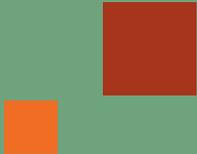


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# Building a Strong Tax Strategy in a Changing Environment

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# New Tax Law

## Where Are We?

- HR 1 - Tax Cuts and Jobs Act.
  - Nov 2 - Legislative text first released.
  - Nov 9 - Approved by House Ways and Means Committee.
  - Bill passes House on 227-203 vote.
- Senate - Tax Cuts and Jobs Act.
  - Nov 9 - “Conceptual mark” released.
  - Nov 16 - Approved by Senate Finance Committee.
  - Nov 21 - Legislative text released.
  - Dec 1 - Bill passes Senate on 51-49 vote under budget reconciliation procedures.

# Tax Reform Bill - First Thoughts

- What was expected?
  - Rate decrease for corporations and most individuals (Got).
  - Estate tax and AMT repeal (Partial).
  - Limitations on interest deductibility (More).
  - Many other revenue raisers pulled from 2014 Camp proposal.
- What surprised us?
  - Nothing on LIFO and nothing significant on carried interests (Wow).
  - Limits on mortgage deduction.
  - Bubble tax rate on individuals to claw back the 12 percent rate (House) (Revenue).
  - No change to capital gains/dividend rates.
  - Major last minute negotiations in Senate - AMT, Trusts and Estate ownership pass-through interests (Trade-offs).

# Tax Reform Bill - Initial Reactions

- What were the challenges?
- State and local tax deduction (High tax states).
- Deficit hawks - Senate bill would fall \$1 trillion short of paying for itself.
- Pass-through concerns - too much of the benefit going to C corporations (Small business).
- Byrd rule compliance - must not increase deficit beyond the \$1.5 trillion allowed in the first decade.

# Business Proposals

# Business Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Corporate income	35% Top rate	20% flat rate; 25% for PSCs; effective tax years after 12/31/17	20% flat rate; effective for tax years after 12/31/18
Corporate AMT	20% on AMT income	Repealed	Same as current law (Late change)
Net operating loss	2 Year carryback and 20 year carryforward allowed to offset taxable income	NOL use limited to 90% of taxable income deductible; carryforward period made indefinite; NOL increased by interest factor	Limited to 90% of taxable income deductible through 2022, then 80% carryforward period made indefinite; no carryback

# Business Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Pass-through income	Taxed at owner's individual rate	<p>25% Rate on business profits, with assumed 70/30 split of wages to business profits</p> <ul style="list-style-type: none"> <li>▪ May elect to prove capital percentage &gt; 30%</li> <li>▪ 0% Capital percentage assumed for personal services</li> <li>▪ 9% Rate for smaller firms that wouldn't otherwise qualify for 25% rate (AGI under \$150k)</li> <li>▪ Passive income all capital</li> </ul>	<p>23% Deduction for business profits; limited to 50% of W-2 wages; sunsets 12/31/25. (Effective 9% reduction)</p> <ul style="list-style-type: none"> <li>▪ Personal service businesses not eligible, except for taxpayers with taxable income &lt;\$250k/\$500k</li> <li>▪ Includes Qualified REIT Dividend in Business income</li> <li>▪ Excludes estates and trusts</li> </ul>

# Business Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Pass-through losses	Passed through to individual	No change	Excess business losses disallowed. Excess loss is aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer, over the sum of aggregate gross income or gain of the taxpayer plus \$500,000 (MFJ). Excess loss will be carried over. Expires after 2025.
Domestic Producers Activity Deduction (DPAD)	9% Deduction on domestic construction related activity income subject to 50% W-2 wage limitation	Repealed	Repealed

# Business Tax Reform Proposals

<b>Provision</b>	<b>Current Law</b>	<b>House Bill (HR 1)</b>	<b>Senate Bill</b>
Capital expensing	MACRS/ADS with 50% bonus depreciation phasing down in future years. Section 179 expensing limits of \$500k/\$2m.	100% Full expensing for investments made after 9/27/17 and before 1/1/23. Extends to used property. Enhances Section 179 expensing to \$5m with phase-out starting at \$20m.	Generally the same, except does not expand expensing to used property. Enhances Section 179 expensing to \$1m, with phase-outs starting at \$2.5m.
Like-kind exchanges	Applies to both real and tangible property.	Applies only to non-inventory real property.	Applies only to real property.
Real property depreciation	Depreciable over a 39 year life.	No provision.	Depreciable life reduced to 25 years. Qualified improvement property reduced to 10 year life.

