Construction Industry Tax Update

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Agenda

1. Tax Landscape
2. CARES Act and other recent changes
3. Biden Tax Proposals
4. 2021 Tax Planning considerations

Tax Madness

Timeline of New Tax Law Changes

- December 22, 2017 - Tax Cuts and Jobs Act
- December 20th, 2019 - SECURE Act
- March 20, 2020 - Family First Coronavirus Act
- March 30, 2020 - CARES Act
- April 24, 2020 - Paycheck Protection and Health Care Enhancement Act
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TCJA - Business Provisions

- Bonus depreciation allowance(100% phased down after 2022, eliminated after 2026)
- Increased section 179 expense allowance for small businesses
- Capitalization and amortization of research and experimentations expenditures (after 2021)
- Section 163(j) limitations on business interest expense
- Net operating loss deduction restrictions**
  - Prohibition of most NOL carrybacks
  - Limitation on use of NOL carryovers to offset taxable income
- Restrictions on Section 1031 like-kind exchange provision to real estate
- Graduated corporate tax rates were eliminated in favor of a single tax rate of 21% of taxable income

** **Temporary exception to allow carryback and remove limitation under the CARES ACT**

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TCJA - Small Business Provisions

- Special tax provisions for exempt small businesses defined with a three-year average annual gross receipts below $26 million and not considered a tax shelters (indexed amount for 2021)
- Special provisions are the following:
  - No requirement to use accrual method of accounting
  - No requirement to use inventories
  - No requirement to apply the uniform capitalization rules
  - No requirement to use percentage of completion for long-term contracts
  - Section 163j

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TCJA – Individual Income and Estate Tax Provisions

- ❑ Slight reduction in tax rates (top rate from 39.6% to 37%)
- ❑ Limitation on itemized deduction for state and local tax deduction
- ❑ Elimination of personal exemption, moving expense, and miscellaneous itemized deductions
- ❑ Increase in the estate and gift tax exemption amount:
    - Indexed for inflation - $11,700,000 for 2021
    - Amounts will revert to pre-TCJA amounts (one-half) after 2025

- ❑ Significant increase in AMT exemption
- ❑ Increase in standard deduction
- ❑ Repeal of former treatment of alimony

Individual provisions generally expire after 2025

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CARES – Tax Related Provisions

- Net Operating Loss utilization for 2018 – 2020
  - 5- year carryback of NOLs
  - Defer application of the 80% limitation on use of NOL Carryovers to offset against taxable income
- Three-year suspension of section 461(l) limitation on use of business losses by non-corporate taxpayer
- Temporary relaxation of section 163(j) limitations
- Employee Retention Credit
- Technical correction for “qualified improvement property”
- Deferred payment of employer share of payroll taxes
- Recovery rebate credits

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CARES – Paycheck Protection Program Loans

- ❑ Loans qualified for partial or total forgiveness, the income from which was not taxable and treated as tax-exempt income
- ❑ Related expense held to be non-deductible by the Internal Revenue Service (until clarified by Congress in December 2020)
- ❑ Continued challenges
  - Timing of recognizing tax-exempt income for basis increase when the loan is forgiven by SBA results in basis limitation on overall taxable loss or distributions in excess of basis
  - S-corps that have prior Accumulated Earnings and Profit – Schedule M-2 mismatch deductible expenses in AAA column and tax-exempt income in OAA

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CAA – Corporate and Business Tax

- Temporary (two-year) restoration of full deduction for restaurant business meals
- "Clarification" of deduction for expenses paid with proceeds of forgiven PPP loans
- PPP Loan round 2 with expansion of forgivable expenses
- Related expense held to be non-deductible by the Internal Revenue Service (until clarified by Congress in December 2020)
- Tax exemption for other benefits (SBA loan payments, shuttered venues, EIDL grants and advances)
- Extension and enhancement of employee retention credit
- Expired/Expiring tax provisions either made permanent or extended for 5 years
  - 179D was made permanent

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CAA – Individual Tax

- Second round or “recovery rebate” stimulus payments to individuals below specified income thresholds ($600)
- Enhanced limitation for charitable contributions
- Permanent reduction of adjusted gross income threshold for deducting medical expenses (from 10% to 7.5%)

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American Rescue Plan Act – Tax Provisions

- Third round or “recovery rebate” stimulus payments to individuals below specified income thresholds ($1,400 each or $2,800 MFJ).
- Unemployment Insurance exempt from federal income tax to individual below specified income thresholds up to $10,200 of benefits received.
- Expanded Child tax credits for 2021 tax year and makes it fully refundable for eligible taxpayers. Special provision to allow advancement of the credit during 2021 calendar year, beginning in July.

