

# THE CURCHIN GROUP

Newsletter

Q3. 2019

Highlights of Opportunity Zone Tax Benefits	1, 3
Are Your Federal Tax Withholdings Accurate?	2
The Investment Value of Fixed Assets	4, 5
Featured Employee	6
Firm News	6

 Like us on Facebook!  
[facebook.com/CurchinGroup](https://facebook.com/CurchinGroup)

## Highlights of Opportunity Zone Tax Benefits

By Edward P. Rigby, CPA

In January the IRS finalized the regulations providing guidance on the Section 199A deduction for qualified business income (QBI). The final regulations retain the majority of the rules contained in the proposed regulations that were issued last August. They provide clarification on issues such as when businesses may be aggregated in determining QBI, how real estate rented to an operating business is treated and what constitutes a specified service business. In conjunction with the release of the regulations last week, the IRS also issued a revenue procedure and a proposed revenue procedure covering the determination of wages and when rental real estate qualifies as a trade or business for purposes of the Section 199A deduction.

### General/Background

The Tax Cuts and Jobs Act tax law changes include a special tax incentive for investments in Opportunity Zone property. The law change is effective on the December 22, 2017 date of enactment and generally allows a deferral of capital gains that are reinvested in certain designated areas called Opportunity Zones. Opportunity Zones are designated at the state level based on certain low income community population census tracts. Further, Opportunity Zones generally are designated based on economic development initiatives to attract investment and startup business activity. The following information summarizes the key rules associated with the Opportunity Zone tax benefits, including guidance issued by the IRS in recently issued proposed regulations.

### Eligible Gain and Taxpayer

According to the IRS' proposed regulations, gain eligible for deferral is capital gain recognized by taxpayers through sales or exchanges with unrelated parties generally from the date of enactment (see above) through December 31, 2026. Capital gain also includes Section 1231 gains (eligible for taxation as a capital gain) from sales of depreciable business property. However, gains that are taxed as ordinary gains (e.g., Section 1245 gains from depreciation recapture) are not eligible for deferral. An eligible taxpayer is a

person that may recognize gains for federal income tax purposes, including individuals, C corporations, S corporations, partnerships, and trusts and estates. Related party transactions generally include sales between certain family members and between companies and owners. For purposes of determining "related party" ownership, a 20 percent ownership threshold instead of the more common 50 percent threshold is imposed. For example, a sale of a capital asset to a taxpayer's company in which he or she owns 30 percent of the equity, is not eligible for the gain deferral.

### Time Period for Election

Eligible gain recognized by a taxpayer may be deferred by electing within a 180 day election period beginning on the date of such sale to reinvest the amount of gain in a qualified opportunity fund. For example, taxpayer A sells stock to an unrelated party and recognizes a \$200,000 net capital gain. Taxpayer A can elect to reinvest the \$200,000 gain in a qualified opportunity fund within the 180 day election period. Note that the deferral is available up to the \$200,000 amount of the gain originally recognized. In contrast, if taxpayer A only reinvests \$150,000 in a qualified opportunity fund, the taxpayer would be required to recognize \$50,000 of gain from the original sale.

### What are Opportunity Zone Funds?

Opportunity Zone Funds are investment entities formed as either partnerships or corporations. Such entities must invest at least 90 percent of its assets in qualified opportunity zone property. Such property includes qualified opportunity zone stock, a qualified opportunity zone partnership interest, or qualified opportunity zone business property. The IRS allows taxpayers to "self-designate" investment vehicles as qualified opportunity zone funds. Form 8996 may be filed by taxpayers to certify that the partnership or

Article continues page 3



CURCHIN

## Are Your Federal Tax Withholdings Accurate?

By Lynn A. Conover, CPA, CFB

It's in the books—the first tax season under the Tax Cuts and Jobs Act of 2017, that is. We knew a lot of what to expect from the new tax law, but one aspect that upset many taxpayers was the epic failure of the updated withholding tables. In other words, employers didn't withhold enough. So employees who typically received refunds in previous years found that they actually owed money for 2018.

According to a survey conducted by ResearchNow/Dynata, 36 percent of respondents said they owed on their 2018 taxes, and 11 percent said they owed for the first time in their lives. Why did this happen?

