



TAX PLANNING FOR CONTRACTORS – WHAT WE KNOW (AND WHAT WE DON'T!)

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1. Employee Retention Credit (ERC)

2020

- ▶ A fully refundable tax credit for certain employers equal to 50% of qualifying wages that an Eligible Employer pays to their employees.
- ▶ The credit applies to qualified wages paid from March 13, 2020 and before January 1, 2021. The maximum amount of credit for all quarters is based on \$10,000 of qualified wages (\$5,000 credit) per employee.
- ▶ PPP and ERC can be used by the same company (not the same wages)
- ▶ An Eligible Employer is one carrying on a trade or business (but also includes tax-exempt organizations) that either:
 - ▶ Fully or partially suspends operation during any calendar quarter in 2020 due to orders from an appropriate governmental authority due to COVID-19; or
 - ▶ Experiences a significant decline in gross receipts for a quarter – i.e., a 50% reduction for the quarter compared to the same quarter in the prior year.

1. Employee Retention Credit (ERC) (continued)

2021

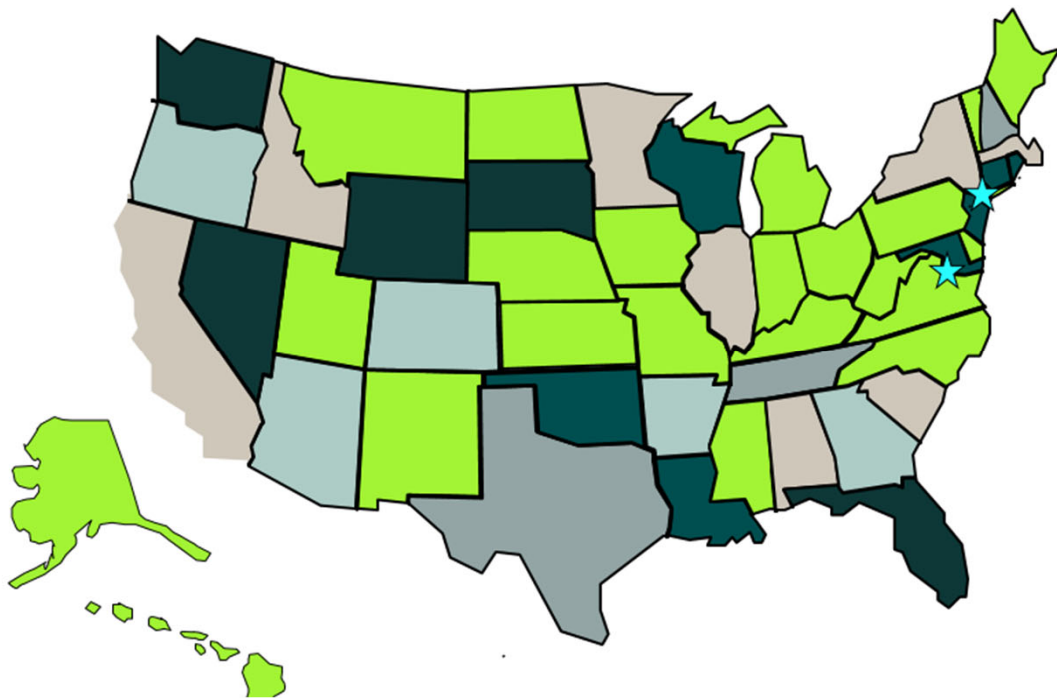
- ▶ Increases from 50% of qualifying wages to 70% (\$7,000 vs. \$5,000)
- ▶ Limitation is quarterly vs. annual (\$7,000 per quarter, \$28,000 for year)
- ▶ PPP and ERC can be used by the same company (not same wages)
- ▶ Qualified reduction in gross revenue 20% (was 50% for 2020, 2021 vs. same quarter in 2019)
- ▶ Increases from 100 employees to 500 employees in 2021.
- ▶ Qualification in previous quarter allows credit for following quarter (if qualified in 2nd quarter 2021, also qualify for 3rd)
- ▶ Some limitations on wages paid to stockholders and family
- ▶ Credit is “taxable” in the quarter it is earned (accrue at year end)
- ▶ Bipartisan Infrastructure and Jobs Act terminates ERTC for 4th quarter 2021.

