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CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

Dimensions

A CPA's Report for the Construction Industry

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The Tax Reform Act

An Overview of Provisions Affecting Contractors

The Tax Cuts and Jobs Act signed into law in late December has been described as the most sweeping tax overhaul in more than 30 years. But the effects go far beyond taxes alone. Many of the new law's provisions could also affect how you organize and manage your construction-related business in the years to come.

Plan on spending some time with your accounting team soon to discuss steps you should take in response to the changes. It's impossible to foresee all the specific issues you might encounter, but here is a quick overview of some provisions that are most likely to affect construction businesses.

Personal Tax Provisions

One of the most talked-about changes in the new law is a reduction in individual income tax rates. Like most of the individual income tax provisions, these cuts are scheduled to expire in 2026 unless Congress takes additional action before then.

Although the law retains seven tax brackets, it redefines most of the bracket boundaries. Other major changes include a doubling of the standard deduction and the child tax credit, although these are offset somewhat by the elimination of personal exemptions.

These changes are reflected in the IRS's recently revised withholding tables. By now you should already have implemented the new withholding rates for your employees.

Another important provision for many contractors is a 20 percent deduction on pass-through income from S corporations and LLCs. This deduction is subject to some complex limitations, however, so be sure to ask your tax professional about it.

For higher-income taxpayers, the Alternative Minimum Tax (AMT) is still in place, but the exemption levels have been increased so fewer taxpayers will be affected. The new law also puts a $10,000 limit on state and local tax deductions and lowers the cap on the mortgage interest deduction to the first $750,000 of principal value.

The 40 percent estate tax also remains in place, but the exemption level has been doubled to $11.2 million, so fewer estates will be subject to it. This provision is scheduled to expire in 2026, so keep this in mind as you consider your long-term estate planning.

Business Tax Provisions

Unlike the changes to personal income taxes, the changes to business income taxes are permanent. The largest and most far-reaching of these is a major cut in the corporate income tax rate.

Starting in 2018, corporations will be taxed at a flat rate of 21 percent, instead of the previous graduated rate structure that topped out at 35 percent. The new law also repeals the corporate AMT.

While these changes are good news for most contractors, some of the other changes are likely to have mixed effects. For example, there are

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Asset Protection

Good Insurance Is Just the Beginning

For many contractors, any discussion about asset protection revolves primarily around various types of insurance. While insurance is a critical component of your asset protection program, it's only part of a larger, more comprehensive effort.

If you haven't reviewed your company's asset protection strategy lately, here are some steps you can take to get started.

Identify Assets and Risks

The first step is to inventory all assets – both business and personal – and identify the risks associated with each. Such a list could be overwhelming so it helps to begin by organizing and prioritizing things. Obviously, you'll give the highest priority to protecting your most valuable assets.

It's also a good practice to prioritize the risks to which your various assets are exposed. Rank risks according to both the likelihood that they will occur and the potential damage they could cause. Plot them on a simple X-Y matrix if that helps, giving the highest priority to risks that rank high on both scales.

Structure Your Business Properly

Your highest priorities are likely to include protecting your personal assets – like your home, savings and personal property – from business creditors or litigants. A common strategy for doing this is to form a corporation or limited liability company (LLC) to shield your personal assets.

The choice of business structure involves other factors in addition to asset protection, though. So work closely with your legal and accounting professionals when considering how to structure or restructure your business.

In some cases, you might be advised to form multiple business entities for various aspects of your operations. The goal is to see that risks from one business activity do not imperil your other businesses.

Multiple layers of holding companies and operating companies can make it more difficult for litigants to attach assets. Establishing a separate LLC to lease real estate or equipment to the operating company is another proven strategy.

Maintain Boundaries

Once you have erected barriers to shield your assets, it's important to maintain and respect those boundaries. Avoid making personal guarantees for lines of credit or other obligations if possible. Take care not to mix personal and corporate funds, and be careful about using your business to provide yourself with unusual personal perks or extravagant purchases.

You should also be scrupulous about maintaining complete and accurate corporate records and documentation.

Reduce Risks and Minimize Exposure

Effective quality and safety programs are important on their own merits – they're just good business. But they also can be valuable tools for protecting your assets against losses due to injuries, accidents or other types of damages.

Your asset protection effort should also include proactive financial management strategies that reduce your company's risk exposure by minimizing unencumbered assets. For example, leasing equipment and vehicles rather than purchasing them outright can reduce the assets at risk in your company. A company that owns significant assets free and clear can be a more tempting target for potential litigants.

Review and Update Insurance

To fully protect both your business and personal assets, you should also maintain adequate and appropriate insurance coverage. Develop a relationship with an experienced and trusted agent who can advise you on the most cost-effective strategies that match your particular risk profile.

In addition to maintaining required workers compensation coverage, you should also regularly review your general liability and property and casualty policies, as well as any umbrella coverage you carry over and above these policies. In some cases, more specialized policies offering business interruption or cybersecurity coverage also might be warranted.

Remember that your assets and risk profile are always changing. So schedule regular policy reviews with your insurance agent to be sure your coverage is still adequate and appropriate to current circumstances.

Please call us to schedule an appointment for an in-depth analysis of your asset protection strategies.

Government Contracting

Changing Accounting Standards Will Have an Impact

With federal officials discussing trillion-dollar infrastructure plans, more and more contractors are looking at government projects as a source of new business.