### Many Moving Parts

The changes that took effect in 2018 were the most sweeping tax reform our country has seen in decades. The nuances and uncertainty in the laws essentially became variables for each individual taxpayer, creating a perfect storm for errors in withholdings and other unexpected balances.

#### **The Motley Fool explains:**

"A big reason so many filers wound up underpaying their taxes in 2018 boils down to changes in withholding. As part of the 2018 tax overhaul, almost all individual tax brackets were lowered to put more money back into workers' paychecks, and the IRS released new withholding tables to accommodate that change. Many people, however, didn't realize that they should've checked their withholding to ensure that they were having the right amount of tax taken out of their earnings. And because they failed to do so, they wound up owing money to the IRS."

The large-scale underpayment was a reminder to taxpayers—many of whom are accustomed to taking their paychecks for what they're worth and giving no further attention to the details, especially when the checks seem larger than usual—to review their withholdings more closely for potential adjustments.

### Bonuses and Stock Options

In situations where clients received bonuses or stock options, we found

that the withholdings were often insufficient.

*"... withholdings were often insufficient."*

Typically, an employer will only withhold a flat percentage from a bonus or stock option. Oftentimes, that amount is not enough. We suggest that if you know you will be receiving a significant compensation payment, such as a bonus or stock option, request your employer withhold the appropriate amount to minimize your tax burden. An accountant can help you determine that amount.

### What to Do Right Now

If you were burned by the new withholding tables, don't just take it as a lesson learned. It will most likely happen again. Now that we are several months into 2019, taxpayers should take corrective action for their withholdings as soon as possible, before it's too late. This is especially important if you owed a large amount of money with your 2018 tax return.

### Moving Forward

In addition to reviewing 2018 to see where you fell short, look ahead to your anticipated income and expenses for 2019 to target a more accurate withholding amount. One finance professional estimates that 80 percent of taxpayers have not updated their withholdings in line with the new tables. If you have income other than compensation and/or are in a transitional year, you may also need to begin paying quarterly taxes.

With the new tax law now settled into place, there is no reason you should have to suffer an unpleasant surprise in your 2019 tax filings like you might have in 2018. Contact Us today to learn how our tax professionals can help you determine if you have adequate coverage and tax optimization for this tax year and in the future.

corporation meets the investment rules for opportunity zone property. Failure to maintain the 90 percent asset test will result in IRS penalties imposed on the investment fund. Further, a qualified fund may be an existing entity as long as the investment into the fund is made after December 31, 2017 and the eligibility tests are otherwise met.

#### Year of Inclusion into Taxable Income for Deferred Gain and Special Basis Rules

The original deferred gain amount is recognized into taxable income upon the earlier of: (1) the date of sale or exchange of the qualified opportunity zone investment, or (2) December 31, 2026. Thus, in the example above, the \$200,000 capital gain originally recognized is only temporarily deferred until December 31, 2026. The amount includible in taxable income is the excess of: (A) the lesser of the amount of gain originally deferred (e.g., the \$200,000 "original gain") or the fair market value of the qualified opportunity zone investment, over the taxpayer's basis in the opportunity zone investment. At the date of the original investment in the opportunity zone, the taxpayer's basis in the investment is considered to be zero. Investments held for a 5 year period are allowed a basis increase equal to 10 percent of the initial deferred gain. In the example above, after a 5 year holding period, taxpayer A increases their basis in the opportunity zone investment from zero to \$20,000 i.e., 10 percent of the \$200,000 deferred gain. After 7 years, the taxpayer is allowed an additional 5 percent basis increase. Further, the amount of gain required to be recognized into taxable income under the above rule will result in a corresponding basis increase in the qualified opportunity zone investment. As discussed below, subsequent appreciation may be excluded from taxation for investments held for at least 10 years.

*"...subsequent appreciation may be excluded from taxation for investments held for at least 10 years."*

#### Special Rule for Investments Held For At Least 10 Years

Although the original deferred gain must be included into taxable income by at least December 31, 2026, investments held for at least 10 years receive a further tax benefit. For such investments held for at least 10 years, the taxpayer may make an election to treat the investment's basis as being equal to the fair market value of such investment on the date of sale. For example, assuming taxpayer A holds their investment for at least 10 years at which time the investment has appreciated to \$300,000. The original deferred gain of \$200,000 would be taxable at December 31, 2026 (the additional basis increases for 5 and 7 year holding periods may also be applicable) with a corresponding basis increase to \$200,000. The subsequent appreciation in fair market value (\$100,000) from \$200,000 to \$300,000 may be excluded from tax at the election of the taxpayer through the special basis increase to fair market value if the 10 year holding period is met.

