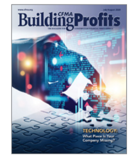


BY RICH SHAVELL

Tax Techniques Column: Most Popular Topics

Nearly five years ago, this *Tax Techniques* column was created to keep construction company owners and CFMs informed on specific tax issues and address them from a useful and practical perspective.

This installment will highlight and include a summary of 17 of the most popular topics that have been covered throughout these years, which fall into three main categories:

1) *Recaps* of recent legislation or regulations and how it impacts contractors;
2) *How-to* articles that decipher and illustrate tax issues that affect all businesses and contractors; and
3) *Analysis* articles that focus on technical construction tax issues.

Naturally, readers should always consult their tax advisor before implementing any tax strategies, especially given that some content may no longer be current.

Recaps of Recent Legislation

"What If There's a Downturn? Tax Implications for Contractors" from the January/February 2020 issue was intended to be an analysis of tax provisions that may prove difficult for contractors in the event of a downturn. And then COVID-19 impacted our economy, and this article proved to be a road map of issues that Congress should consider.

In fact, several of the tax issues in this article were addressed in the *Coronavirus, Aid, Relief, and Economic Security Act* (CARES Act).[1] The inability to carryback net operating losses (NOLs) to generate cash was retroactively and temporarily addressed for NOLs generated in 2018 (as well as 2019 and 2020).[2] These NOLs can now be carried back five years, which is different from what was described in the article.

Also, individual taxpayers (i.e., S corporation shareholders) are no longer limited from fully using excess business losses carried forward to the current tax year.[3] NOLs, along with a few other issues in this article (i.e., the limitations on interest expenses deductions[4]) were adjusted by Congress, albeit temporarily in some cases.

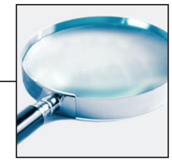
"Two 2019 Tax Laws Impact Multiple Years" from the May/June 2020 issue is a recap of the ***Taxpayer Certainty and Disaster Tax Relief Act of 2019*** (Disaster Act) and the *Setting Every Community Up for Retirement Enhancement Act of 2019* (SECURE Act).[5]

This article highlighted the need for contractors to elevate discussions with tax advisors to ensure that available refund opportunities are pursued. There were several retroactive tax provisions permitting 2018 amended tax filings, which can result in tax refunds. This includes various extenders, such as §179D depreciation deductions, credits related to labor (i.e., work opportunity tax credit), the liberalization of and changes to retirement plans and distributions from these plans, etc. There are also new prospective tax deduction/credit opportunities like credits for establishing new company-sponsored retirement plans and others.

The *Tax Cuts and Jobs Act* (TCJA) passed in late 2017 spawned several articles. In the March/April 2018 issue, "Tax Cuts & Jobs Act: Reevaluating S vs. C Corporations" evaluated whether contractors should consider restructuring as a C corporation to take advantage of the new lower flat federal corporate 21% tax rate. One major issue is whether a C corporation should replace the S corporation as the new, ideal entity type for closely held businesses. The optimal answer is not straightforward and, as always, depends on the taxpayer's specific circumstances.

The September/October 2018 issue tackled "The New Qualified Business Income: An Overview." Beginning in 2018, taxpayers can deduct up to 20% of their income from pass-through entities such as S corporations and partnerships with certain limitations. The new qualified business income (QBI) deduction provides shareholders and partners of pass-through entities with an effective tax rate reduction so pass-through businesses are treated similar to C corporations under the TCJA.

The March/April 2019 issue looked at the change in the revenue threshold defining a small contractor with "The New



Small Contractor Threshold: Transition Requirements for Tax Purposes." Construction contractors are generally required to use the percentage-of-completion method (PCM) of accounting for long-term contracts for tax reporting purposes.

However, if a contractor's average annual gross receipts are below a statutory threshold, then other tax reporting methods are permissible. The TCJA law permits an increased number of contractors to take advantage of the more favorable tax reporting methods such as the cash method and the completed-contract method (CCM).

How-To Articles

A disquieting issue for closely held businesses and contractors is managing the "Tax Implications of Debit Shareholder Loans," which was addressed in the July/August 2016 issue. Debit shareholder loans enable shareholders of closely held businesses to utilize company funds for various purposes. And, as much as the CFM or outside CPA might advise against such loans being left open at year-end or at interim reporting dates, these loans are periodically necessary.

