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# Construction Dollars and Sense

**Tax and Financial Reporting News and Tools**

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**Briefly:**
→The new tax law has a special calculation based on 20% of business income, with some limitations. Now is the time to structure out the limitations.

## The Tax Cuts and Jobs Act

**(TCJA) has a new 20%** deduction for non-C corporation businesses. It is earned at the company level and computed on the personal tax return. It applies to most construction businesses for 2018.

**The new deduction is Section 199A** of the tax Code. It is similar to the prior Section 199 Domestic Production Deduction, which ended in 2017, but with extensive rules on calculations, limitations, phase-outs, carry-overs, and application. It does not apply to specific businesses, including medicine, law, and consulting but should apply to all construction including architecture and engineering. While some design / build can appear to be consulting, it is not disqualifying for purposes of this deduction. The purpose of the new deduction is to give a rate reduction to pass-throughs since C corporations had their top rate reduced from 35% to 21%. This 199A deduction makes the new top rate of 37% for individual returns, an effective rate of 29.6% for the business income (37% x 80% = 29.6%) on an individual return.

**One of the limitations,** for current focus before the end of the year, is the wage requirement. Wages of at least 50% of the deduction amount are required. This can be a limiting factor for the small sole proprietor who self performs all its work and pays no wages, or the general contractor who subs all the production with very little in actual wages paid directly from the business. Now is the time to evaluate the expected 199A deduction and restructure sufficient wages to maximize the deduction for 2018. At the individual tax return level, the pass-through income, along with the other income of the owner, can be under $315,000 on a joint return and not have the 50% wage rule as a limiting calculation. But there is a phase-out calculation and above $415,000 the 50% wage calculation is fully limiting

**But just increasing wages may not** work well in all cases. There are operational restrictions against artificially changing subs from independent contractors to employees receiving a W-2 for wages. And the owner of an S corporation needs to closely calculate the cost of the additional payroll taxes for his increased wages compared to the benefit of the new 20% deduction.

**Perhaps a more common situation** is the S corporation which may be paying higher compensation to the owners than is necessary and thereby reducing the available 20% deduction. Reasonable compensation to owners of S corporations is required by the IRS rules, but "reasonable" is not defined. Consider, for example, a group of S corporation owners with combined W-2 wages of $500,000 who can reduce that to $400,000, and at the same time increase their distributions by a similar amount. Since compensation is a company deduction while distributions are not, this restructure of cash flow from the company to the owners just increased the Section 199A deduction by $20,000 ($100,000 x 20%).

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