#### Requirements for Opportunity Zone Investments

The recent IRS proposed regulations provide further guidance on the requirements imposed on opportunity zone investments including original issuance requirements, substantial improvements required for existing zone property, and active trade or business rules. In general, stock in a qualified opportunity zone corporation must be issued solely for cash at its original issuance after December 31, 2017. Likewise, a partnership equity interest must be issued solely for cash after December 31, 2017. These opportunity zone investments must own opportunity zone tangible property that has either an original use within the zone or is substantially improved. Substantial improvement means that for existing properties within the zone, the opportunity zone fund must make improvements to the property over a 30 month period at least equal to the property's adjusted basis in the hands of the fund at the beginning of the 30 month term. The IRS' proposed regulations indicate that for land and building in existence within a zone at December 31, 2017, the taxpayer is only required to make improvements over the 30 month period at least equal to only the building's adjusted basis (i.e., the basis of the land is not factored into the substantial improvement rule).

#### What is a Qualified Opportunity Zone Business?

A qualified opportunity zone business must meet active trade or business asset tests and certain businesses such as golf clubs, race tracks and liquor stores are not eligible. Further, the use of the business property must be substantially used within the zone. The active business test means that at least 50 percent of the gross income of a qualified opportunity zone business is derived from the active conduct of a trade or business in the opportunity zone.

#### New Jersey State Conformity

The New Jersey Division of Taxation recently issued guidance indicating that the state of New Jersey will allow taxpayers to enjoy the benefits of opportunity zone investments.

#### Conclusion/Summary

Taxpayers recognizing eligible gains (i.e., capital gains from sale transactions between unrelated parties) may elect to defer the original gain until at least December 31, 2026 by investing the gain amount in a qualified opportunity zone fund. Such funds can be formed as either a corporation or partnership. The IRS' proposed regulations allow a fund to "self-certify" that eligibility tests (including a 90 percent asset test) are met. Form 8996 can be submitted to the IRS to certify eligible status as a qualified opportunity zone fund. Failure to meet investment standards will result in penalties. Taxpayers have 180 days from the original sale to "roll over" the eligible original gain into an opportunity zone fund. Taxpayers holding investments for at least 10 years may achieve exclusion of gain in excess of the original deferred gain amount as discussed above. Further, a complex set of rules such as original use, substantial improvements, active business and asset holding requirements are imposed for qualified investments.





## *The Investment Value of Fixed Assets*

*By William C. McNamara, CPA, CCIFP®*

Contractors, take a look at your balance sheet. Your fixed assets—such as your property, plant and equipment—have been the basis of numerous tax law changes in recent years. They also provide an all-purpose planning tool for you as a business owner.

While the new laws allow us to depreciate or write off equipment purchases sooner, we want to look at ways to hold the value of these items on your books, thus increasing your net worth. Significant dollars are invested in the property acquired by a contractor, and that value is as important as cash or contracts receivables.

### **Favorable but Not Final**

The Tax Cuts and Jobs Act of 2017 provided huge write-off incentives to tangible personal property. Fixed assets with a useful life of 15 years or less are now allowed a 100% write-off of the cost basis under tax depreciation rules. Provided that the asset was new and necessary in the trade or business, the owner could deduct from taxable income the entire purchase price of their equipment acquisitions. However, these favorable tax considerations should not be the end of the planning process for a contractor. Rather, there are a host of additional items warranting further consideration. Let's examine a few of them and envision how these pieces fit together.

### **Timing is Everything...**

While the deferral of taxable income is often a large topic of conversation prior to year-end, the financial statement or book income needs a few moments of attention. By electing bonus depreciation for tax, timing differences are created under Generally Accepted Accounting Principles (GAAP) for financial statement reporting practices. These timing differences create the need to record the future deferred tax charges on a company's profit. So, when tax depreciation is higher than the books, we see a deferred tax charge being recorded. Accelerated depreciation allows us to take more expense today and postpone recognition of taxes on profits until later periods. GAAP has us adjusting the measurement to reflect this future liability.