# Interest Deduction

- Every business would be subject to a disallowance of the interest deduction for net interest expense in excess of 30 percent of an adjusted income amount.
  - House proposal uses EBITDA.
  - Senate uses taxable income without NOLs, interest, or pass-through deduction.
- Any excess would be carried forward to the succeeding five years.
- Businesses with average gross receipts of \$25m (House) or \$15m (Senate) or less would be exempt and House provision would not apply to real property trades or businesses.

# Example 1

Company generates taxable income, before interest expense, of \$500,000. Their gross receipts are \$30m. They have \$300,000 in interest expense from various sources. The deduction for interest expenses would be limited to \$150,000 ( $\$500,000 \times 30\%$ ) the other \$150,000 would be carried forward to future tax years.

# Accounting Methods

- Several thresholds used for accounting methods would be raised to expand use for small businesses - House would increase threshold to \$25m and Senate to \$15m for:
  - Availability of cash method for corporations and partnerships with corporate partners (was \$5m) - great for small businesses - effective 1/1/18.
  - Businesses eligible for cash method would account for their inventories using book method.
  - Requirement to compute UNICAP (was \$10m).

# Accounting Methods

- Required use of percentage of completion for long-term contracts - businesses below threshold could use any exempt contract method (was \$10m) - Watch change of accounting method!
- Senate provision requiring (accrual) taxpayers to recognize income no later than when recognized under GAAP - Leads to problems.

# S versus C Example 2 - House Plan

1. \$2m of Construction business income.
2. New York activity - 100%.
3. 1 Shareholder.
4. No other income.

	<b>S Corp - As Is</b>	<b>C Corp - As Is</b>	<b>S Corp - Reform</b>	<b>C Corp - Reform</b>
Business inc.	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000
Less: NY Tax (A)	(137,000)	(130,000)	-	(130,000)
Less: DPAD	(180,000)	(180,000)	-	-
Taxable inc.	\$ 1,683,000	\$ 1,690,000	\$ 2,000,000	\$ 1,870,000
Tax (Federal (B))	\$ 612,134	\$ 574,600	\$ 645,540	\$ 374,000
Tax on dividend (C)	\$ -	\$ 347,700	\$ -	\$ 401,700
Total tax (A+B+C)	\$ 749,134	\$ 1,052,300	\$ 782,540	\$ 905,700
Tax rate overall	37.45%	52.61%	39.13%	45.20%

# Business Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
R&D Credit	Credit allowed on qualifying activities. Expenses can be deductible or may be amortized over a period of not less than 60 months.	Retained  After 2022, capitalize/amortize expense over 5 years (or 15 years if outside of US).	Retained  After 2025, capitalize/amortize expense over 5 years (or 15 years if outside of US).
WOTC and new markets credit	Credits available for qualifying business activities.	Repealed	Retained
Historic rehab credits	Available for rehabilitation of historic, income producing buildings.	Repealed	Retained with some changes.

# Other Provisions

- Broad changes for multinational companies with shift to a territorial tax regime in both bills, but very different.
- Mandatory deemed repatriation of undistributed foreign earnings.
- Senate proposed repeal of IC-DISCs.
- Various changes included to compensation and benefits, including transportation and parking benefits.
- Repeals 50 percent deduction of business-related entertainment expenses.

# Year-End Planning Considerations

- Defer Recognition of Revenue. (??)
- Extra conservatism on estimated job profits. (C-corporations).
- Accounting method changes. - May not require filing.
- Company structure (C vs S).
- Like-kind exchanges. - Before year-end, watch automobiles.
- Advanced payments of SALT items.

