THE IMPACT OF TAX REFORM TO ARCHITECTURE AND ENGINEERING COMPANIES

On December 22, President Trump signed the tax reform bill, "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," into law, marking the largest change to U.S. tax policy since the 1980s.

With most of the provisions already in effect, it's important that architecture and engineering executives review the changes that occurred during the conference process to understand the impact to their companies.

To help them navigate the key provisions affecting the architecture and engineering industries, we've summarized the top considerations and implications below.

PROVISION	SUMMARY OF CHANGES	IMPLICATIONS FOR ARCHITECTURE AND ENGINEERING COMPANIES
Reduce the corporate tax rate	Reduces the top corporate tax rate from 35 to 21%. **Effective date:** Effective for taxable years after Dec. 31, 2017.	**Industry View:** Positive ***What's at stake:*** Reduced tax burden for architecture and engineering companies.
Lower Taxes on Pass-Through Business Income	Creates a deduction available to pass-through filers of 20% on pass- through income subject to certain limitations. This includes "qualified real estate investment dividends."	**Industry View:** Positive ***What's at stake:*** Reduced tax burden for architecture and engineering companies structured as pass-through entities.
Changes to the Depreciation of Commercial Assets	Eliminates the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property, and provides a general 15-year recovery period for qualified improvement property, unchanged from current law. Depreciable life of commercial assets is unchanged from current law. Retains the existing 40-year alternative depreciation system (ADS) cost recovery period for nonresidential real property, but would contain a reduced 30-year ADS period for residential property and a 20-year ADS period for qualified property improvement. Expands bonus depreciation for new qualified property investments to 100% from 50%. Applies to both new and used property. Effective date: Effective for property placed in service	**Industry View:** Positive-to-Neutral **What's at stake:** The impact of this provision differs based on a company's cost recovery structures. The change is positive for companies that rely on full expensing for personal property and new qualified improvement property with a 15-year recovery period and bonus depreciation. For companies with cost recovery structures under regular depreciation, this change is neutral. Taxpayers that have elected to use the real property trade or business exception to the interest limitation would be required to use the longer ADS periods for depreciation. Additionally, if the property is depreciated under ADS, it is not eligible for a bonus.
Expansion of Section 179 deduction	Expands the definition of qualified real property to include improvements to nonresidential real property including roofs, heating, ventilation, air conditioning, fire protection, alarm systems, and security systems. Increases the amount companies can deduct in purchases from the current ceiling of $510,000 to $1 million and increases the phase out threshold to $2.5 million.	**Industry View:** Positive **What's at stake:** Eases the tax burden of financing property improvements.

PROVISION	SUMMARY OF CHANGES	IMPLICATIONS FOR ARCHITECTURE AND ENGINEERING COMPANIES
Limitations on Interest Deductibility	Revises Section 163(j) and expands its applicability to every business, including partnerships. Generally, caps deduction of interest expense to interest income plus 30% of adjusted taxable income, which is computed without regard to deductions allowable for depreciation, amortization, or depletion. Disallowed interest is carried forward indefinitely. Contains a small business exception. Effective date: Effective for taxable years after Dec. 31, 2017.	**Industry View:** Neutral **What's at stake:** Real property trades or businesses are allowed to elect out of the limitation since they do not benefit from full expensing provided to tangible personal property. Generally, any real property trade or business, including ones conducted by widely-held corporations and REITs, may be considered real property trades or business. Taxpayers electing to use the real property trade or business exception to the limitation on interest deductibility would be required to use ADS methods for depreciation for residential, nonresidential, and qualified improvement property.
Eliminate ability to carryback Net Operating Losses (NOLs)	Generally, eliminates taxpayers' abilities to carryback NOLs, and will limit the use of NOLs to 80% of taxable income. NOLs will no longer have an expiration period. **Effective date:** The elimination of carrybacks is effective in taxable years after Dec. 31, 2017.	**Industry View**: Negative **What's at stake:** Potential cash flow obstacle.
Expansion of Cash Method of Accounting	Raises the average annual gross receipts threshold from $5 million to $25 million for C corporations, partnerships with a C corporation partner, or a tax-exempt trust or corporation with unrelated business income, regardless of whether the purchase, production, or sale of merchandise is an income- producing factor. **Effective date:** Effective for taxable years after Dec. 31, 2017.	**Industry View:** Positive **What's at stake:** Reduced tax and recordkeeping burden for smaller architecture and engineering companies.

TACKLING TAX REFORM: 5 INITIAL STEPS COMPANIES CAN TAKE NOW

1. **Assess impact.** Tax professionals will likely need to review the bill text manually and measure their company's specific circumstances against it to assess the impact of each provision, as well as the holistic effect on their company's bottom line.
2. **Assemble a team.** While the heaviest burden may fall on accountants, companies and their finance teams will have an important role to play to gather all the necessary data.
3. **Dig into the data**. Assessing the impact of tax reform requires a substantial amount of data to be readily available. Companies need to move from modeling the impact of tax reform to focusing on data collection and computations as soon as possible.
4. **Establish priorities**. When considering which aspects of tax reform to tackle first, focus on the areas that could have the greatest impact on your company. For architecture and engineering companies, landmark provisions include: changes that could influence entity choice (reduced corporate tax rates and lower taxes on pass-through business income) and the elimination of NOL carrybacks. As a preliminary step, taxpayers operating in the architecture and engineering industries should consider their overall choice of entity to minimize tax liabilities under the new law.
5. **Initiate tax reform conversations with Somerset**. Tax reform of this magnitude is the biggest change we've seen in a generation, and will require intense focus to understand not only how the changes apply at a federal level, but also navigate the ripple effect this is likely to have on state taxation as well. There are numerous considerations and complexities to consider and many opportunities may exist depending on specific short and long term goals and facts and circumstances.