ACEC

American Council of Engineering Companies

of Indiana

Finance Forum Notes

October 16, 2018 from 11- 1 p.m.

Hilton Garden Inn, 10 E. Market Street, Indianapolis, IN 46204

A. Introduction of ACEC Indiana

B. Introduction of Facilitators: Scott Sutton, Jason Bainter and Jenny Ray

TOPICS FOR DISCUSSION

1. AASHTO & FAR Update
   a. No major changes from previous year
   b. Biggest change: max compensation changed in May 2018 to $525,000 if revenue exceeds $16M
   c. Compensation is escalated 3 percent annually, but technically won't disclose until February 2019
   d. David Brewer's replacement still not named at INDOT—current contact Natalya Thomas nthomas@indot.in.gov; once official replacement is named, Somerset CPAs will set a meeting with staff
   e. Recommended FAR Training: Dan Purvine, A/E Clarity in coordination with NHI, also offers webinars with same content as in-person training at a lower cost
   f. Now more in line with surrounding states
   g. A disconnect does exist between contract writing and the audit side at INDOT

2. Internal Controls
   a. Biggest issue is segregation of duties
   b. Consider where you can break up custody within processes
   c. Best practice: having a supervisor approve time sheets
   d. Initialing steps demonstrates to an auditor that the actions occurred
   e. Biggest thing lacking on invoices is proper approval—signature, project number and overhead account number are ideal to include
   f. Company credit cards—go in eyes wide open—show an extrapolation of overhead, wherein management sees the effects of lost receipts in overhead rates

3. Financial and KPI Metrics
   a. Some firms look at monthly trending reports: bookings, backlog, revenue, helps if all in alignment with this system
   b. Multiplier, utilization (hours vs. dollars) total collection period
   c. Net review (per direct labor hour) total hourly cost, direct labor cost (average pay rate)

4. Risk Management
   a. Be cautious of cyber-attacks, asking for funds that seem reasonable, consider double checking in person/ over the phone as e-mails can be easily hacked

5. Government Compliance Programs

   a. For the first time, ACEC Ohio has a voice with the Columbus Regional Airport CRAA Authority (CRAA) in a meaningful way with a very positive impact. In 2011, the ACEC Ohio Board of Directors discussed issues relative to the way the CRAA treated engineering firms mostly in relation to disallowances in overhead rate calculation as well as allowances for employee labor rates. A letter was sent to the airport authority at that time and no action was taken* The CRAA has a new CEO, Joe Nardone, who heard from many engineering companies about the overhead rate calculation. Through ACEC Ohio Board Member, Sandy Doyle-Ahern, the letter written in 2011 was again presented to the airport authority. After review by the Executive Team at CRAA, Mr. Nardone announced two weeks ago that the airport will move to use an engineering firm's ODOT audited overhead rate on new projects moving forward.

6. Internal Value Formulas
   a. Consider owners are not getting younger and active Mergers & Acquisitions activity
   b. Look at number based formulas, not subjectivity

7. New Section 199A Pass-Through Tax Deduction
   a. The Tax Cuts and Jobs Act created a new 20% tax deduction for pass-through firms, including S corporations, partnerships, and sole proprietorships. ACEC and its member firms advocated successfully to ensure that engineering firms have full access to the new tax deduction.
   b. R & D Tax Credit, mostly used on the vertical side for building envelope, HVAC and lighting
   c. 179D Deduction: Somerset has a quick video about 179D online.

8. General Tax
   a. Entertainment expenses are no longer allowable, meals are 50 percent allowable
      i. If a firm wants to treat a client to dinner and a game, it is advised to provide a meal outside of the entertainment venue for 50 percent allowable and then the game is all unallowable
      ii. If a firm has a suite where food and entertainment is combined, must ask for an itemized receipt or it is all unallowable
   b. Cash Balance Plan – it is a defined benefit plan that allows owners to sock away more retirement funds as they get older. Some owners can contribute up to about $155k a year in this plan. A great retirement tool if a company is growing and budgets to keep growing and has excess cash.

9. ESOPs and Other Ownership Transition Options

   a. Somerset CPAs is working on multiple succession plans a month
   b. 10 year for a succession plan is ideal—offers more options for transition
   c. Let next generation in to see finances, risk, sales operations
   d. "Deferred Compensation Plan." This
   e. allows for firms to keep talent around and grooms employees to invest in the company for potential future ownership opportunities. Companies can identify which employees they want to select for deferred compensation and act upon it to their own schedule (outside of an annual review/ bonus structure.)

10. Open Discussion

ACEC Indiana approves the course this program as a legitimate source of 2 PDHs. This course proved to be an orderly process of instruction, which was approved by ACEC Indiana, an approved provider according to IC 25-1-4-0.2, and designed to directly enhance a professional engineer's knowledge and skill in providing services relevant to the practice of engineering. Please retain this document for your continuing education records.

ACEC
CONTINUING EDUCATION

Qualified Business Income Deduction Example
Non-service business

	Qualified Business Income	500,000			
	W2 Wages from Business	2,500,000			
	Capital Gains (individual level)	2,500			
	Taxable Income before gains	750,000			
	Step 1:				
	Qualified Business Income	500,000	20%	100,000	
	Step 2:				
	Is it limited by:				
1	W2 Wages from Business	2,500,000	50%	1,250,000	More than $100,000
2	Taxable Income before gains	750,000			
	Less Capital Gains	(2,500)			
	Taxable Income after gains	747,500	20%	149,500	More than $100,000
	Qualified Business Income Deduction	**100,000**			

	Qualified Business Income	100,000			
	W2 Wages from Business	500,000			
	Capital Gains (individual level)	2,500			
	Taxable Income before gains	81,000			
	Step 1:				
	Qualified Business Income	100,000	20%	20,000	
	Step 2:				
	Is it limited by:				
1	W2 Wages from Business	500,000	50%	250,000	More than $20,000
2	Taxable Income before gains	81,000			
	Less Capital Gains	(2,500)			
	Taxable Income after gains	78,500	20%	15,700	LIMITED
	Qualified Business Income Deduction	**15,700**			

The Lesser of Taxable Income (after capital gains) X 20% or Qualified Business Income X 20%

SOMERSET
CPAs AND ADVISORS

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.