February 26, 2019

Good News Regarding Excess Business Losses For Your Pass-Through Construction Business

CONSTRUCTION, INTERNAL REVENUE SERVICE, TAX
BY MARK DIPIETRANTONIO

If you own a construction business, you know all too well that one or more bad contracts can make or break the financial results for the year. If you were in this scenario for the year ended December 31, 2018, your tax advisor may have been bracing you for the new rules that could limit the deductibility of the potential business operating loss in 2018. While the limitation on Excess Business Losses, still exists, the IRS has recently issued guidance (and Form 461) that may provide good news.

Excess Business Loss Limitation

Given the speed at which the 2017 Tax Reform Act was passed, it's not surprising that very little guidance exists regarding the calculation of the Section 461(l), Excess Business Loss Limitation. The IRS's website, however, provides the following:

> An Excess Business Loss is the amount by which the total deductions attributable to all of your trades or businesses exceed your total gross income and gains attributable to those trades or businesses, plus $250,000 (or $500,000 in the case of a joint return).
>
> A "trade or business" can include, but is not limited to:
>
> - Schedule F (farm) and Schedule C (self-employment) activities.
> - The activity of being an employee.
> - Other business activities reported on Schedule E (rental & pass- through income).
> - Business gains and losses, including pass-through income and losses attributable to the sale of property by a trade or business (Form 4797 and Form 8949).
>
> Excess business losses that are disallowed are treated as a net operating loss carryover to the following taxable year.

This guidance appears to be taxpayer-friendly, given the items that can be included as business income:

- Salaries and wages of being an employee can offset business losses from other sources.
- Capital gains (and losses) reported on *Form 8949 – Sales and Other Dispositions of Capital Assets* will used to offset ordinary business losses, this could potentially mean that the gain (or loss) from the disposition of interests in partnerships and S corporations may offset

business losses.

- Gains (and losses) from *Form 4797- Sales of Business Property* are available to offset business losses.

The inclusion of salaries and wages that are attributable to a trade or business is good news, and could potentially increase the deductibility of a loss generated by a pass-through trade or business. For example, if a married taxpayer's only source of income for the 2018 tax year was $1,000,000 of wages and a tax loss of ($1,500,000) from a 100% owned pass-through construction business, the taxpayer may be able to deduct the entire $1,500,000 pass-through loss on his 2018 individual income tax return. This is due to the fact that the wages ($1,000,000) could be considered trade or business income and be counted when determining his 2018 net trade or business loss of $500,000 ($1,500,000 - $1,000,000).

It's important to note that above example has been simplified to illustrate the utilization of wages in calculating excess business loss. The example does not consider "at-risk" and "passive activity" loss limitations that are applied before calculating the amount of excess business losses. The impact of those limitations is beyond the scope of this article.

If you have any questions related to the impact of the excess business losses rules on your construction company, do not hesitate to contact Mark A. DiPietrantonio or another member of the Schneider Downs Construction Industry Group.

You've heard our thoughts… We'd like to hear yours

The Schneider Downs Our Thoughts On blog exists to create a dialogue on issues that are important to organizations and individuals. While we enjoy sharing our ideas and insights, we're especially interested in what you may have to say. If you have a question or a comment about this article – or any article from the Our Thoughts On blog – we hope you'll share it with us. After all, a dialogue is an exchange of ideas, and we'd like to hear from you. Email us at contactSD@schneiderdowns.com.