### **...And Speed Isn't**

Since often our financial statements are evaluated by banking and surety underwriting standards, deferred tax liabilities, both current and long-term, impact areas of liquidity like the current ratio and working capital calculations. While the deferral of taxable income reduces current tax expense and improves current cash, it may not be the best answer for the business. Maybe the combination of using the Internal Revenue Service established MACRS tables and Section 179 depreciation allows a contractor to obtain the same deferral of taxable income. By using a slower method, we get a residual depreciation expense in a subsequent tax year.

### **Salvage Value**

An additional consideration for book reporting is the establishment of salvage value. Rarely, after a 5-7-year period, is a piece of equipment more than a pile of scrap iron. Many assets have either trade-in values or auction values; identifying a salvage value before book depreciation is calculated will reduce the depreciable charge of an asset for GAAP reporting benefits. It will also increase the net book value of the asset, which will improve the carrying value and correctly provide the appropriate amount of residual.

### Closing Considerations

As stated earlier, banks and surety underwriters are evaluating the strength of a company's financial statement. Oftentimes, the net book value of equipment is one of the larger dollar values posted on the contractor's balance sheet. By reflecting a salvage value, we increase the reporting of total assets. Book depreciation expense is reduced, allowing a contractor to show a larger balance in retained earnings. Net capital accounts are closely monitored and are often used in many bank covenants, surety programs, and state bidding qualifications.

We can't leave the world of fixed assets without a discussion on repairs and maintenance. Before accelerated depreciation rules came into existence, analyzing repairs to determine if they extended the useful life of an asset had much more priority. Despite all of the tax law nuances, repairs and maintenance calculations and classifications are still important to the contractor. An easy example of why is readily evident when a contractor endures a New Jersey Sales Tax audit. Any contractor who has undergone this audit can appreciate the need to be diligent.

Too often, repairs and maintenance are not reclassified to fixed assets when they truly extend the useful life. And too often, those repairs and maintenance invoices do not reflect the proper amount of sales tax charged. This creates a use tax liability, which is not an immaterial amount of dollars. Invoices should be scrutinized for tax charged on materials and labor, if not extending the equipment's useful life. Additionally, some specialty equipment used in a manufacturing operation for cement or asphalt production has its own considerations and benefits.

Lastly, we remind clients to understand listed property rules for vehicles under 6,000 pounds and trucks with gross vehicle weight over 26,000 pounds. Both items roll with unique rules that, if not identified and managed in a timely manner, can create hidden tax burdens or the loss of some tax saving benefits to the contractor.

For assistance with these and other important accounting issues for contractors, **contact the Curchin Group.**



# CURCHIN

200 Schulz Drive, Suite 400  
Red Bank, NJ 07701

## Featured Employee:



### CAROLINE SIGONA, STAFF ACCOUNTANT

Caroline joined The Curchin Group in 2016 as a staff accountant directly after graduating from Rowan University with a B.S. in Accounting. She works on audits for Financial Institutions, Not-for-Profit Entities, Homeowners Associations, 401Ks and Pensions and provides ACH exam services. She also prepares tax returns for individuals, exempt organizations and corporations. At Curchin Caroline enjoys the close-knit atmosphere and the opportunity to work on a variety of clients and projects to gain the most experience in the accounting profession. Outside of work, she enjoys going to the beach and spending time with family and friends.

## Firm News

### UTCA 2019 CONVENTION

*September 26 - 28, 2019*

The Curchin Group is gearing up for UTCA's 2019 Convention at the Tropicana in Atlantic City.

Visit our team at Booth #78 for quick tips, recommendations and answers surrounding accounting and finance for construction businesses. Curchin is one of the only firms offering specialized accounting for A/E/C in New Jersey and the Mid-Atlantic. To learn more, visit [curchin.com/construction](http://curchin.com/construction).

### 2019 CURCHIN OPEN

*November 6, 2019 - 3:30pm - 6:30pm*

Everyone's favorite indoor miniature golf tournament is back for the 14th year! We are seeking sponsors and prize donations to help make this year's Curchin Open a success.

Support the 2019 Curchin Open charity recipients, HOPE Sheds Light and the Boys & Girls Clubs of Monmouth County, while also promoting your organization.

To learn more about sponsorship opportunities or to register for the event, visit [curchin.com/curchin-open](http://curchin.com/curchin-open).