# Individual Proposals

# Individual Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Tax rates	7 Brackets; top rate of 39.6% on income >\$418.4k/\$470.7k (single/joint); plus 0.9% Medicare tax on income >\$200k/\$250k	4 Brackets; top rate of 39.6% on income >\$500k/\$1m; ("bubble tax" of 6% on income \$1m-1.2m); no change on Medicare tax	7 Brackets; top rate of 38.5% on income >\$500k/\$1m; rates sunset 12/31/25; no change on Medicare tax
Capital gain/qualified dividend rates	Maximum 20% rate for LT capital gains and dividends	Same as current law	Same as current law
Standard deduction	\$6,500/\$13,000 (2018)	\$12.2k/\$24.4k	\$12k/\$24k through 12/31/25
Personal exemptions	\$4,050 exemption for each member of household; phased out for higher AGIs	Repealed	Repealed through 12/31/25

# Individual Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
AMT	26%/28% on AMT income	Repealed	Preserves AMT but increases exemptions through 12/31/25
Estate tax, GST, and gift tax	40% After exemption of \$5.5m/\$11m; \$14k annual exemption per gift donee	40% Estate and GST through 2023; both repealed in 2024; gift tax lowered to 35% exemptions increased to \$10m/\$20m	40% After exemption of \$10m/\$20m; increased exemption sunsets 12/31/25
SALT deduction	State and local income or sales taxes deductible; property taxes fully deductible	Property taxes up to \$10k deductible; other SALT generally non-deductible	Property taxes up to \$10k deductible; other SALT generally non-deductible; repealed through 12/31/25

# Individual Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Itemized deduction limitation	Itemized deduction phase-out begins at \$320k MFJ; \$266k single (2018)	No limitation	No limitation through 12/31/25
Affordable Care Act	Those who fail to maintain health coverage owe penalty of 2.5% of AGI, or \$695 per adult/\$345.50/per child in 2017	N/A	Penalty lowered to \$0
Carried interest	Taxed as LT investment income	Adds holding period requirement of 3 years for gains on carried interest in an investment	Same as HR 1
Miscellaneous itemized deduction	Subject to a 2% floor	Elimination of employee business expenses	Elimination of all miscellaneous itemized deductions through 2025

# Individual Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Child tax credit	\$1,000 per child under age 17. Phase-outs begin at modified AGI of \$110k MFJ.	Increased credit to \$1,600 per child; plus \$300 credit for non-child dependents. Phase-out increased to \$230k MFJ.	Increased credit to \$2,000 per child and increases age to include those under 18. Reverts to under 17 again in 2025. Expires 12/31/25. Increases phase-out to \$500,000 MFJ.
Mortgage interest	Deduction on first \$1m of debt used to secure primary or secondary residence and first \$100k of home equity debt.	Interest deductible on first \$500k of debt (effective for debt incurred after 11/2/17) and limited to primary residence only.	Same as current law, but suspending the deduction for home equity interest. Applies until 12/31/25.
Alimony payments	Deductible by payor and income to payee.	Repealed for agreements after 2017.	Not addressed.

# Individual Tax Reform Proposals

Provision	Current Law	House Bill (HR 1)	Senate Bill
Tax prep fees	Deductible	Repealed	Repealed
Casualty losses	Deductible	Repealed unless it is related to 2017 hurricanes	Limited to Federally declared disasters - limit expires 12/31/25
Moving expenses	Deductible	Generally repealed	Repealed through 2025
Teacher expenses	\$250 Deductible	Eliminates deduction	Increases to \$500 - expires after 2025
Gain on sale of principal home	Gain of \$500k (MFJ) excluded. Must have lived in home 2 of 5 years.	Must have lived in home 5 of last 8 years. Gain excluded once every 5 years.	Same as House bill, but expires 12/31/25
Medical expenses	Deductible to extent exceeds 10% of AGI	Repealed	Lowers 10% threshold to 7.5% for tax years 2017 and 2018

# Year-End Individual Tax Planning Strategies - Income

- In general, it is best to defer income to 2018.
  - Contribution to qualified retirement plans.
  - Harvesting capital losses.
  - Stock options - if feasible, delay exercise until 2018.
  - Timing of billings/collections for cash basis sole proprietors.
  - Defer retirement plan/IRA distributions (other than RMDs).

