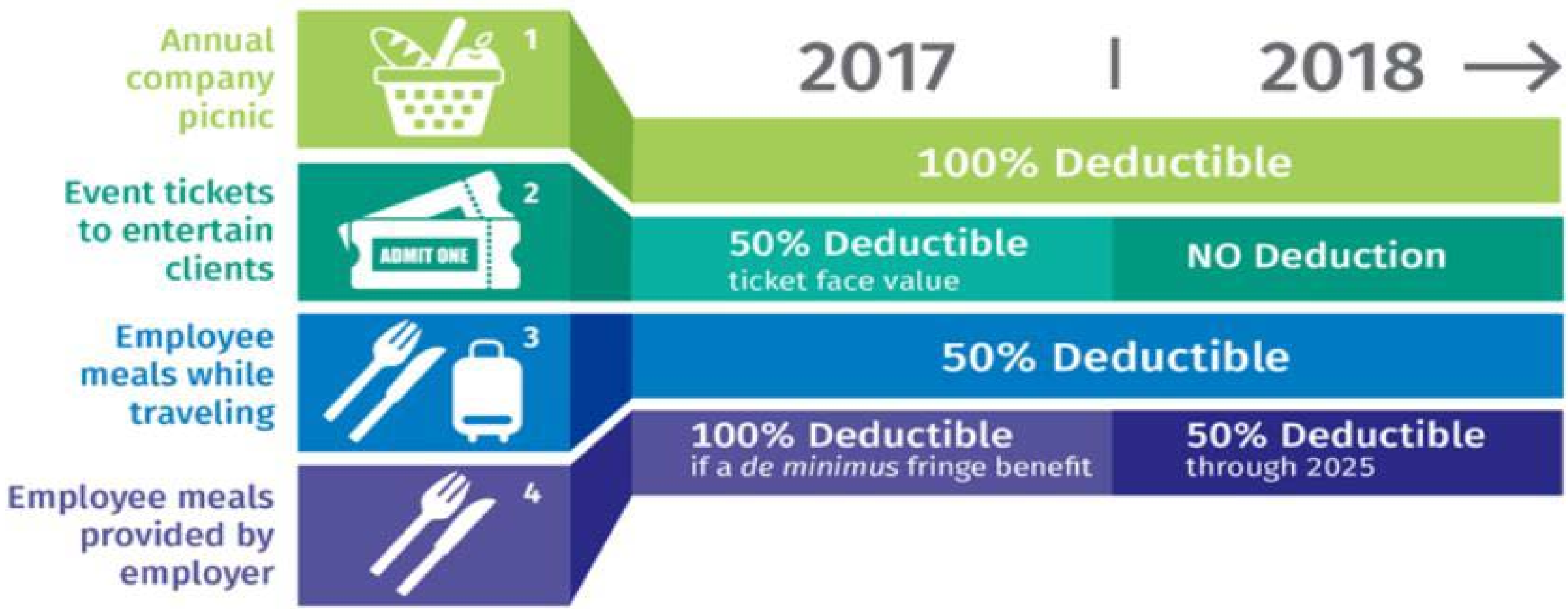
- For tax years beginning after 12/31/2017, Domestic Production Activity Deduction (DPAD) no longer exists

Business Deduction Changes

Meals & Entertainment

- Generally, no deduction is allowed for entertainment, amusement or recreation – even for business development or customer relations purposes
- 50% deduction for meals associated with a trade or business is generally allowed
  - Example: If a company takes a client to a baseball game, the cost of the tickets would not be an allowable business deduction, but the cost of a meal could be, so long as the receipt for the meal is separate from the tickets
- The 50% deduction applies to certain meals provided to employees that were previously 100% deductible

Business Deduction Changes



1 IRC §274(e)(4)
2 IRC §§ 274(l)(1)(B) and 274(n)(1)(B), as stricken by the 2017 Tax Cuts Act
3 IRC §274(n)(1)
4 IRC §274(n)(2)(B), prior to amendment by the 2017 Tax Cuts Act IRC §274(o)

Source: CCH Intelliconnect

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Business Deduction Changes

Like-Kind Exchanges

- Code §1031 only applies to exchanges of real property (real estate) that is for productive use in a trade or business or for investment
  - Property that no longer qualifies: vehicles, equipment, personal property, etc.
- Property located in the United States is not considered like-kind to property located outside of the United States
- Applicable to exchanges completed after 12/31/2017