2. SALT Cap Workaround







SALT Cap Workaround – IRS Notice 2020-75 Gave Green Light

- ▶ Enabling pass-through entities to deduct entity-level SALT payments as business expenses in place of non-deductible itemized deductions over the “SALT cap” of \$10,000.
 - ▶ **Revised BBB Plan as of 11/3/21 – Increases SALT Cap to \$72,500 for 2021.**
- ▶ Many states require elections, some by partner, and SALT PTE tax payments have due dates.
- ▶ Probably need to make a payment by December 31, 2021 to ensure deductibility on 2021 federal return.

2. SALT Cap Workaround (continued)



As of 10/26/2021

Key	
	States without an elective/mandatory PTE tax regime
	Historic, pre-2021 PTE tax states
	States with elective PTE tax effective for 2021 tax year
	States with elective PTE tax effective for 2022 tax year
	States that impose entity-level income tax on PTE
	States without income taxes or entity-level income taxes for PTE

3. Net Operating Losses Allowed a 5 Year Carryback and Not Limited by 80% of Taxable Income Rule

- ▶ This applies to NOLs from 2018, 2019 or 2020.
- ▶ Fixes glitch for fiscal 2018 returns, allowing 2 year carryback
- ▶ Planning opportunity
 - ▶ Carry back prior year losses. Compare prior year tax rates to current.
 - ▶ Maximize fiscal year end 2020 losses to create carry backs (depreciation, etc.)

4. Limitation on Net Business Losses Suspended

- ▶ For non-corporate taxpayers who under TCJA were limited to using net business losses to the extent of \$250,000 (\$500,000 for married filing joint), taxable incomes for 2018, 2019 and 2020 can be computed without this limitation.
- ▶ Planning opportunity
 - ▶ Consider amending 2018 to take increased loss allowed.
 - ▶ Review 2019 and 2020. Net operating losses created?

5. More Business Interest Expense Allowed

- ▶ Under the TCJA, net business interest is limited to 30% of Adjusted Taxable Income (unless certain exceptions apply). For 2019 and 2020 this is increased to 50%.
 - ▶ Partnerships and partners are subject to special rules:
 - ▶ The 50% ATI rule does not apply to partnerships for 2019. This rule applies at the entity level in 2020.
- ▶ Planning opportunity
 - ▶ Review prior period elections related to interest limitations.
- ▶ Revised BBB plan would amend rules to apply this limitation at the partnership or S-corporation level.

6. Bonus Depreciation is Allowed on Qualified Improvement Property (QIP) costs

- ▶ The legislative error in the TCJA is fixed and QIP now is eligible for immediate write-off.
- ▶ This provision is retroactive (2018 and 2019).
- ▶ Planning opportunity
 - ▶ Allows 100% deduction for many improvements to property placed in service vs. 39 years
 - ▶ Review prior period construction projects and amending tax returns
 - ▶ Consider marketing to building owners (pay apps, etc. to document accounting)
 - ▶ RE businesses that made election out of these rules can file a 3115 to elect in and apply more favorable QIP rules – Need to model

7. Charitable Contribution Rules Amended for 2020

- ▶ Corporation Charitable Deduction Limit
 - ▶ Increased from 10% of Taxable Income to 25% of Taxable for 2020.
 - ▶ Planning opportunity
 - ▶ Might allow the use of additional charitable contributions or deductions previously limited.

8. Build Back Better Plan – House Ways and Means

- ▶ Corporate Income Tax Increase
 - ▶ The current flat corporate rate of 21% is replaced with a rate of 18% up to \$400,000, 21% \$400,000 to \$5 million, 26.5% over \$5 million
 - ▶ Graduated rate phases out over \$10 million
 - ▶ Personal service corporations (architects/ engineers) pay 26.5%
 - ▶ No book minimum tax provision

8. Build Back Better Plan – Revised 10/28/21

- ▶ Corporate Profits Minimum Tax (CPMT)
 - ▶ Impose a 15% Alternative Minimum Tax (AMT) on adjusted financial statement income of applicable corporations that report over \$1B in profits to shareholders.
 - ▶ Indefinite carryforward for an AMT credit and financial statement losses.
 - ▶ Effective date of January 1, 2023.
 - ▶ Corporation must have a 3-year average of adjusted financial statement income of over \$1B beginning with 2020, 2021 and 2022.
- ▶ Surtax on corporate stock repurchases
 - ▶ Bill would impose a 1% excise tax on a publicly traded US corporation for the value of any of its stock that is repurchased by the corporation during the year.