# Year-End Individual Tax Planning Strategies - Deductions

- In general, it is best to accelerate deductions to 2017.
- Accelerate those deductions that are slated to be cut.
  - State income taxes.
  - Tax preparation fees.
  - Miscellaneous itemized deductions and medical expenses (House bill).
  - Real property taxes.
- Take into account the AMT and the 3 percent haircut on itemized deductions.
- Accelerate sizeable charitable contributions.

# Questions???

## Lots & Lots & Lots of Questions...

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# Appendix A



Comparison of House and Senate Tax Reform Bills

<u>Provision</u>	<u>House Version of H.R. 1, the Tax Cuts and Jobs Act</u>	<u>Senate Version of the Tax Cuts and Jobs Act</u>
<b>Individual Rates (Married Filing Jointly)</b>	12% \$0 - \$89,999 25% \$90,000 - \$259,999 35% \$260,000 - \$999,999 39.6%* \$1 million +  * 12 percent bracket phases out over \$1 million at \$6 for every \$100 of AGI over \$1 million	10% \$0 - \$19,049 12% \$19,050 - \$77,399 22% \$77,400 - \$139,999 24% \$140,000 - \$319,999 32% \$320,000 - \$399,999 35% \$400,000 - \$999,999 38.5% \$1 million +  *Expires 12/31/25
<b>Corporate Rates</b>	20%	20% beginning 1/1/19
<b>Personal Service Corporations (C-Corp)</b>	25%	20%
<b>Standard Deduction</b>	Increased to \$12,000 for individuals, \$24,000 for married filing jointly	Increased to \$12,000 for individuals, \$24,000 for married filing jointly*  *Expires 12/31/25
<b>Individual Alternative Minimum Tax (AMT)</b>	Repealed	Increased exemption amounts and phaseout thresholds*  *Expires 12/31/25
<b>Corporate Alternative Minimum Tax (AMT)</b>	Repealed	No provision
<b>Pass-Through Business Income</b>	Capped at 25%;  Income for active shareholders* over 25% defaults to 70% ordinary income and 30% to 25% rate cap;  Alternative "return on investment" calculation available if depreciable capital times Federal short-term rate plus 7 percent exceeds 30% net business income;  First \$75,000 of net business income taxed at special 9% rate for owners with less than \$150,000 in taxable income, then phases out up to \$225,000. Special rate phased in over 5 years  * Defined under Section 469	23% deduction on pass-through income*;  Deduction not allowed for reasonable compensation paid to S-Corp owners;  Limited to half of W-2 wages for individuals with over \$250,000 in business income (\$500,000 MFJ)**;  Effective top marginal rate on pass-through income of 29.6%;  Excess business losses disallowed. Excess loss is aggregate losses of active shareholders, over \$500,000 (MFJ) or \$250,000 (Ind)  *23% deduction expires 12/31/25 ** Phases out at \$300,000 (ind)/\$600,000 (MFJ)

<u>Provision</u>	<u>House Version of H.R. 1, the Tax Cuts and Jobs Act</u>	<u>Senate Version of the Tax Cuts and Jobs Act</u>
<b>Passive Shareholder</b>	100% of passive income* capped at 25% rate.  *Defined under Section 469	Passive shareholder* income subject to 23% deduction**.  *Defined under Section 469 **23% deduction expires 12/31/25
<b>Service Businesses*</b>	Defaults to 100% of income from service businesses treated as wages*;  Service businesses eligible for special "small business rate"  *Defined under Section 1202(e)(3)(A) plus financial services *Can access 25% through ROI calculation if over 10% capital investment	Excluded from receiving the 23% deduction above \$500,000 (MFJ) and \$250,000 (Ind)*  *Phases out at \$600,000/\$300,000 **Expires 12/31/25
<b>Expensing</b>	Temporary full expensing for property currently eligible for bonus depreciation for 5 years;  Applies to new and used equipment	Temporary full expensing for property currently eligible for bonus depreciation for 5 years;  Applies to new equipment only
<b>Section 179 Expensing</b>	Temporarily increased to \$5 million with \$20 million phaseout for 5 years;  Energy efficient HVAC equipment added  *Indexed to inflation	Permanently increased to \$1 million with \$2,500,000 phaseout;  Roofs, HVAC, fire protection, alarms, and security systems added  *Indexed to inflation
<b>Real Property Depreciation</b>	No provision	Depreciable life reduced to 25 years
<b>Cash Accounting</b>	Available to C-Corps and Pass-Throughs with up to \$25 million in gross receipts, including inventories*  *Farming and Professional Service Corporation Exemptions from Accrual Retained	Available to C-Corps and Pass-Throughs with up to \$15 million in gross receipts, including inventories*  *Farming and Professional Service Corporation Exemptions from Accrual Retained
<b>UNICAP Exemption</b>	Increased to \$25 million	Increased to \$15 million
<b>Small Contractor Exemption</b>	Increased to \$25 million	Increased to \$15 million
<b>Interest Deduction</b>	Interest exceeding 30 percent EBITDA not deductible. Exempts real property trades or businesses. Exempts businesses with less than \$25 million in gross receipts.	Interest exceeding 30 percent EBIT not deductible. Exempts real property trades or businesses. Exempts businesses with less than \$15 million in gross receipts.
<b>State and Local Taxes</b>	Repealed except for \$10,000 property tax deduction allowance	Repealed except for \$10,000 property tax deduction allowance*  *Expires 12/31/25