- Student loan debt forgiveness - although no provision in the law to exclude, IRC Sec 108(f) changed to excluded from taxable income (2021 through 2025).
- COBRA premiums can be subsidized on employees that were let go during the pandemic during the period April 1, 2021 through Sept 30, 2021.
- Credit for Paid Sick Leave under the FFCRA act enhanced and extended on a voluntary basis to 9/30/ 2021.

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POLLING QUESTION

Employee Retention Tax Credit

Employee Retention Tax Credit

- The Employee Retention Credit is a **fully refundable payroll tax** credit for employers equal to 50 percent **(2020)** or 70 percent **(2021)** of **qualified wages** (up to a $10,000 cap) that **Eligible Employers** pay their employees.
- Businesses qualify based on a significant decline in gross receipts or full/partial shutdown of their business.
- The credit is based on wages paid after March 12, 2020, and before January 1, 2022.
- The maximum credit amount with respect to **EACH EMPLOYEE** is $5,000 **per year** **(2020)** or $7,000 **per quarter** **(2021)**.
- For-profit and tax-exempt organizations qualify.

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Summary –What Every Business Needs to Evaluate

1. Did your business experience a 50% reduction in gross receipts in any quarter of 2020 compared to the same quarter in 2019?
2. Was your business required to be partially or fully shut down under a state or local order at any time from March 12 to the present?
3. How many full-time employees did your business have in 2019?
4. Did your business experience a 20% reduction in gross receipts in the 4th quarter of 2020 compared to the 4th quarter of 2019?
5. Did your business experience a 20% reduction in gross receipts in the 1st quarter of 2021 compared to the 1st quarter of 2019?
6. Does your business anticipate a 20% reduction in gross receipts in the 2nd, 3rd, or 4th quarter of 2021 compared to the 2nd, 3rd, or 4th quarter of 2019, respectively?

***Aggregation rules apply to commonly owned businesses (revenue decline, operations suspension and total number of employees)**

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THE EVOLUTION OF THE "SHUTDOWN"

Pennsylvania

- Effective March 23, 2020 – May 8, 2020 shutdown for "non-life sustaining" business shutdown subject to a "waiver" process.
- Effective May 8, 2020 return to work subject to site staffing limitations.

New Jersey

- Effective March 24, 2020, construction projects may continue so long as businesses "***reduce staff on site to the minimal number necessary to ensure that essential operations can continue [. . .].".***

Delaware

- Effective March 24, 2020 "life sustaining business" authorized to proceed.

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2021 Enhancements

- Revise definition of significant decline in gross receipts
  - **20% reduction for 2021 vs 50% reduction for 2020**
- Credit increased to **70% for 2021 vs 50% for 2020**
- Qualified wages per employee increased
  - **$10,000 per quarter for 2021 vs $10,000 per year for 2020**
- Revise definition of qualified wages
  - **500 employees for 2021 vs 100 employees for 2020**
- Election to use prior quarter gross receipts to determine eligibility
- Extended credit through December 31, 2021 (ARPA)

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What is a Significant Decline in Gross Receipts? – ENHANCEMENT

- **2020 ERTC** – all of 2020
  - Gross receipts decline by at least 50%

- **2021 ERTC** – 1/1/2021 thru 12/31/2021
  - Gross receipts decline by at least 20%
  - Compare Q1 2021 to Q1 <u>2019</u>
  - Compare Q2 2021 to Q2 <u>2019</u>

  - Special rule - Eligible Employers can elect to use the preceding quarter's gross receipts which would include looking back to Q4 2020 for purposes of Q1 2021 credit eligibility
    - Example – Compare Q4 2020 to Q4 2019 to determine Q1 2021 eligibility