Whether you are new to government contracting or already have extensive experience with it, recent changes to U.S. accounting standards mean you should take a fresh look at what's required to successfully work in this arena.

Federal Acquisition Regulation

All federal government contracts are subject to the Federal Acquisition Regulation (FAR), which spells out specific processes and procedures you must follow. FAR requirements are becoming increasingly common on state and local government projects as well.

Most federal contracts also contain a provision that allows the government to audit your billings, underlying costs, fees and rates. In particular, FAR Part 31 contains detailed guidance on overhead costs that are reimbursable by the government.

The overhead cost requirements apply to time-and-materials and cost-plus contracts, of course, but even fixed-price contracts are subject to audit under the FAR.

Revenue Recognition Standard

In addition to verifying compliance with Part 31 overhead allowances, FAR audits also verify that your job costing systems comply with generally accepted accounting principles (GAAP). But GAAP standards are undergoing some major changes, and the effects of these changes on government contracts are not yet entirely clear.

The Financial Accounting Standards Board's new revenue recognition standard (ASU 2014-09) supersedes the previous rules that were used to properly recognize and report revenue on long-term government contracts. The new standard went into effect in calendar year 2018 for many publicly traded companies. Most private companies will need to comply by calendar year 2019.

The previous GAAP standard spelled out detailed rules that were specific to each industry, but the new standard focuses more on broad principles. As a result, there is greater reliance on management judgment regarding key contract terms and classifications.

These changes make it more important than ever that you fully understand your rights and responsibilities under FAR regulations and are clear about the contract's specific language, scope and performance obligations.

Call us today for more information about FAR compliance and the new revenue recognition standard.

Tax Reform for Contractors

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new limits on the amount of net operating losses (NOLs) your company can apply to other years' taxes. Starting with your 2018 return, NOL carrybacks to prior years have been eliminated, and NOL carryforwards will be limited to 80 percent of your company's taxable income.

The new law also limits the deductibility of net interest expense to 30 percent of earnings before interest, taxes, depreciation and amortization (EBITDA). Starting in 2022, interest expense deductions will be limited to 30 percent of earnings before interest and taxes (EBIT).

Another change that will affect many construction businesses is the repeal of the domestic production activities deduction under Section 199 of the Internal Revenue Code. The new law also increases the Section 179 expensing limit and makes changes to the research and development (R&D) tax credit – two more provisions that are often used by contractors.

Starting in 2018, the new law will allow certain small contractors with less than $25 million in gross receipts to choose the cash method of accounting rather than the accrual method. Some might also be able to choose something other than the percentage-of-completion method to account for revenue from long-term contracts.

But remember that such choices would have a significant impact on numerous other tax and accounting questions. So talk with your accounting professionals first before you start considering any such changes.

Stay Tuned

In addition to the points mentioned here, there are many other provisions of the Tax Cuts and Jobs Act that are likely to affect both your business and personal tax situations.

We will keep you updated on the new tax law as these issues become clearer in the months to come.

Call us to schedule a review of the new tax law's impact on your business.

IN 1944, Thomas Saltmarsh, Harold Cleaveland and Charles Gund pooled their talents and modest resources to form a partnership for the practice of accounting. The three founding partners soon established a client base that included large and small businesses, as well as commercial and governmental accounts. Their success was attributed to their guiding principles of honesty and integrity, accuracy and thoroughness, quality client service and, most importantly, the belief that service to the community is an individual as well as a corporate, responsibility.

TODAY, Saltmarsh offers a variety of services — from accounting and taxation to consulting — all based on the Firm's mission statement and core values. It is this philosophy, based on the principles of yesterday, that has helped the Firm grow to one of the largest locally-owned certified public accounting firms in the Southeast.

SALTMARSH CONSTRUCTION ADVISORS are here to meet the specific needs of contractors, home builders and related trades within the construction, real estate and development industries. Because we truly understand construction accounting and financial management, contractors and developers of all sizes and different trades rely upon our experience. Need assistance? Contact the construction advisors at Saltmarsh or call us today at 800.477.7458.

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Build Value for a Successful Exit

Succession planning can present a formidable challenge for principals in privately held construction companies. This is especially true if there are no family members or key managers who are ready to take over the business.

As retirement approaches, it can be tempting to begin tapering off and building up cash while you look for a buyer. However, such an approach can seriously diminish your business's value.

Here are three important points to remember if you're thinking about selling your privately held company soon.

1. Keep working on the backlog. Most of your business's value comes from its future revenue potential. But don't let your pursuit of new jobs get in the way of quality. Low-margin contracts or projects with questionable financing will lower the value of your business.

2. Keep equipment, vehicles and other assets in good repair. Stay up-to-date with scheduled maintenance and replace aging equipment as necessary. A healthy backlog is less valuable if the new owner will need to replace old, worn-out equipment in order to perform the work.

3. Clean up the operations – and the books. Strip out any non-operating assets and extraneous business operations or spin-offs. Be careful not to pay any personal expenses through the business. If the books are not clean, prospective buyers will discount the value of the business for their own protection.

Also, be sure you're paying yourself a reasonable salary rather than relying on capital distributions for income. Taking only a token salary distorts your company's true profit picture, so most buyers will make further downward adjustments before making an offer.

If you have questions about business value or succession planning, please call us for an appointment.

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