8. Build Back Better Plan (continued)

- ▶ Maximum Individual Income Tax Rate
 - ▶ The Plan increases the maximum individual tax rate to 39.6% from the current highest rate of 37% for those who make more than \$450,000.
 - ▶ Currently top bracket begins at \$628,000
 - ▶ Effective 1/1/2022
 - ▶ 3% surcharge for those with AGI over \$5 million

8. Build Back Better Plan – Revised 10/28/21

- ▶ New surcharge on high-income individuals – Effective 1/1/22
 - ▶ 5% surcharge on an individual's modified adjusted gross income in excess of \$10M (\$5M MFS)
 - ▶ Additional 3% surcharge (8% total) on t/p's modified adjusted gross income in excess of \$25M
 - ▶ Modified AGI
 - ▶ Does not include 199A deduction
 - ▶ Does not include itemized deductions
- ▶ Estates and Trusts – Effective 1/1/22
 - ▶ 5% surcharge on adjusted gross income in excess of \$200K.
 - ▶ Additional 3% surcharge on adjusted gross income in excess of \$500K

8. Build Back Better Plan (continued)

- ▶ 3.8% Net Investment Income Tax
 - ▶ Under current law, the 3.8% Net Investment Income Tax is paid on the lesser of 1) the taxpayer's net investment income; or 2) the amount by which adjusted gross income exceeds certain thresholds (\$250,000 for joint filers and \$200,000 for single filers).
 - ▶ Plan would apply "the taxes consistently on those making over \$400,000."
 - ▶ Would include S corporation earnings currently exempt from 3.8% tax or self employment tax.
- ▶ Revised BBB Plan – Expand scope of the NIIT to cover "specified income" derived in the ordinary course of business for taxpayers with greater than \$400K or \$500K (MFJ)
 - ▶ Would not be assessed on income with FICA already imposed.
 - ▶ Effective for tax years beginning after 12/31/21.

8. Build Back Better Plan (continued)

- ▶ Increased Long-Term Capital Gain and Qualified Dividend Rate - **Not in revised BBB**
 - ▶ Rate increases to 25%
 - ▶ Effective date 9/13/2021
- ▶ 20% Pass-Through Deduction Limited to \$500,000 at the owner level (\$2.5 million income if one owner) - **Not in revised BBB**
- ▶ Decreases estate and gift lifetime exclusion from \$11.6 million to \$5 million. - **Not in revised BBB**
 - ▶ No minority or lack of marketability discounts for non-business assets.
 - ▶ Effective 2022

8. Build Back Better Plan (continued)

- ▶ Extends the Carried Interest Rule from 3 years to 5 - **Not in revised BBB**
 - ▶ Allows capital gain treatment for certain ownership interests.
- ▶ Allows deduction of R&D expenses (vs. amortization) through 2025. – **Remains in revised BBB**

8. Build Back Better Plan (continued)

- ▶ Limitation of excess business losses for individuals made permanent
 - ▶ The TCJA created a limitation on the use of excess business losses over a \$500,000 threshold (\$250,000 for married separate filers). Such excess could not be currently used and became part of the taxpayer's net operating loss carryover for future years. The CARES Act removed this limit for 2018, 2019 and 2020. However, the limitation applies for 2021 through 2025. Plan would make it permanent.
- ▶ **Revised BBB Plan –**
 - ▶ Same as above regarding permanency.
 - ▶ Carried forward losses no longer would be considered an NOL
 - ▶ Instead, excess losses may be carried forward to succeeding tax year where they would be an excess business loss for that year.

8. Build Back Better Plan – (continued)

- ▶ Current rule - Exclusion of gain from the sale of QSBS limitation
 - ▶ 75% exclusion of gain from QSBS for stock acquired after 2/17/2009.
 - ▶ 100% exclusion of gain from QSBS for stock (and elimination of AMT preference) acquired after 9/27/2010.
- ▶ **Revised BBB Plan**
 - ▶ The 75% and 100% exclusion rates and the elimination of the AMT preference item would not apply to taxpayers with adjusted gross income equal or exceeding \$400K, as well as any trust or estate.
 - ▶ Would apply to all sales or exchanges of QSBS after 9/13/21.