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Significant Decline in Gross Receipts – EXAMPLE & ENHANCEMENT

2021 ERTC – Start: 20% decline; Stop: 20% decline

EXAMPLE 1

	Gross Receipts	2019 Gross Receipts	Percentage of Prior Year	
2021 1st Quarter	400,000	555,000	72%	**QUALIFY**
2021 2nd Quarter	600,000	555,000	108%	**QUALIFY**

EXAMPLE 2

	Gross Receipts	2019 Gross Receipts	Percentage of Prior Year	
4th quarter 2020	400,000	555,000	72%	**Lookback Election**
1st quarter 2021	600,000	555,000	108%	**QUALIFY**

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What Are Qualified Wages? – ENHANCEMENT

- **2020 ERTC** – all of 2020
  - **100** or FEWER employees - **ALL** wages paid to an employee
  - **100** or MORE employees - **ONLY** wages paid to an employee for **NOT** providing services
- **2021 ERTC** – 1/1/2021 thru 12/31/2021
  - **500** or FEWER employees - **ALL** wages paid to an employee
  - **500** or MORE employees - **ONLY** wages paid to an employee for **NOT** providing services

  - Based on **2019** headcount

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2021 Employee Retention Tax Credit – Other Considerations

Considerations:

- Wages used in Paycheck Protection Program loan forgiveness cannot also be claimed for ERTC
- Health insurance costs, including self-insurance, are eligible expenses for ERTC
- ERTC reduces eligible wages for R&D credit purposes
- If qualified for credit, can either reduce payroll deposits throughout the payroll quarter, request advance refund (through Form 7200) or claim refund on the Form 941 filing.

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POLLING QUESTION

Tax Landscape

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Green Book – May 28, 2021

- Treasury Department document release "General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals"
- Outlines President Biden's tax proposals in greater detail
- Congress must draft and pass tax legislation
- Presidential campaign proposals **not** included –
  - repeal of IRC Sec 199A
  - 28% cap on tax benefit of itemized deductions
  - repeal or modification of $10,000 state and local income tax limitation
  - increase in estate tax
  - tax on financial institutions with assets over a certain threshold
  - modification of income cap for payroll taxes

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Corporate Tax

- Increase flat corporate income tax from 21% to 28%
- 15% minimum tax based on book income (corporation income > $2B)
- Effective Date: Jan 1, 2022
- Fiscal year corporations – blended rate initial year
  - 21% **plus**
  - 7% multiplied by portion of tax year that occurs in 2022
- 15% minimum similar to AMT that was repealed under TCJA

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Net Investment Income Tax (NIIT) and Self-Employment Contributions Act (SECA)

- Effective Date: Jan 1, 2022
- Apply either NIIT or SECA to pass-through income (partnerships and S corporations) – AGI in excess $400,000
- SECA now to include (only for high-income, materially participation)
  - limited partners (under IRC Sec 469)
  - S Corporation shareholders
- NIIT now to include income from trade/business not subject to SECA
  - real estate professionals
- Considerations:
  - SECA partially deductible
  - Taxpayer may have offsetting losses from NII or SECA

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Individual Tax Rate Increase

- Increase top individual rate from 37% to 39.6%
- Effective Date: Jan 1, 2022
- 2022 – top marginal rates
  - $509,300 married filing joint
  - $452,700 single
  - top marginal rate applies to lower thresholds than current law ($628,300 MFJ / $523,600 single) – level in effect during 2017, as adjusted for inflation

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Capital Gain Tax Increase

- Tax CG at ordinary rate – AGI over $1M MFJ / $500K Single
  - indexed for inflation after 2022
- Effective Date: retroactive to "date of announcement"
  - still not clear – April 28th (American Families Plan), May 28th (Green Book), or other?
- Clarifications
  - $1M threshold is based on AGI and equal to MFJ / Single
  - all sources of income (including CG) used to measure $1M threshold
- Example (provided in Green Book)

A single taxpayer with $900,000 in labor income and $200,000 in long-term capital gain income would have $100,000 of the capital gain taxed at the current preferential tax rate (23.8% including the NIIT), while the remaining $100,000 of gain, the amount in excess of $1,000,000, would be subject to tax at ordinary income tax rates.

