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Accounting and Taxation

TAX REFORM AND THE CONSTRUCTION INDUSTRY:

Hotly debated tax reforms could have a significant impact on the construction industry.

CURRENT PROPOSALS AND POLICY SUGGESTIONS TO STIMULATE GROWTH

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The tax reform debate is heating up in Washington, D.C., with the House GOP and the administration putting forth their initial proposals for what could be the most comprehensive reform of the tax code in more than three decades.

However, while the administration and congressional leadership have made it clear that tax reform will be a top priority in the coming months, the tax-writing committees have a long way to go in terms of turning a broad policy framework into detailed (and passable) legislation. As negotiations continue into the summer, it is important to remember that the proposals currently on the table are just the starting point — any tax reform legislation that we see later this year could have stark differences from the current House GOP blueprint and President Trump's plan.

With that being said, there are areas of agreement between the administration and House Republicans that the tax-writing committees are likely to pursue. Here are a few of the main reforms (with an analysis of their potential impact on the construction industry).

Reduction in marginal and corporate tax rates

The administration and GOP leadership are in lock-step agreement when it comes to lowering both the marginal and corporate tax rates to stimulate economic growth. The questions are: How low can those rates go without ballooning the federal deficit, and what provisions of the tax code will need to be cut to pay for the reduction in rates?

As it stands, the House GOP blueprint calls for the corporate rate to be reduced from 35 percent to 20 percent and for sole proprietorships and pass-through entities to be taxed at 25 percent. Marginal tax rates would be collapsed from the current seven tax bracket structure into three new brackets of 12 percent, 25 percent, and 33 percent, with the intent of reducing and simplifying the tax burden on individuals.

The thinking here is pretty straightforward — by reducing both rates, U.S. companies and U.S. business owners would have additional capital on hand to reinvest back into their operations. When applied to the construction industry, such an across-the-board cut for businesses (no matter their size or entity type) would very much benefit the sector at large, providing the extra capital needed to invest in new infrastructure and attract skilled labor.

Repeal of the alternative minimum tax (AMT)

As many business owners and tax advisors will tell you, the alternative minimum tax (AMT) floor can be a thorn in the side of companies (construction or otherwise) when claiming federal tax credits, incentives, and deductions. Oftentimes, companies that qualify for certain pro-business tax incentives would be effectively barred from their use due to AMT restrictions (businesses cannot utilize these incentives to lower their tax liability below the AMT floor).

The repeal of AMT would, in theory, allow companies to utilize these incentives, bringing additional dollars for reinvestment back into the industry. A similar step was taken – although not on as grand of a scale – when the AMT bar for the federal Research and Development (R&D) Tax Credit was eliminated for "eligible small businesses" (defined as businesses with less than $50 million in average gross receipts for the previous three years) as part of the Protecting Americans from Tax Hikes (PATH) Act of 2015. That modification to the R&D credit has immense potential in terms of stimulating job creation and economic growth – and with the proposed repeal of AMT, it looks as if congressional leadership and the tax-writing committees are looking for an even greater kick-starter for the economy. With its potential to provide greater access to pro-business incentives, the repeal of AMT would appear beneficial to the construction industry.

Border tax adjustment

While these first two proposals do look good for the construction industry, there is a tradeoff for lower tax rates, and many construction companies may not like what they have to give up in return. In particular, construction firms that import materials from overseas could be subject to one of the more controversial measures of the House GOP plan – the border adjustment tax (BAT).

In a nutshell, the border adjustment tax is a tax that is placed on imports but not on exports, with the broader policy goal being to encourage companies to purchase U.S.-made goods and materials. The BAT is also a significant component of the House GOP plan to offset cuts in the marginal and corporate rates, with the tax estimated to raise more than $1 trillion in federal revenue.

If implemented, what does the BAT mean for construction companies? It means the cost of building materials will increase, as many construction firms rely on imported goods to complete their projects. For many construction companies, the reduction in tax rates might be worth the tradeoff – but that all depends on how reliant a construction firm is on imported materials.

Removal of business tax credits/incentives

In addition to the BAT, in order to find additional offsets, the House GOP and the tax-writing committees will also be looking to eliminate certain business credits and incentives. While the R&D Tax Credit (everyone's favorite business incentive) is safe and could potentially be expanded, there are other incentives claimed within the construction industry that could be on the chopping block, including the Section 199 Domestic Production Activities Deduction (DPAD) and other popular business incentives.

Will that tradeoff be worth the elimination of these incentives? That will be dictated on a case-by-case basis for each company.

Tax policy suggestions

Looking at these proposals, it is obvious that the overarching policy goals are domestic job creation and economic growth. Being such a vital sector of the economy, it is clear that the construction industry plays an important role in both areas, and I would like to offer our policymakers a few suggestions with an eye toward initiatives that would benefit the industry.

Extend Section 179D. Originally put in place as part of the Energy Policy Act of 2005, the Energy-Efficient Commercial Building Deduction (better known as Section 179D) has proven to be effective in not only helping to modernize U.S. infrastructure, but also in generating immense value for the construction industry. A federal tax incentive that provides an up to $1.80 per square foot tax deduction for buildings that are made more energy-efficient, Section 179D allows architecture, engineering, and construction firms to benefit from the energy saving enhancements made to government-owned buildings at the federal, state, and local levels (such as K–12 schools, universities, and other public structures).

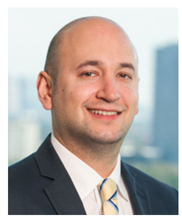
Through Section 179D, our consultancy has seen over $1.5 billion put back into the pockets of builders and designers across the nation, providing these companies with the ability to hire additional employees and remain competitive against overseas competition. Best of all, Section 179D is a technology-neutral approach to incentivizing energy savings — it doesn't matter how a company gets there. As long as a firm is reducing energy usage according to certain requirements, the company will qualify for the deduction.

Section 179D unfortunately expired at the end of last year, and given its impact in creating jobs, promoting economic growth, and modernizing our infrastructure, extending the deduction should have vast bipartisan support.

Keep DPAD in place. The entire point of the BAT is to encourage the purchase of U.S.-produced goods. In the same vein, DPAD is designed to reward companies for producing those goods in the first place. If the goal of the administration and congressional leadership is to promote economic growth and domestic manufacturing, it would seem that sacrificing this particular incentive as an offset for lower marginal and corporate rates would be counterintuitive.

Implemented in 2005, DPAD allows qualifying businesses to receive an up to 9 percent tax deduction on income earned from qualified production activities. DPAD is a valuable deduction for U.S. companies that manufacture building supplies here in the United States.

As we move forward, there will be plenty of debate around the topic of tax reform, but preserving these two incentives should be a vital part of any legislation that we see later this year. With domestic job creation and economic growth on the minds of our policymakers, Section 179D and DPAD would seem to fall perfectly in line with these policy goals.



Andy Gerstenhaber is a Director of Energy Credits and Incentives for alliantgroup as well as a member of the American Institute of Architects (AIA). He has been instrumental in helping hundreds of architecture, engineering, and contracting firms claim valuable energy incentives through the 179D energy-efficient commercial building deduction. Andy received his Bachelor of Science in Regional Development from University of Arizona, and enjoys educating small to mid-sized companies on the importance of claiming the 179D deduction. Andy is an integral part of the alliantgroup team, striving to help companies receive the full benefit of federal and state tax incentives aimed at creating jobs and spurring American innovation.