8. Build Back Better Plan (continued)

- ▶ Excluded from the Build America Back Plan (though described on the Biden campaign website)
 - ▶ The Social Security Tax “Donut-Hole” (which would have caused social security taxes to apply to earnings in excess of \$400,000).
 - ▶ 6.2% social security tax comes back to life at \$400,000.
- ▶ Limitation on value of itemized deductions to 28%.
- ▶ Eliminates like-kind exchange for real estate > \$500,000.
- ▶ Loss of Estate Tax Basis Step-Up.
 - ▶ Gifts or estates would pay tax as if assets were sold if over \$2.5 million.

9. Construction Industry Audit Technique Guide (4/19/21)

- I. Overview
- II. Long-Term Contracts
- III. Small Construction Contractors
- IV. Large Construction Contractors
- V. Mid-Contract Change in Taxpayer
- VI. Financial Accounting vs. Tax Accounting
- VII. Home Builders & Land Developers
- VIII. Other Issues in Construction
- IX. Income Probes
- X. Construction Joint Ventures
- XI. Additional Resources



<https://www.irs.gov/pub/irs-pdf/p5522.pdf>

10. Highlights of Audit Guide

- ▶ Exhibit 1-1 Federal Tax Law & Guidance
 - ▶ 7 pages of Code/Regs/Rulings/Proc/Cases
 - ▶ Including “Basic Engineering Case.” Contract took more than two years to complete. POC vs. Completed Contract
- ▶ Exhibit 1-3 Construction Industrial Resources
 - ▶ 5 pages of Associations and Publications
- ▶ Separate Audit Guide for Look-Book Interest
- ▶ \$26 Million Gross Receipts Test
 - ▶ Includes related parties and all income (vs. only trade or business income pre-2018)

10. Highlights of Audit Guide (continued)

- ▶ 10 Methods of Accounting
 - ▶ Cash
 - ▶ Accrual
 - ▶ Hybrid
 - ▶ Accrual Excluding Retainage
 - ▶ Completed Contract
 - ▶ Exempt Contract Percentage of Completion
 - ▶ Percentage of Completion
 - ▶ Percentage of Completion Simplified Cost
 - ▶ Percentage of Completion 10% Method
 - ▶ Percentage of Completion Capitalized Cost Method (70% / 30% for residential construction)

Note: Change in long-term methods require Commissioner's approval.

10. Highlights of Audit Guide (continued)

- ▶ Confirms that overbillings are taxable on Accrual Method
- ▶ Accrual excluding retainage is allowable method for contractors (receivable and payable)
- ▶ Provides details of 95% complete or customer using subject matter for completed contract test
- ▶ Allocation of direct and indirect costs for Completed Contract Method
- ▶ Alerts agents to uninstalled materials inclusion for tax POC purposes
- ▶ Warranty & contingencies not included in tax estimated cost to complete
- ▶ Residential contracts include nursing homes, retirement and assisted living, prisons, and dorms

10. Highlights of Audit Guide (continued)

- ▶ IRS to include claims, bonuses, and disputed compensation if included for financial statements
- ▶ Review of ASC 606 Financial Statement vs. Tax Revenue
- ▶ Lists expected book-tax differences, including
 - ▶ Loss contracts
 - ▶ Uninstalled materials
- ▶ Home construction contracts and common improvements
 - ▶ Howard Hughes Co. – Not constructing dwelling units. Not allowed to use Completed Contract Method
 - ▶ TAM 201650014 / Shea Homes – Rough grading and fine grading included. CC allowed

10. Highlights of Audit Guide (continued)

- ▶ Smaller contractors (no bonding, etc.) might under report income
- ▶ Built-in gains when C Corps convert to S.
 - ▶ Deferred revenue can be taxable
- ▶ Alternative minimum tax on any contracts other than POC or home construction
 - ▶ Compare financials to tax returns
- ▶ Joint Ventures
 - ▶ Confirm basis and contributions to capital
- ▶ Exhibit 11-1 Construction Industry Interview Questions
- ▶ Exhibit 11-2 Cost Allocation Process

11. GAAP 606: Possible Tax vs. Financial Considerations

- ▶ Cannot implement 606 for tax purposes unless electing limited compliance
- ▶ Were contracts combined or severed for GAAP?
- ▶ Are warranty costs accrued/included in contract costs?
- ▶ Does the transaction price include “constraint of variable consideration”?
- ▶ Has profit from claims been recognized?
- ▶ Has transaction price been allocated to performance obligation vs. contract level?
- ▶ Have uninstalled materials been classified as inventory?
- ▶ Are there contract assets or prepaid construction costs being recognized and amortized?
- ▶ Does not impact tax methods for retainage receivable, retainage payable, < 10% method deferral, cost allocation, home and residential deferrals, etc.