Conversely, a single taxpayer with $1,100,000 in labor income and $500,000 in long-term capital gain income would have all long-term capital gain income taxed at ordinary income tax rates under the administration's proposal.

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Tax Gain on Assets at Death, Upon Gifting and Other Events

- Eliminate Step-up in Basis - asset appreciation transferred by gift or upon death will be taxed
  - Transfers to spouse would be exempt

- Allow a $1 million per person exclusion for other unrealized gains on property transferred by gift or held at death

- Special exemptions apply to illiquid assets - certain family owned and operated businesses
  - Tax would be due on a gift of this property until the business is sold or ceased to be a family owned business.
  - Tax on illiquid assets transferred at death could be paid over a 15-year fixed payment plan

Revenue Effects of Tax Proposals

Increase the corporate rate to 28%	$858 B
Revise GILTI	$534 B
Financial account information reporting	$463 B
Repeal BEAT and replace with SHIELD proposal	$390 B
Tax capital gains at ordinary income tax rate for high income individuals and tax unrealized appreciation at death for some estates	$323 B
Increase top individual rate to 39.6%	$132 B
Eliminate fossil fuel preferences	$35 B
Extend and modify the Child Tax Credit	-$449 B

Renewable & alternative energy tax incentives	-$265 B
Make permanent the American Rescue Plan Act of 2021 (ARPA) expansion of the health insurance premium tax credit	-$163 B
Make permanent ARPA expansion of the earned income tax credit (EITC) for childless workers	-$105 B
Make permanent ARPA changes to the Child & Dependent Care tax credit	-$104 B

POLLING QUESTION

Tax Planning Approaches

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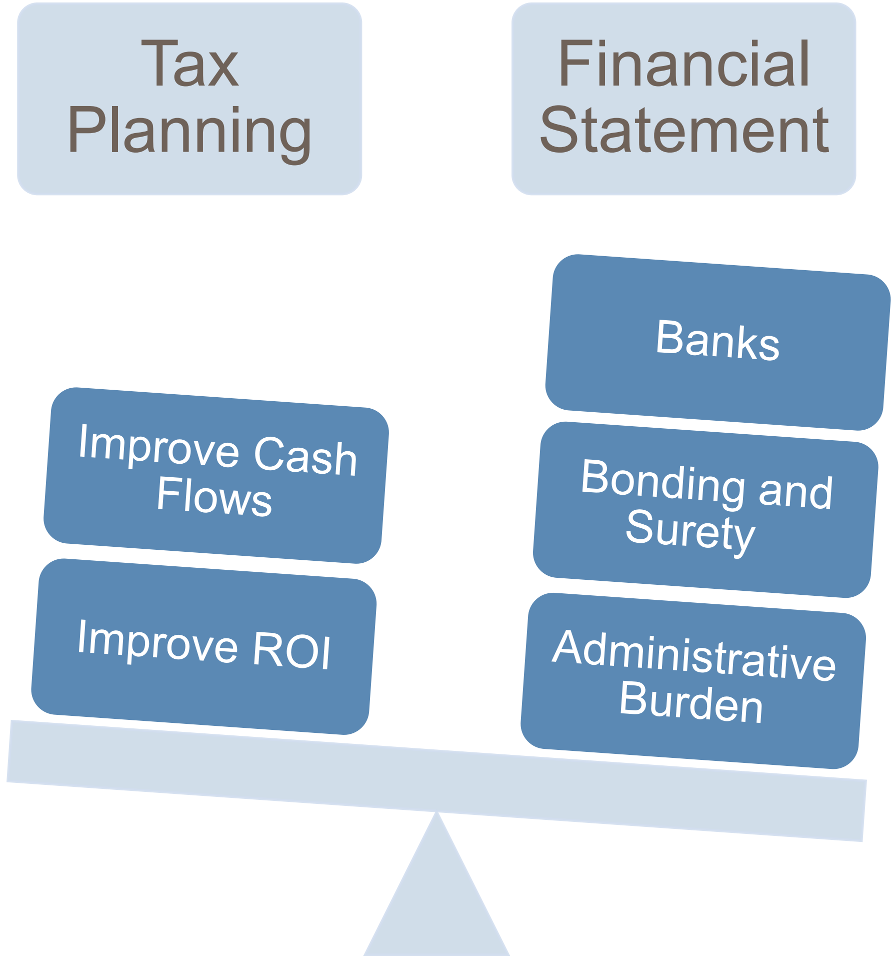
Tax Planning - Consider the Right Balance