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Business Deduction Changes

Interest Expense Limitation

- New rules limit interest expense to 30% of adjusted taxable income (ATI)
- Disallowed interest carries forward indefinitely

Exemptions:

- $25 million or less gross receipts test
- Certain real estate/farming businesses
  - ADS depreciation election required
- Regulated utilities
- Floor plan financing

Business Deduction Changes

Adjusted Taxable Income	
Pre 01/01/2022	Post 12/31/2021
Taxable Income	Taxable Income
+ Interest Expense	+ Interest Expense
- Interest Income	- Interest Income
+/- Pass-through items	+/- Pass-through items
+/- Non Trade or Business Items	+/- Non Trade or Business Items
+ Depreciation Expense	
+Amortization Expense	

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Business Deduction Changes

Carryforward of excess interest

- Is treated as paid/accrued in each succeeding tax year until fully deducted
- Can only offset excess income from the same activity

- Excess business income does not carry forward.

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DEPRECIATION CHANGES

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Depreciation Changes

Bonus Depreciation

- Rate changes (for 2018 it is 100%)
- Acquisition dates matter
- Applicable for MACRS property having a recovery period of 20 years or less
- Applies to new ***and*** used property

Used Property Eligibility Requirements:

- The taxpayer did not use the property prior to acquiring it
- Not acquired from a related party
- Not acquired from a component member of a controlled group of corporations

Business Deduction Changes

Rate	In Service After	In Service Before
100%	9/27/2017	1/1/2023
80%	12/31/2022	1/1/2024
60%	12/31/2023	1/1/2025
40%	12/31/2024	1/1/2026
20%	12/31/2025	1/1/2027
0%	12/31/2026	

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Depreciation Changes

Impact on Cost Segregation Studies

- Bonus eligibility of used property makes studies more appealing
- The personal property and land improvements identified when a building is purchased are also now eligible for bonus depreciation
- 100% bonus will front load the depreciation deductions from the studies allowing larger current deductions and tax savings
- As bonus rates decrease, special attention will be needed to verify acquisition dates that straddle reporting periods

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Depreciation Changes

Code § 179 expensing

- Deduction limit increased to $1,000,000
- Asset acquisition phase-out limit increased to $2,500,000
- Eligible qualified real property definition expanded
  - Includes roofs, HVAC, fire protection, alarm & security systems
- $25,000 limit on SUV's is not adjusted for inflation

Depreciation Changes

Luxury Automobiles

- If the taxpayer elects out of bonus depreciation, the maximum allowable depreciation deduction is:
  - $10,000 for the first year,
  - $16,000 for the second year,
  - $9,600 for the third year, and
  - $5,760 for each successive taxable year in the recover period
- If the tax payer claims 100% bonus depreciation, the maximum allowable depreciation deduction is:
  - $18,000 for the first year,
  - $16,000 for the second year,
  - $9,600 for the third year, and
  - $5,760 for each successive taxable year in the recovery period

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ACCOUNTING METHOD CHANGES

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Accounting Method Changes

Changes for companies with less than $25 million in Gross Receipts

- Expanded ability to use the cash method of accounting
- Reduced requirements to account for inventory
- Elimination of applicability of §263A (UNICAP)
- Increase in long-term contract accounting threshold

Changes for companies with more than $25 million in Gross Receipts

- None, still considered “large” business

Accounting Method Changes

Cash Method of Accounting

- Income is reported when constructively received
- Expenses reported when paid
- Basic form of accounting and easiest to control income at reporting periods

Increased thresholds of:

- $1 million (manufacturing) and $10 million of gross receipts with inventory
- $5 million average annual gross receipts for corporations or partnerships with corporate partners

- New threshold is $25 million in average receipts over the prior three years (aggregation rules apply for controlled groups and commonly controlled business)

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Accounting Method Changes

Accounting for Inventory

- Can treat inventory as non-incidental materials and supplies (deductible when consumed)
- A method that conforms to the taxpayer's method of accounting reflected in their financial statements or books and records
- May ease administrative burden of tracking inventory and costs of goods sold

- Exemption from §263A for taxpayers that meet the $25 million average gross receipts test
  - Reduces the need for a "tax" inventory value and a book value