CFMs should ensure that advances and loans to shareholders are properly documented with a formal note, an appropriate rate of interest, repayment terms, maturity date, and if feasible, collateral. Importantly, the CFM should then ensure that the terms are adhered to until the loan can be fully paid down or, in some cases, effectively adjusted to zero.

Tax Depreciation

Tax depreciation is a ubiquitous issue that seems to be adjusted almost yearly. We presented a primer with "The Various Buckets of Depreciation: A Review of Current Rules & Changes," which was first published in the January/February 2017 issue, and then updated in the May/June 2018 issue after the TCJA passed ("The Various Buckets of Depreciation: Current Rules & Changes"). A quick reference guide was included with the described strategies to maximize depreciation deductions.

The CARES Act recently put to rest a needed technical correction addressed in the updated article relating to whether qualified improvement property (QIP) qualifies for bonus depreciation. This is important because it covers much of what we typically consider leasehold improvements.

Tax writers had not explicitly designated QIP for the 15-year class life, which means these assets would technically fall under a default recovery period of 39 years. This caused QIP to be technically ineligible for bonus depreciation as of the start of 2018. Congress, being aware of the drafting error, was expected to rectify this via a technical correction.

In the CARES Act, Congress retroactively applied the technical correction that enables QIP made by the taxpayer to be depreciated over 15 years for tax purposes. The result is, in many cases, a significant deduction because 15-year property currently qualifies for first-year bonus depreciation.

Depreciation was also covered in the March/April 2017 issue with "Taking Advantage of IRC §179D," which provides an accelerated tax depreciation deduction, not credits, for certain property should the building's energy savings meet specified levels.

The article stated that CFMs should consider IRC §179D when undertaking projects that increase energy efficiency in one or more of three specified building system categories: interior lighting, HVAC, or the building envelope. The deduction should be considered by contractors working with government-owned buildings because of the potential allocation of the deduction to the building's "designer," which can include the engineer, contractor, architect, environmental consultant, or energy provider.

The 2019 Disaster Act mentioned earlier reinstates the §179D deductions retroactively to 2018 and also for both 2019 and 2020.[6]

"Understanding Cost Segregation Studies & Potential Tax Benefits" in the March/April 2016 issue was an update to a 2002 article on cost segregation studies. A cost segregation study is a financial and engineering study of new or existing property or improvements to identify tangible personal property and other improvements that qualify for shorter tax depreciable lives. The study enables acceleration of federal (and sometimes state) income tax depreciation, resulting in federal income tax savings. A cost segregation study can save the property owner taxes, mitigating the carrying cost of the property.

Maximize Deductions & Avoid Issues

Just like depreciation articles, others were written with the intention to explain how to maximize tax deductions and avoid various tax issues. Among others, here are a few topics to consider.

Maximizing tax deductions and maintaining proper documentation is a concern for all CFMs, so "Primer on Contractor Tax

Deductions for Car & Truck Expenses" was published in the November/December 2019 issue since contractors invest in and use many types of vehicles, including cars and trucks.

Navigating the rules and regulations can be daunting – mileage deductions, listed property rules, whether or not to include vehicle allowances in employee wages, and determining depreciation are just some of the issues that must be addressed.

"Meals & Entertainment Deductibility: New Requirements & Opportunities" is another deduction addressed in the January/February 2019 issue. Prior to the TCJA, tax law permitted a 50% deduction for entertainment, amusement, or recreation-type expenses, so long as taxpayers could substantiate that the expenses were "directly related to" or "associated with" trade or business.

Given the broad application of these tests, taxpayers were previously able to deduct recreational and sometimes loosely related activities as necessary business expenses. However, the TCJA removed the IRC language that previously allowed deductions for such catch-all activities.

Not only will the TCJA impact businesses' taxable income, but companies must also alter their accounting procedures. Prior to the new law, most businesses accounted for both types of expenses under one joint "meals and entertainment" expense account. However, under the new law, businesses will have to account for their non-deductible entertainment expenses separately from their meal and entertainment expenses by differentiating between 50%- and 100%-deductible items within their chart of accounts.

"Deducting Bad Debts for Tax Purposes: A Primer" was published in the July/August 2019 issue. If and when amounts owed to a company are not paid, then the unpaid amounts can (at least) be deductible as bad debts for tax purposes. There are several issues to consider: accounting method; business vs. nonbusiness debt; establishing worthlessness; partial worthlessness; deductions where the customer files for bankruptcy; statute of limitations; tax benefit rule; and related party loans.

