

Chairman, ABC National Tax Advisory Group
Shavell & Company, P.A.,



New Tax Deduction Specifically Available for Contractors, Engineers and Architects

How would you like to wipe out 9% of your net income from federal income tax - just because you are in the construction industry? I know you'd agree that would be a step in the right direction. Now, contractors, architects and engineers are the beneficiary of a new law that permits just that. The new law is phasing-in starting in 2005.

Businesses may claim a deduction that is equal to a percentage of the income earned from production activities undertaken in the U.S. This includes: manufacturing, food production, software development, film and music production, production of electricity, natural gas or

water, construction, engineering and architectural services. Part of the reason behind the new deduction is for an incentive for domestic production and to increase domestic jobs.

This new Domestic Production Activity Deduction (DPAD) equals the lesser of:

- A percentage (3%, 6% or 9%) of the smaller of:
 - (1) The qualified production activities income ("QPAI") of the taxpayer for the tax year; or
 - (2) Taxable income for the tax year.
- 50% of the W-2 wages of the employer for the tax year.

The percentage is statutorily set at 3% for tax years beginning in 2005 and 2006, 6% for tax years beginning in 2007-2009, and 9% thereafter. The fundamentals work like this.

Assume that ABC Construction Company has the following results for the year 2010:

- Gross receipts of \$10 million
- Qualified production activities income (QPAI) of \$1 million
- Taxable income of \$1.1 million
- W-2 wages of \$900,000

1. First multiply QPAI times the statutory rate of 9% for a potential deduction of \$90,000 (\$1 million times 9%);

2. We then compare the potential deduction of \$90,000 to taxable income of \$1.1 million and conclude the \$90,000 is smaller so we made the first hurdle;

3. Lastly, we compare the \$90,000 to one-half of W-2 wages (i.e. \$900,000 of wages times 50%) and conclude that the \$90,000 potential deduction is smaller so we made the last hurdle and the resulting DPAD in this example is \$90,000.

Unfortunately, there is an abundance of complications in getting to the results. Among the many confusing and complex aspects of this new deduction are:

- Not all construction services qualify as "production activities";

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Rich Shavell, CPA, CCFP is President of Shavell & Company, P.A. CPAs and Consultants in Boca Raton and Stuart, FL. Rich has been an advocate for contractors over the last twenty years presenting comments before the IRS on proposed regulations and testifying before the House and Senate on behalf of ABC. Currently, Rich serves as Chair of ABC's National Tax Advisory Group. Locally he serves on our Chapter's Legislative Committee and Rich is the 2005 winner of the South FL Business Journal's Excellence in Accounting Award in Construction. For more information visit www.shavell.net or call (561) 997-7242.

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- How to allocate expenses in computing qualified production activities income;
- How to complete the computations at the pass-through level such as an S Corporation shareholder level;
- How to compute the W-2 wage limitation; and
- How to treat affiliated groups and related party activities.

On January 3, 2006 ABC National submitted written comments* to the IRS on the Proposed Regulations that were issued expressing concern that the proposed regulations "are neither simple nor entirely fair in its application to our construction company members and other construction firms in

the industry".

On January 11, 2006, representing ABC, I presented oral testimony at the IRS Hearing in Washington, DC on the proposed regulations under Section 199 for the new DPAD. Part of that testimony was to make recommendations to simplify the new rules and to also tell the IRS:

"ABC is very pleased that construction activities qualify for the Section 199 deduction. At the same time, we're concerned that many of our contractor members and other taxpayers will be surprised to learn that tax preparation costs need to increase in order for them to secure this congressionally mandated and valuable tax incentive under Section 199. We are hopeful that the final regulations are not incongruous with the current discussions regarding the need to overhaul and thereby simplify our tax system."

The point was further expressed that the current complexity is probably not what our legislators had in mind when they were looking to put this very important incentive into our tax code.

The new deduction is law, so make sure you take advantage of it. You will need to work closely with your outside CPA and internal accountants to ensure you are capturing the information necessary to properly compute the new Domestic Production Activity Deduction.

For a copy of the written comments visit www.shavell.net and click on "news/downloads".

New Do Not Call List for Cell Phones

As of February, 2006, all cell phone numbers are being released to telemarketing companies and you will start to receive sale calls. YOU WILL BE CHARGED FOR THESE CALLS...

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