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Accounting Method Changes

Long-term Contract Accounting

- Increase of the $10 million threshold requiring the use of percentage of completion method of accounting to the average gross receipts test of $25 million for projects with completion dates less than two years out
- Can elect to use the cash, accrual or completed contract methods of accounting
- Only applies to contracts entered into after December 31, 2017, restatement of contracts entered into prior to that date do not get restated

Accounting Method Changes

Process to change methods of accounting

- A Form 3115 will be a required filing to change any of the mentioned accounting methods
- The preceding accounting methods fall under REV PROC 2018-40, providing automatic consent, eliminating potential IRS user fees
- Only applies to contracts entered into after December 31, 2017, restatement of contracts entered into prior to that date do not get restated

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SECTION 199A DEDUCTION FOR PASS-THROUGH ENTITY OWNERS

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Section 199A

- Provides a 20% deduction on qualified business income for owners of sole proprietorships, S-corporations and partnerships
- Effective for tax years ending after 12/31/2017 and before 1/1/2026 (it is set to expire)

Section 199A

Qualified Business Income is:

- Net amount of income, gain, deductions and losses with respect to a qualified trade or business, generally net income

QBI is not:

- Capital gains and losses
- Dividend and interest income
- Income not effectively connected with a U.S. trade or business
- W-2 wages (including shareholder wages) or guaranteed payments

Section 199A

Limitations:

- The deduction is limited to 20% of QBI or 20% of the excess of taxable income over the sum of any net capital gains for taxpayers under the following taxable income thresholds:
  - $157,500 for individual taxpayers
  - $315,000 for married taxpayers filing jointly
- For taxpayers over the taxable income thresholds, the limitation is the lesser of:
  - The overall limitation noted above
  - The greater of:
    - 50% of the W-2 wages with respect to the business, or
    - 25% of the W-2 wages with respect to the business plus 2.5% of the unadjusted basis of all qualified property

Section 199A

Concept of Netting

- If an individual's QBI from at least one trade or business is less than zero, they must offset the QBI attributable to each trade or business that produced net positive QBI with the QBI from each trade or business that produced negative QBI in proportion to the relative amounts of net QBI with a positive amount
- If total QBI is negative, the 199A deduction is $0
- Negative QBI carries over to subsequent years and is treated as a separate trade or business in those years

Section 199A

Concept Aggregation

- If individuals choose to aggregate, they combine QBI, W-2 wages and unadjusted basis of qualified property prior to making the limitation calculations
- Requirements to be eligible to aggregate:
  - Common control between entities
  - Disclosure of aggregation
  - Must satisfy two of the following three factors:
    - Provide products and services that are the same or customarily offered together
    - Share facilities or significant centralized business elements
    - Operate in coordination with, or rely upon, one or more of the businesses in the aggregated group

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Section 199A

Real Estate Industry Concerns:

- Additional guidance is needed to determine which real estate activities rise to the level of a trade or business
- QBI is not dependent upon passive, material participation, non-passive status
- Grouping and other re-characterizations under passive activity rules are not applicable at this time