12. What do you need to know to do tax planning for construction contractors in 2021? Same thing as every other year!

- ▶ What is Income Year-to-Date?
 - ▶ Any audit adjustments in the pipeline?
 - ▶ Job schedules reviewed / approved by client?
 - ▶ Fixed asset purchases and disposals?
 - ▶ PPP money included in income?
 - ▶ Employee retention credits receivable?

13. Projected Income for Remaining Months

- ▶ From management
- ▶ Document in planner where projections came from (CYA)
- ▶ Compare to prior years actual operations for remaining months (reconcile with prior year-end adjustments)
 - ▶ Is this year going to finish better or worse than last year?
 - ▶ How did prior year projection compare to actual?
 - ▶ Any unusual adjustments in prior year planning?

14. Prior Year Tax Return

- ▶ Non-deductible accruals (reserves / workers' comp, accruals)
- ▶ Additions / reductions to income due to prior year deferrals (cash vs. accrual, tax methods for contracts, etc.)
- ▶ Net operating loss carry forwards
- ▶ AMT credit carry forwards
- ▶ Contribution carry forwards
- ▶ Average gross receipts for past three years (greater or less than \$26 million)

15. Review Related Entities

- ▶ Aggregation for gross receipts purposes (\$26 million threshold / look-back limits)
- ▶ Allocation of lower brackets, AMT exemption, etc.
- ▶ Intercompany accruals and payments matching of methods (cash vs. accrual)
- ▶ Equalize income / losses and complete documentation (invoices, interest paid, etc.)
 - ▶ Recommend monthly calculation and payment

15. Review Related Entities (continued)

- ▶ Be aware of business loss limitations at owner level
 - ▶ Net \$500,000 limit
 - ▶ Excess carries forward
 - ▶ Waived for 2018-2020 due to COVID legislation
- ▶ Estate and gift planning
 - ▶ Will rates, exemptions, economy, etc. ever align again?

16. Review Type of Entity Considering Tax Laws and Proposals

- ▶ C Corporation
- ▶ S Corporation
- ▶ LLC or Partnership

17. Review Tax Method of Accounting

- ▶ Cash (allowed for entities < \$26 million in revenue)
- ▶ Accrual
- ▶ Accrual excluding retainage
- ▶ Completed contract (allowed for contractors < \$26 million in revenue)
- ▶ Percentage of completion
- ▶ Tax percentage of completion
- ▶ Percentage of completion excluding retainage payable
- ▶ Percentage of completion excluding subcontractor payable (Paid if paid)

17. Review Tax Method of Accounting (continued)

- ▶ Percentage of completion capitalized cost method (residential)
- ▶ Consider change of method prior to year-end if commissioner's approval is required.
- ▶ Changes to long-term contract methods require permission (not automatic - \$11,500 fee)
- ▶ Changes to cash/accrual/accrual excluding retainages are "automatic" up to due date of the return, including extensions (Attach Form 3115 to return)

17. Review Tax Method of Accounting (continued)

- ▶ Review method prior to 1986 or large contractor status (“normal” method)
- ▶ Change to cash method under TCJA is automatic and requires a Section 481 adjustment
 - ▶ Attach Form 3115 with limited disclosure
- ▶ Change to completed contract is automatic and is on the cut-off method
 - ▶ No 3115 needed if percentage of completion was not elected when \$10 million exceeded

18. Calculate Deferrals Available for Contracts Not Subject to Percentage of Completion

- ▶ Non-long-term contracts (use overall method of accounting) – cash / accrual / accrual excluding retainage)
- ▶ Home Construction Contracts (Shea Homes, Inc., T.C.)
- ▶ Residential contracts (30%)

19. Calculate Possible Deferrals for Method of Accounting

- ▶ Cash method – accelerate payments prior to year-end (do not accelerate receipts)
- ▶ Accrual – book liabilities and expenses (overbilling equals taxable income)
- ▶ Accrual excluding retainage (receivable and payable)
- ▶ Completed contract – do not accelerate completion (test % complete)

