SHAVELL & COMPANY, P.A.
Certified Public Accountants and Consultants

Memo

To: **Clients & Friends**
From: **Rich Shavell, CPA, CVA, CCIFP**
Date: **January 2018**
Re: **Implications of New Tax Bill for Contractors**

Here are a few things to consider from the new Tax Bill. Most of these provisions are effective for the 2018 tax year and as you heard in the general press, many are subject to a five-year sunset provision.

- **Business Issues**
    - The small contractor exemption from reporting under percentage of completion has expanded. The completed-contract method is now applicable to taxpayers with average annual gross receipts under 25 million across the prior three years (up from 10 million on prior tax law).
    - C-corporations (1120) will be taxed at a flat 21% rate (down from 34% & 35%).
    - Corporate (1120) alternative minimum tax (AMT) has been repealed (individual AMT still applies).
    - Domestic production activities deduction (DPAD) has been repealed.
    - 20% deduction for qualified business income from pass-through entities (S-corporations and partnerships).
        - Like the DPAD that was just repealed, this new deduction faces a few limitations including a 50% wage threshold.
        - Therefore, with the highest marginal personal tax rate now set at 37%, the effective tax rate - ***<u>if you can use the 20% deduction</u>*** - is approximately 29.6% (37% times 80% of the passthrough income after the new deduction).
    - Depreciation:
        - Bonus depreciation is permissible now for both new and used property and is back to 100% for a couple of years including a retroactive effective date of 9/27/17.

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    - Section 179 depreciation expensing has been increased to $1 million per year (up from $500k). Nevertheless, bonus depreciation will likely be utilized first in the next few years while it is set at 100%.

  - Meals and entertainment deduction:
    - Entertainment costs will be 100% disallowed – previously 50%.
    - Meals are still deductible at 50% and has been expanded to include in-house/ cafeteria expense, which was 100% deductible and is now 50% deductible.

  - Net operating loss (NOL) carrybacks are repealed, but can be carried forward indefinitely. Moreover, the NOL only can be used in subsequent years to offset up to 80% of taxable income.

- **S-Corporation vs C-Corporation: a major question**

  - Given the lower tax rate for C-corporations, in a limited number of situations it may be worth considering making the switch to a C-corporation or adding a new C-corporation to the business' operations to obtain that lower rate.
  - However, remember that even with the C-corporation tax rate being 21%, the C-corporation is still subject to double taxation when the residual cash is sent to the shareholder as a dividend. Dividends continue to be taxed at a maximum 20% rate. Therefore, the combined rate approaches 40%.
  - Compare this combined corporate rate of almost 40% with the blended rate for passthrough entities that can take the new 20% deduction. As noted above, the passthrough income is taxed at roughly 30%, if you qualify to use the new deduction; or 37% without the new deduction.
  - The decision is not entirely clear and many factors must be considered. We expect most closely-held businesses will continue to utilize passthrough entities and face tax at the shareholder/individual rates.

- **Personal Taxes**

  - Tax rates adjusted with highest marginal rate reduced from 39.6% to 37%.
  - Obamacare individual mandate repealed (starting 2019): Individuals will no longer pay a fine for not having minimum health care coverage.
  - Overall limitation on itemized deductions suspended: Taxpayers will not have their itemized deductions reduced as their income elevates above a threshold.
  - The standard deduction is increased: $12,000 for single and $24,000 for married filing joint. However, exemptions per individual are no longer permitted.
  - Mortgage interest deduction limited: Only interest paid on debt up to $750,000 will be deductible (down from the current $1 million threshold).
  - Alimony payments are neither deductible by the payor nor included in the income of the payee spouse for agreements executed or modified after 12/31/18.
  - Estate tax exemption has been doubled for a few years.

Many other rules apply, and this is a simplistic recap. Always consult with Shavell & Company or your tax advisor before implementing any ideas contained herein. To discuss your specific circumstances, call us today: **(561) 997-7242**