Analysis Articles

These articles are typically more theoretical or delve into technical issues.

In the May/June 2017 issue, contractors were warned about a relatively obscure and confusing tax issue in "Converting from a C to an S Corporation? Beware the Built-in Gains Tax." To avoid double taxation, a C corporation may consider converting to an S corporation.

However, when the fair value of an entity's assets at the relevant date of conversion is more than its tax basis, a C corporation may incur the built-in gains tax, which applies to certain assets that have appreciated or are converted to cash after a C corporation changes to an S corporation. This extra tax can surprise "converting" businesses, especially contractors that use a more favorable revenue recognition method for tax purposes, such as the cash basis or CCM.

"Tax Implications of Owning Your Corporate Headquarters" in the September/October 2019 issue discusses an assortment of tax issues for contractors to construe when owning or buying property from which to operate their business. Contractors that own their corporate headquarters can build equity, increase cash flow, and reduce income tax liabilities. At the same time, entities must be properly established and tax elections timely filed.

There are many other issues to consider such as tax ramifications of refinancing the property's mortgage, distributing net funds available after refinancing, addressing the purchase of a partial interest whereby a new member buys into the LLC, new rules regarding parking lots, etc.

One of the more difficult articles to draft was "Tax Implications of Selling a Construction Business" from the March/April 2020 issue. This subject is laced with complexity, so charts were used to detail computations such as capital gains and depreciation recapture income at various statutory tax rates.

This article discusses asset vs. stock sales, installment sale treatment, special elections under IRC §338, interplay of QBI deductions, reporting purchase price allocation, and other potential issues. At the outset, contractors and CFMs should understand how the transaction is structured, what taxes may apply, and what the projected after-tax proceeds will be for the pending transaction.

In the January/February 2016 issue, "Construction Tax Accounting Methods & Choices: An Overview" explains potential complexity faced by a contractor when evaluating the various choices for reporting revenues for tax purposes. Accounting for income from construction contracts is not always easy or straightforward.

Some methods can accelerate income, while others allow a contractor to legally defer income. When reviewing the options, consider three overriding issues:

1) Is the construction contractor considered "small" for tax purposes?

2) Is the contract short-term (i.e., started and completed during the tax year) or long-term?

3) Does the nature of the work performed fall within a specialized category (e.g., residential or home construction contracts)?

A Look Back – Thank You

Since I've been writing for *CFMA Building Profits* for 30 years and this is my last installment of this column, I asked for space to thank a few people who have helped me over the years.

CFMA Building Profits has been blessed with a continuous run of outstanding editors, including Paula Wristen, who was the first editor I had the pleasure of working with 30 years ago. Today, Kristy Domboski serves as CFMA's Director of Publications & Managing Editor of *CFMA Building Profits*. Kristy is a friend and someone whose judgment all *CFMA Building Profits'* authors can depend. She leads a team who perform a herculean job every two months. Planning issues, procuring articles, working with authors, enlisting volunteers to undertake third-party reviews, managing the printing process, and – while coordinating all of that – simply editing the outstanding articles and ensuring every endnote is accurate!

Thank you to all of the technical reviewers who have invested their time in CFMA to ensure all of the articles in *CFMA Building Profits* are technically accurate. Specifically, I'd like to thank Alan Clark, who has reviewed numerous articles over the years. While *CFMA Building Profits* authors typically do not know who reviews their articles, being longtime friends, Al and I sometimes end up discussing technical issues in these *Tax Techniques* articles. Al is always insightful, practical, and technically accurate. Thank you, Al, for your invaluable help over the years.

Numerous professionals at Shavell & Company, P.A. have helped with research, pulling endnotes, and assisting in so many ways – thank you to all of them.

Thank you to my spectacular and over-worked wife, Stacey, for her constant support and encouragement.

Writing for CFMA

Writing for the magazine is rewarding beyond anything I can express, and you get a lot of help when you volunteer. As an example, about eight years ago, I offered to collaborate on an article with Sue Fry, a CFM for a South Florida contractor, who wanted to write her first article. I helped with the outline and made some suggestions, but Sue wrote the entire article. After, I helped her work through the editorial review followed by the technical review. In a short time, she had her first article published in *CFMA Building Profits*, "Subcontractor Prequalification After the Great Recession" (March/April 2013).

