CFMA

CONSTRUCTION FINANCIAL MANAGEMENT ASSOCIATION

The Source & Resource for Construction Financial Excellence

January 17, 2014
The Honorable Max Baucus
Chairman
Senate Finance Committee
United States Senate
Washington, DC 20510

Via e-mail

Re: Discussion Draft to Reform Certain Business Provisions

Dear Chairman Baucus:

The Construction Financial Management Association (CFMA) is “The Source & Resource for Construction Financial Professionals” and the only nonprofit organization dedicated to serving the construction financial professional. Headquartered in Princeton, NJ, CFMA currently has more than 6,600 members in 88 chapters throughout the US and Canada.

Established in 1981, CFMA’s General Members represent all types of contractors, as well as developers, construction managers, architects, engineers, principals, and material and equipment suppliers. Associate Members include the accounting, insurance, surety, software, legal, and banking specialists who serve the construction industry.

CFMA is pleased to take the opportunity to provide comment to the Discussion Draft to Reform Certain Business Provisions (the Draft) dated November 21, 2013

The following represents our comments from the perspective of CFMA members associated with both large and small construction companies and related service providers. Taxes are an important part of the daily life of CFMA members and tax law changes impact the individuals and their companies as well as the construction industry as a whole. Some of the provisions of the Draft will have an adverse impact on CFMA members, their companies and employees, and the industry as a whole at a time when policy should strengthen and encourage recovery rather than hinder it at the expense of this industry, which is such a major part of the United States economy. Nonetheless, we commend some of the provisions of the Draft as important and helpful to the industry and the country.

Modification and Permanent Extension of Section 179

CFMA commends and agrees with the proposal for the extension of the $500,000 expensing allowance and the extension to $1,000,000 for years beginning in 2015. This has been a widely used and important provision for the construction industry in the past and the permanent extension and expansion proposal will considerably help the post-recession challenges of the industry. Furthermore, the indexing for inflation helps to keep the provision permanent and relevant in the future. Businesses need tax law and policy that is simple and consistent for current and future business planning.

P**ooled Asset Cost Recovery and Depreciation System**

CFMA vigorously disagrees with the concept of required depreciable property pools, implemented in an after-the-fact manner.

With a tax regime that has historically been based on "cost", the pooled asset and applicable rate proposal may provide, over time, a tax asset pool with little, or no, relation to the cost of the underlying assets. CFMA disagrees with this significant departure from historical tax accounting. With the proposed pool concept, depreciation will continue for an asset, potentially and theoretically almost forever, even long after the asset is disposed. This is contrary to the basic concept of expensing the cost of a capitalized asset to operations as it is used or consumed in the operations of the taxpayer.

The administration of the asset pools in an equipment-intensive industry such as construction will create pools that can have multiplied miscalculation in years subsequent to an error or miscalculation in a prior year. With the present depreciation methods, an error for one asset would not create an error for the entire fleet of assets for all subsequent years.

The calculation of the pool balances as proposed in the Draft can create phantom assets with meaningless balances. This is evidenced by the proposed section of the Draft on Terminal Losses and the section on Asset Pools with Negative Balances, recognizing that a pool may have a positive balance with no assets in the pool, or a negative balance with assets in the pool. Such a system does not recognize the reality of asset ownership and does not adhere to the basic concept of matching of costs to revenues in a tax period.

Along with our recommendation to eliminate the pools which are proposed by the Draft, CFMA suggests that the provisions of Section 1031 for like-kind exchanges be retained in the law. Contractors frequently upgrade one piece of equipment for another with a trade-in of the old for the new. In this equipment-intensive industry, turning a typical equipment or vehicle trade into a taxable transaction will discourage transactions that are healthy for a recovering industry and the economy as a whole. Elimination of the asset pool concept should be in conjunction with retaining Section 1031.

The establishment of the pool in the first taxable year beginning after December 31, 2014, with the assets of pooled property held by the taxpayer on that date, effectively changes depreciation of assets mid-course in the depreciable life of previously acquired assets. This proposed retroactive change in tax law is contrary to prior tax policy and disruptive to effective business planning. CFMA firmly disagrees with such retroactive application of proposed new tax law.

Cash Method of Accounting

A good change, with which CFMA agrees, is the proposed increase from the $5,000,000 limitation on the use of the Cash Method to $10,000,000, complementing the proposed reform to coordinate other tax provisions and simplify tax law for smaller contractors. Among other results of the proposal, this resolves uncertainty about the applicability of prior Revenue Procedures issued in 2001 and 2002 with different rules for different entities for the use of the Cash Method.