OPPORTUNITY ZONE TAX INCENTIVES

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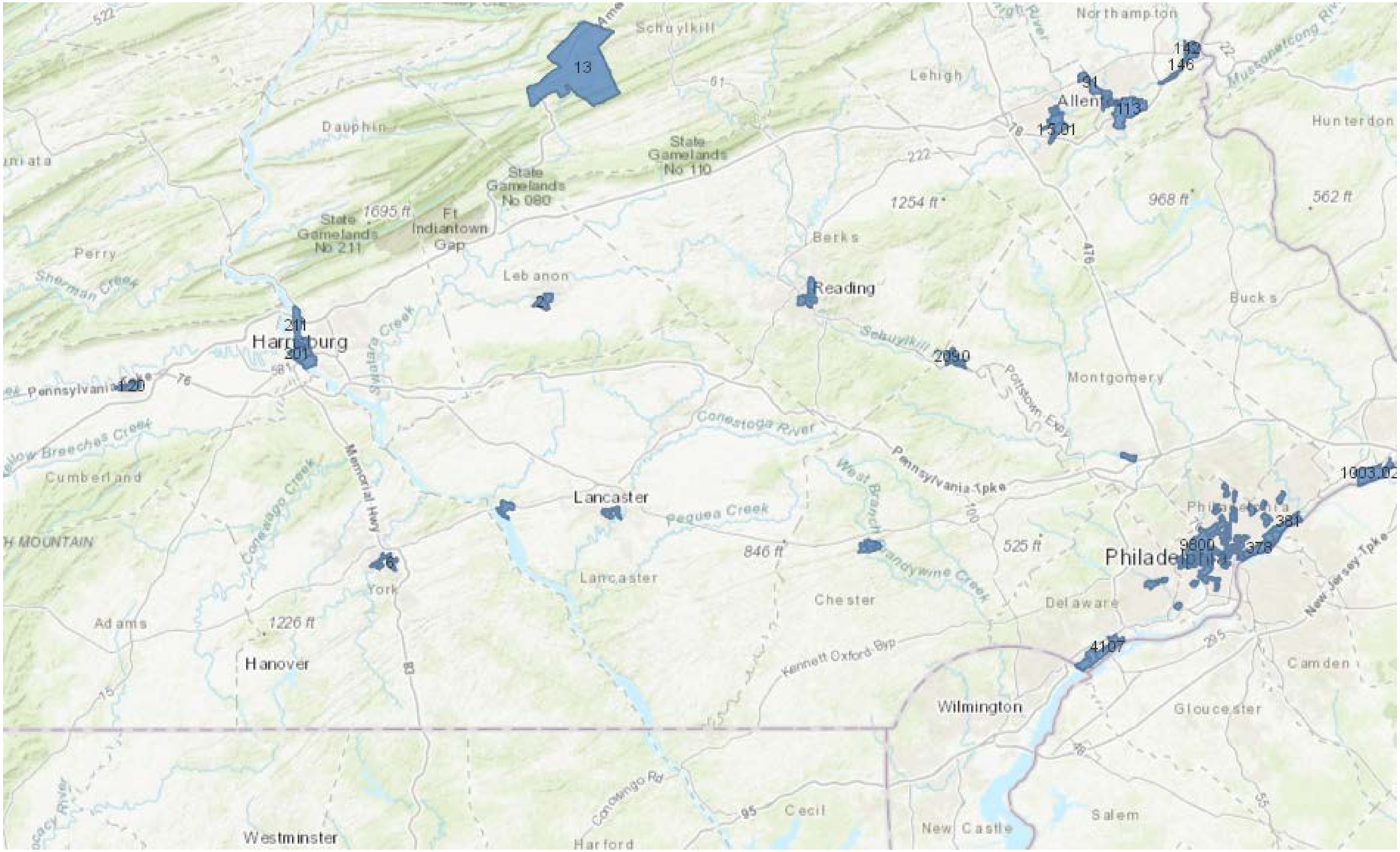
Opportunity Zone Tax Incentives

- The Opportunity Zone Program was created to spur economic growth in low income or distressed areas
- There are more than 8,700 census tracts covering areas in every state, DC, and the U.S. territories
- In our local area, there are zones in Lancaster, Reading, Harrisburg and York; with 300 total across the commonwealth



Schuylkill
Northampton
Lehigh
Dauphin
Hunterdon
Allentown
Berks
Reading
Lebanon
Perry
Harrisburg
Bucks
Montgomery
Cumberland
Lancaster
York
Adams
Hanover
Chester
Delaware
Philadelphia
Wilmington
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Opportunity Zones

How do they work:

- Taxpayers receive a deferral on capital gains taxes by investing capital gains into Qualified Opportunity Funds and potential tax forgiveness on part of the investment, if reinvested within 180 days
- Qualified Opportunity Funds use the investments to reinvest into Qualified Opportunity Zone Property
- Only the gain needs to be reinvested, not necessarily the entire proceed amount from a transaction

Opportunity Zone Tax Incentive

- Defer capital gain (long-term or short-term) recognition until the earlier of December 31, 2026 or when the Opportunity Fund investment is sold
- Forgiveness of capital gains tax on 10% of the capital gain if the QOF is held for 5 years
- Forgiveness of another 5% (for a total of 15%) if the fund is held for 7 years
- If the QOF is held for more than 10 years, gain is forgiven when sold

