TAX IMPLICATIONS FOR CONSTRUCTION CONTRACTORS

These tax implications are essential to any construction contractor who may face imminent losses during this pandemic. Stay informed during these volatile times to improve your cash flows and profitability. You need to prepare thoroughly for the future and avoid contract losses by speaking to your tax advisers.

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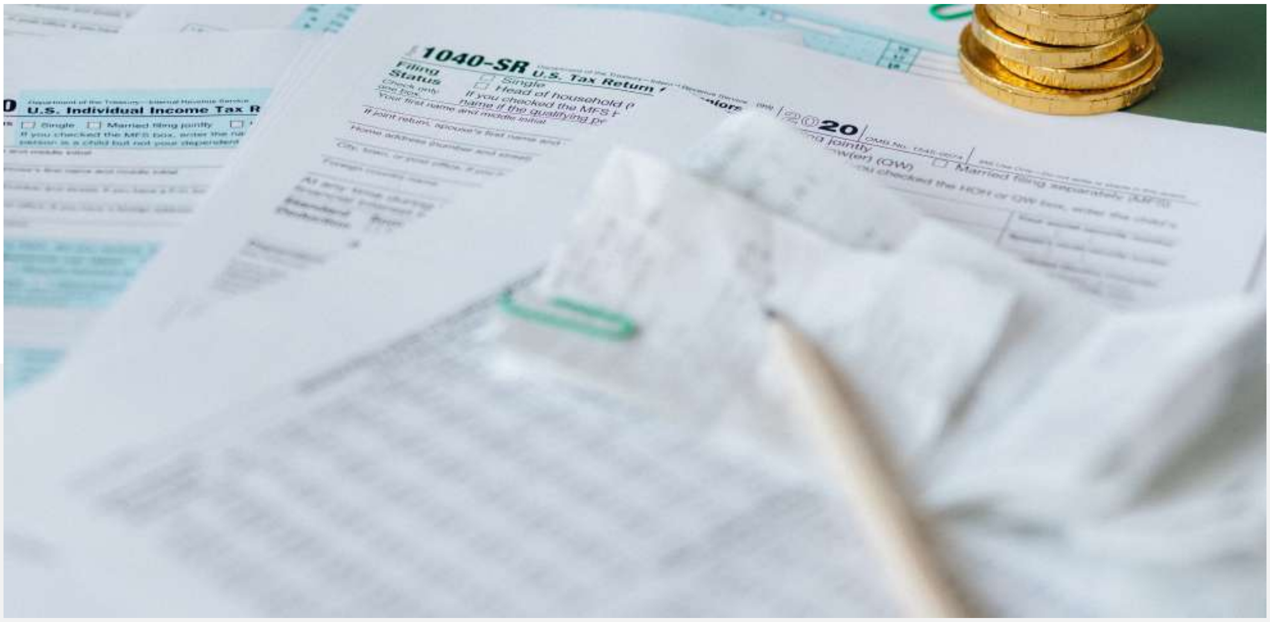
TAX IMPLICATIONS

There has been a lot of changes and volatility in the construction industry due to the ongoing COVID-19 crisis. With this type of environment, it is even more important to understand all the tax implications that are available in the current economic state. Knowing the most recent tax and financial changes can help prepare for the recessionary impacts essential to survive the pandemic's economic climate. Recent rules, programs and tax implications that have been put in place this year are discussed below.

QUALIFIED BUSINESS INCOME (QBI) DEDUCTIONS

The QBI tax applies to all construction contractors and results in a 20 percent deduction of the qualified business income. The tax had a very positive impact on all contractors who maintained a stable financial status. However, it is essential to note that considerable losses in the sources of QBI can negatively impact the industry and reduce the deduction to zero in the year 2020 when the pandemic struck hard for the first time.

It is possible to carry over any negative QBI that was not exhausted in the previous year. It would be best to be very keen on the tax implications' positive and negative impacts for a business owner or management board. It would help if you always tracked the deductions of the QBI losses.



PERMISSIBLE TAX DEFERRALS

You can always use tax deferrals when you need to reduce the current year's taxes or generate liquidity. Equally important, you can also use them to reverse the adverse effects from a previous year. A quick illustration is where a construction contractor can be allowed a tax deferral option available in the 10% method to defer income from long-term contracts. When the construction contractor has massive success in his jobs, they can have many new contracts that will be rated below 10%. It allows the contractor to clear the prior revenue that was deferred in the past year.

Other tax implications can create tax deferrals to a later date in the next year. The methods used for the 10% deferrals may include:

- **The completed-contract method** - applies to contractors who work within a smaller threshold, commonly regarded as small contractors. Some home construction contractors also use the technique.

- **Retainage of short-term contractors** - contractors who may be using accrual method for their accounting activities will retain them for a short time.

- **The cash method** - is commonly used by small contractors who work on smaller projects.

LOSS LIMITATIONS

In the past, contractors were able to carry forward large net operating and business losses to offset future tax obligations. The changes in the Tax Cuts and Jobs Act of 2017 now only allow for 80% of taxable income to be offset. The losses cannot be carried back to prior years, but can still be carried forward indefinitely. In addition to changes in net operating losses, business losses are limited to stricter restrictions and can only be applied to daily operations and not passive income sources.

INTEREST LIMITATIONS

Whenever a contractor incurs losses during a poor economic climate, they can seek loans from banks and other financial institutions. The business interests applied to this debt that can be deducted now can be limited according to the Tax Cuts and Job Act (TCJA). TCJA allows large contractors that get average gross receipts that exceed $25 million. It can only get deductions up to 30% of their taxable income.

Large contractors' taxable income can be calculated from the net earnings before deducting interest, depreciation, tax, and amortization. Other deductions that will not have been removed are QBI and NOL taken in the previous year.

GUIDANCE ON PPP LOANS

The PPP program was an essential lifeline for countless businesses across America. Since the inception of the Payment Protection Plan (PPP) in April 2020, several updates and interpretations were recorded to create awareness of the loan program. Since it was a new program that was rapidly implemented by the Small Business Administration, many people got confused and some were not sure how to interpret the loan program. According to Associated Contractors of America, 18% of members had received the loans and even thought of paying them back. The program is currently under upgrades to make it more appealing and user friendly.

The changes in the PPP loans affect every member who was entitled to the loans. A statement by the Treasury Department says that all businesses who had received PPP loans above $2 million and had already raised an order to be pardoned will be audited from the federal guidance updates. Also, the new PPP loans have given lenders more duties than ever before. Lenders are required to confirm if the borrower received the application and have to verify all the receipts, documentation for payroll and other expenses and check the numbers for all applications that have been made.

The amendment to the CARES act, includes specific changes to the PPP loans including:

- Extension of the covered period from 8 to 24 weeks to help increase cash flows.
- The maturity extension from 2 to 5 years.
- Changes the forgiveness of costs from 75/25 payroll to 60/40 for more non-payroll expenses.
- Deferral of the payroll taxes to the end of the pandemic-stricken year.

It appears that Congress may be acting for a second round of PPP loans, so be sure to stay compliant on any existing participation in the SBA programs in case the business requires additional funds.

ABOUT CIVE®

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Corporate Headquarters

5444 Westheimer Rd, Suite 1440

Houston, Texas 77056

Phone : 281-870-8727

Fax : 281-870-8728

Toll Free : 1-800-979-4442

CIVE®