19. Calculate Possible Deferrals for Method of Accounting (continued)

- ▶ Percentage of completion – capitalized G&A – retainage payable
 - ▶ Less than 10% complete jobs
 - ▶ Non-deductible loss jobs (POC for tax. 100% for GAAP)
 - ▶ Projection of jobs to be completed or exceed 10% completion at year-end
 - ▶ Home or residential deferral

20. Review Depreciation

- ▶ Code Section 179D deduction for energy efficient government projects

21. Calculate Alternative Minimum Taxes for Pass-Through Owners

- ▶ Depreciation (AMT & ACE)
- ▶ Basis adjustment for sale of assets (AMT & ACE)
- ▶ Contract preference (tax POC vs. tax method)
 - ▶ Includes 30% residential deferral
 - ▶ Does not include home or non long-term contracts
 - ▶ Does not include < 10% complete contracts

21. Calculate Alternative Minimum Taxes for Pass-Through Owners (continued)

- ▶ Increase in cash surrender value
- ▶ Difference in regular tax and AMT NOL's
- ▶ Percentage depletion
- ▶ Works both ways (contract preference can increase or decrease AMT)

22. Calculate Pass-Through Owner Qualified Business Deduction (20%)

- ▶ Review limitation amounts (W-2 wages, construction gross profit)
- ▶ Salaries vs. distributions (salaries reduce the deduction)
 - ▶ Reasonable owners' salaries and guaranteed payments must be deducted
- ▶ Must be “trade or business” income
- ▶ Real estate rental can qualify if related to trade on business

23. Review Possible Tax Credits Available

- ▶ Research and development
- ▶ Energy credits
- ▶ Work opportunity credits

24. Calculate Look-Back

- ▶ Review accurate allocation of costs to jobs.
- ▶ Insure accurate timing of completion of jobs.
- ▶ Review for post-completion settlements (cost or revenue on prior completed contracts).
- ▶ At owner level for look-back.

25. Review Owner's Tax Situation

- ▶ Maximize use of lower brackets. Between companies and owners
- ▶ AMT for flow through entities
- ▶ Timing of payments
- ▶ Bond indemnification / loan guarantee fees (0.5% to 1.75%)
(avoids payroll taxes and excess compensation issues)
- ▶ Tax withholding vs. estimated tax deposits
 - ▶ Annualization for construction contractors
- ▶ Future and projected tax rates due to legislation or business cycles

26. Before and After Tax Planning

- ▶ Change in tax liability / tax due.
- ▶ Take credit for previous planning (cumulative savings). “After planning” will never be higher than “before”.
- ▶ Planning saves taxes in the current year and estimated taxes for following years.
- ▶ Even if “just deferred” who would not do this?

27. Detail Listing of “To Do” Before & After Year-End (i.e. Pay Officer Bonuses, etc.)

- ▶ Pay estimated payments / withhold taxes from bonus to avoid penalties.
- ▶ Pay 2021 estimated state taxes for SALT cap workaround
- ▶ Review cost allocation on jobs finishing better than expected.
- ▶ Guaranteed payments to partners.
- ▶ Gifting and continuity planning.
- ▶ Purchases of equipment
- ▶ Completion of contracts

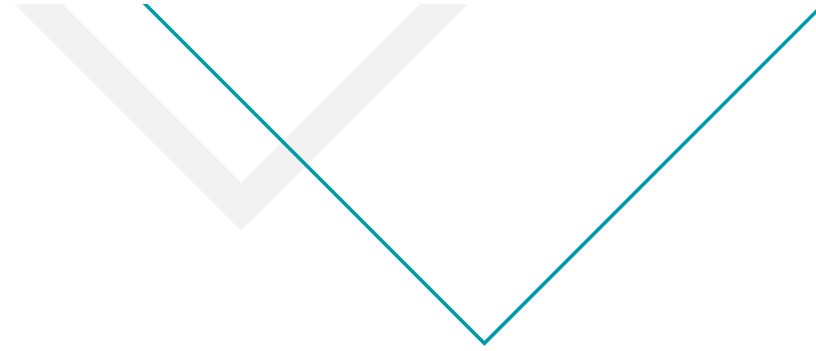
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Thank You!

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