We disagree with the proposed limitation of the $10,000,000 Average Annual Gross Receipts (AAGR) at both the entity level and at the partner, shareholder, beneficiary, or similar level. While some entity and pass-through limitations can be effectively applied and administered, such as the dual limitation on the Section 179 deduction, this cash method limitation cannot be effectively administered. In order for the entity to properly comply it would need to correctly determine that all the passthroughs meet the dollar limitation for the prior three tax years. The reporting entity may not have access to the tax returns of the passthroughs or the passthroughs may not correctly determine or improperly represent their $10,000,000 test status, thus subjecting the entity to a risk of incorrectly reporting on the cash method, as well as the other passthroughs also reporting incorrectly. If the entity reports on the Cash Method but a passthrough does not meet the test, the passthrough would not have the information to recompute an alternate method at the passthrough level. Thus the entity may be forced from a proper use of the Cash Method (because of that uncertainty with its passthroughs) when, in fact, the Cash Method was an allowable method. CFMA suggests that the AAGR limitation on the use of the Cash Method as proposed by the Draft be solely limited at the entity level and not additionally limited at the passthrough level.

We also disagree with the limitation on changing back to the Cash Method during the subsequent four years immediately following the taxable year for which such change was first required if the $10,000,000 test is later satisfied. While IRC 1361(b)(3)(D) has a similar timing restriction for re-electing S corporation status after a prior S status was terminated, this proposed limitation in the Draft on the Cash Method is based on the AAGR of the entity and is more like the $10,000,000 AAGR provision of IRC 460(e)(1)(B)(ii) for long-term construction contracts which requires the change to the Percentage-of-Completion Method (PCM) only for the year following the failure of the AAGR test but not for any extended period of time if the AAGR subsequently falls below the $10,000,000 test. That 460 provision actually requires the entity, unless elected otherwise, to revert back to its prior normal method for its long-term construction contracts. Construction industry taxpayers use many methods, including the Cash Method, an Accrual Method, and the PCM. This provision in the Draft would create confusing differences for small construction taxpayers, who were on an Accrual Method compared to the Cash Method, when their AAGR drops below the $10,000,000 test. Tax complexity can be greatly reduced with similar provisions for similar restrictions with similar dollar limitations. Similar AAGR benchmark requirements for the small entities will facilitate the administration of tax law by both the Service and the taxpayers.

Additionally, since this proposal includes an indexing of the $10,000,000 for inflation for the use of the Cash Method, CFMA suggests indexing for inflation the similar AAGR provision of IRC 460(e). That $10,000,000 provision of Section 460 has been the same amount since introduced in 1986. Before that time, the prior law had a $25,000,000 provision. Prior bills have been introduced with a $40,000,000 provision for the required change to PCM, which is reasonable based on the time since the introduction of the 1986 law. CFMA recommends a $40,000,000 provision, and, as a secondary alternative, a return to the pre-1986 $25,000,000 provision indexed for inflation after 2014.

Additionally, since the proposal significantly relaxes the cash reporting rules from the $5,000,000 AAGR to $10,000,000 AAGR for a broad group of taxpayers, the construction industry still has a significant restriction for the taxpayers in that under-$10,000,000 group. IRC 56(a)(3) requires the PCM as an adjustment for the alternative minimum tax for C corporations and for passthrough entities. To simplify and facilitate the administration of tax law for the Service and the taxpayers, as well as provide greater parity for the construction industry with other industries, we suggest that adjustment be eliminated from Section 56 of the Code.

Percentage of Completion for Certain Long-Term Contracts

CFMA disagrees with the Draft proposal to require home and residential construction contract reporting on the PCM for contractors with AAGR exceeding $10,000,000. Many homebuilders who would be impacted by this change do not have the resources to effectively manage the required changes which would aggravate noncompliance with the rules and regulations. For these contractors, the timing difference is probably not a significant impact to raising revenue as a part of overall tax reform. Furthermore, regulations are currently proposed to limit perceived abuses of the definition of home construction contracts.

In closing, we respect your and the Senate Committee on Finance's commitment to providing high-quality, operational financial reporting laws. The due process afforded to those, such as CFMA, wishing to comment on discussion drafts affecting our constituency is an important and valuable part of this process. Again, we are grateful for your efforts and welcome the opportunity for further discussion.

Respectfully submitted,

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CFMA
President & CEO