<u>Provision</u>	<u>House Version of H.R. 1, the Tax Cuts and Jobs Act</u>	<u>Senate Version of the Tax Cuts and Jobs Act</u>
<b>Net Operating Losses (NOLs)</b>	Follows AMT rule for NOLs to be carried forward indefinitely. Deduction of NOLs limited to 90% of current year taxable income;  NOL carrybacks eliminated, except for one-year carrybacks for certain disaster losses.	Follows AMT rule for NOLs to be carried forward indefinitely. Deduction of NOLs limited to 90% of current year taxable income;  Limited to 80% of taxable income in 12/31/22;  NOL carrybacks eliminated, except for one-year carrybacks for certain disaster losses.
<b>Domestic Production Activities Deduction (Section 199)</b>	Repealed	Repealed
<b>Mortgage Interest</b>	Deductible up to \$500,000;  Home equity deduction repealed;  Interest from second home deduction repealed	Deductible up to \$1 million;  Home equity deduction repealed
<b>Estate/Gift/GST Taxes</b>	Estate tax exclusion doubled from current level* to \$10.98 million for 5 years (40 percent rate retained), then estate and GST tax fully repealed after 2023;  Stepped-up basis retained;  Gift tax exclusion raised to \$10 million, rate lowered to 35%  *Indexed to inflation from 2011	Estate and gift tax exclusion doubled from current level* to \$10.98 million**      *Indexed to inflation from 2011 **Expires 12/31/25
<b>Like-Kind Exchanges (LKEs)</b>	LKEs for real property only. Equipment disallowed.	LKEs for real property only. Equipment disallowed.
<b>Indexing</b>	Chained CPI for inflation adjustment	Chained CPI for inflation adjustment
<b>Private Activity Bonds (PABs)</b>	Repeals tax exemption for all PABs issued after 2017	No provision
<b>Historic Tax Credit</b>	Repealed	10% credit for pre-1936 buildings repealed;  20% credit for certified historic structures amortized over 5 years
<b>New Markets Tax Credit</b>	Prospectively repealed beginning in 2018. Existing credits can be used for up to 7 years.	No provision
<b>Municipal Bonds</b>	No provision	No provision
<b>Advanced Refund Municipal Bonds</b>	Repealed	Repealed

<u>Provision</u>	<u>House Version of H.R. 1, the Tax Cuts and Jobs Act</u>	<u>Senate Version of the Tax Cuts and Jobs Act</u>
<b>Highway Trust Fund</b>	No provision	No provision
<b>Carried Interest</b>	Imposes a 3-year holding requirement for long-term capital gains in investment partnerships	Imposes a 3-year holding requirement for long-term capital gains in investment partnerships
<b>Work Opportunity Tax Credit (WOTC)</b>	Repealed	No provision
<b>Independent Contractor</b>	No provision	No provision
<b>Paid Leave</b>	No provision	12.5% to 25% tax credit* for employers offering at least 2 weeks paid family and medical leave to employees earning up to \$72,000**  *Expires 12/31/2019 **Employee must get at least 50% normal wages
<b>Composite Plans</b>	No provision	No provision