Traditional Contractor Tax Planning Ideas

Strategy	Benefit	Applicability
Cash Method Account for small contractor	Ability to deferral significant income and reduce tax liability	Any contractors with average gross receipts of less then $26 million
10% election method	Defer the recognition of income if cost to complete is less than 10%	Applies to any contractor that is using PCM
1. Exclusion of Retainage Payable 2. Pay if Paid Deferral	Ability to lower the percentage to complete for tax reporting by excluding the retainage payable numerator in the cost to complete formula	Certain contractors that have specific language in their contract that fail the all-events test under IRC 61 and state law will enforce the Pay if Paid clause provision

Tax Planning Focus for 2021 – Accounting Methods

- **Payroll taxes deferred by CARES Act** – adopt "recurring items exception" method of reporting payroll taxes
- **Advance payments method** - Accrual method business deferral recognition of a portion of the payment to the next tax year
- **Qualified Software development costs** incurred through 2021 can be expensed rather then capitalized. After 2021 required to be capitalized and amortized.

- **Qualified Improvement property** made to the interior portion of nonresidential property placed in service after December 31, 2017 is depreciable over 15 years and qualifies for 100% bonus depreciation
- **Residential rental property** – taxpayers that have made a "real property trade or business election" can request a method change to depreciate such property over 30 years instead of 40 years.

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Tax Planning Focus for 2021

- ❑ Choice of entity
- ❑ Qualified small business stock
- ❑ Loss utilization
  - ❑ Carryback potential expired after 2020
  - ❑ Restoration of 461(l) limitation on excess business losses
  - ❑ Basis limitations for pass-through entities
  - ❑ Section 382 limitations on corporate tax attributes

- ❑ Fixed asset acquisition planning
- ❑ Research and experimentation credit
- ❑ Estate planning for closely-held businesses
- ❑ Transaction cost analysis
- ❑ Like-kind exchange on real estate
- ❑ Installment sale
- ❑ State and Local - Entity Level Tax analysis

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2021 Tax Planning – Income and Deductions

Planning Considerations:

- Accelerate Income?
  - Collect cash prior to year end (cash basis method Taxpayers)
  - Collect outstanding retainages
  - Close out jobs
  - Incur job costs if possible to accelerate PCM income recognition
  - Sell assets – recognize gains (timing of LTCG rate increase)
- Defer Deductions?
  - Elect out of bonus depreciation?
  - Do not elect Section 179
  - Defer significant capital expenditure purchases to 2022
  - Harvest capital losses for carryover

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Questions?

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Contact the Presenters

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Carlo has a wide range of experience providing tax and business advisory services to privately-held companies in various industries including manufacturing, distribution, and construction. He advises owners and key executives through the various cycles of their business related to corporate and individual tax matters (i.e., growth, maturity, exit) and represents them in front of the IRS.

Carlo specializes in tax compliance and strategic planning. As the firm's Construction Industry Group Co-Leader, he forms relationships with and educates construction companies and trade organizations in the region on tax matters that impact the industry and their businesses. Carlo's extensive experience in business and tax-related topics has earned him the opportunity to present at external industry events on a regular basis. He also oversees the firm's internal tax training programs.

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Brad provides a variety of tax services & strategies, including tax compliance, tax planning, and tax research for corporations, multi-state companies, partnerships, trusts, and high-net-worth individuals. He has a diversified range of experience providing services to a variety of companies in the construction, manufacturing, real estate, distribution, and service industries. Brad actively participates in developing and presenting professional in-house training and is a member of Kreischer Miller's Construction Industry Group, where he assists with construction accounting methods and other best practices.

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