If you are a CFMA member and have yet to write an article for *CFMA Building Profits*, now is the time! Authoring an article for *CFMA Building Profits* is far less difficult than I thought it would be. You get so much help throughout the process from the many current and past authors within CFMA. And you will have exceptional guidance from Kristy Domboski and her remarkable team. Call 609-945-2427 or e-mail Kristy at *kdomboski@cfma.org* today and volunteer – you will not be disappointed. ■

Endnotes

1. *The Coronavirus Aid, Relief, and Economic Security Act.* P.L. 116-136; H.R. 748.
2. IRC §172(a) as amended by CARES Act §2303(a)(1)).
3. IRC §461(l)(2) as amended by CARES Act §2304(b).
4. IRC §163(j)(10)(A)(i) as amended by CARES Act §2306(a).
5. *www.congress.gov/bill/116th-congress/house-bill/1865.*
6. *www.congress.gov/bill/116th-congress/house-bill/1865.*

RICH SHAVELL, CPA, CVA, CCIFP, is President of Florida-based Shavell & Company, P.A., a full-service CPA and consulting firm specializing in serving contractors. Rich joined CFMA in 1990 and has served the Association in various capacities. Rich is a longtime author for *CFMA Building Profits* having authored articles for thirty years for this publication. Rich served as Chair of CFMA's Tax & Legislative Affairs Committee, is a current member of CFMA's Emerging Issues Committee, and serves on the Board of CFMA's South FL Chapter.

Phone: 561-997-7242
E-Mail: info@shavell.net
Website: www.shavell.net

Turn to the next page for links to all articles mentioned here.

Tax Techniques **Article Index**

Listed in chronological order, here are the articles that were mentioned with links to CFMA BP Online.

"Two 2019 Tax Laws Impact Multiple Years" (May/June 2020)

www.cfmabponline.net/cfmabp/20200506/?pg=82#pg82

"Tax Implications of Selling a Construction Business" (March/April 2020)

www.cfmabponline.net/cfmabp/20200304/?pg=83#pg83

"What If There's a Downturn? Tax Implications for Contractors" (January/February 2020)

www.cfmabponline.net/cfmabp/20200102/?pg=74#pg74

"Primer on Contractor Tax Deductions for Car & Truck Expenses" (November/December 2019)

www.cfmabponline.net/cfmabp/20191112/?pg=66#pg66

"Tax Implications of Owning Your Corporate Headquarters" (September/October 2019)

www.cfmabponline.net/cfmabp/20190910/?pg=82#pg82

"Deducting Bad Debts for Tax Purposes: A Primer" (July/August 2019)

www.cfmabponline.net/cfmabp/20190708/?pg=57#pg57

"The New Small Contractor Threshold: Transition Requirements for Tax Purposes" (March/April 2019)

www.cfmabponline.net/cfmabp/20190304/?pg=50#pg50

"Meals & Entertainment Deductibility: New Requirements & Opportunities" (January/February 2019)

www.cfmabponline.net/cfmabp/20190102/?pg=65#pg65

"The New Qualified Business Income: An Overview" (September/October 2018)

www.cfmabponline.net/cfmabp/20180910/?pg=59#pg59

"The Various Buckets of Depreciation: Current Rules & Changes" (May/June 2018)

www.cfmabponline.net/cfmabp/20180506/?pg=61#pg61

"Tax Cuts & Jobs Act: Reevaluating S vs. C Corporations" (March/April 2018)

www.cfmabponline.net/cfmabp/20180304/?pg=60#pg60

"Converting from a C to an S Corporation? Beware the Built-in Gains Tax" (May/June 2017)

www.cfmabponline.net/cfmabp/20170506/?pg=68#pg68

"Taking Advantage of IRC §179D" (March/April 2017)

www.cfmabponline.net/cfmabp/20170304/?pg=83#pg83

"The Various Buckets of Depreciation: A Review of Current Rules & Changes" (January/February 2017)

www.cfmabponline.net/cfmabp/20170102/?pg=67#pg67

"Tax Implications of Debit Shareholder Loans" (July/August 2016)

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"Understanding Cost Segregation Studies & Potential Tax Benefits" (March/April 2016)

www.cfmabponline.net/cfmabp/20160304?pg=64#pg64

"Construction Tax Accounting Methods & Choices: An Overview" (January/February 2016)

www.cfmabponline.net/cfmabp/20160102?pg=59#pg59