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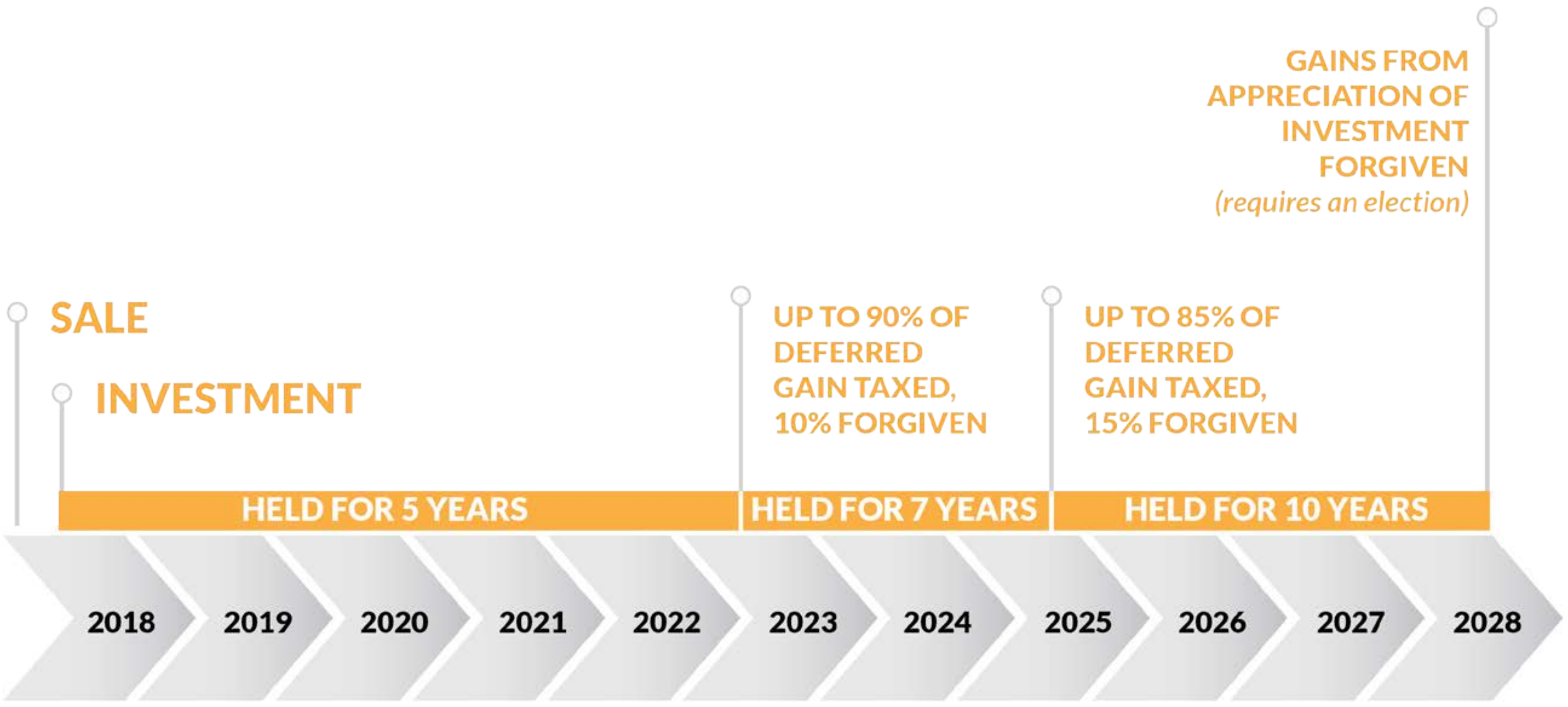
Opportunity Zone Tax Gain Deferral



Opportunity Zone Fund: Process

- Investment set up as a partnership or corporation for investing in eligible property or businesses that are located in a Qualified Opportunity Zone
- Funds can self-certify eligibility with the IRS, if done timely and file the proper forms
- 90% of the funds assets must be invested in QOZ property, tested every 6 months
- The rules are complex for direct and indirect investment of QOF into Qualified Property, and are not final

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Opportunity Zone Fund: Who Can Benefit?

- Existing fund managers looking for additional capital
- High net worth individuals with significant unrealized gains
- Real Estate developers and contractors
- Existing businesses looking to expand

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