The new Tax Cuts and Jobs Act is largely positive for business but has some potentially devilish details to navigate. This is an inevitable result for a measure pieced together through a myriad of compromises among varied interests. But then, as has also been observed, if both sides are dissatisfied, chances are it’s a good deal overall.

Corporate tax rate
The centerpiece of the TCJA is the cut in the statutory corporate income tax rate from 35 percent to 21 percent. The hope is that the tax cut will provide more money to sink into capital expenditures, potentially leading to improved labor productivity, which could allow a business to rationalize paying higher wages, lowering prices, improving products, or some combination.

The Penn Wharton Budget Model, budgetmodel.wharton.upenn.edu, estimates the effect of the TCJA across 19 main industrial sectors. Of these, the construction industry will be among those that will fare the best (16.01 percent effective tax rate, down from 28.5 percent), according to the model. It also projects the real estate, rental and leasing sector will also see a great benefit (10.85 percent, down from 26.5 percent). And, the Model estimates that manufacturing, overall, will see a lesser—although still significant—benefit (10.94 percent, down from 17.51 percent).

Expensing of equipment
Another potential pro-growth win in the Act allows businesses to write off the cost of investments more rapidly. As the Washington Examiner, washingtonexaminer.com, put it, this represents “a long-overdue end to complicated and time-consuming depreciation schedules.”

Interest on debt
The deduction for net business interest is now limited to 30 percent of adjusted taxable income, although interest in excess of that can be carried forward. This is in effect for four years, followed by an even tougher threshold going forward. Business Insider, businessinsider.com, opines that this could hamper growth for small businesses by making it more difficult to borrow money.

A boon for pass-through entities
A little-noted provision bestows a 20 percent income deduction for pass-through entities (e.g., sole proprietorships, partnerships and S corporations), which helps smaller businesses compete. Of interest to our industry is that some engineering and architecture firms will not be disqualified from these tax breaks, according to an Inc., inc.com, article.

Devilish details
Another important consideration is the role of the Federal Reserve which, since 2008, has kept interest rates low to encourage borrowing to spur economic growth. Business News Daily, businessnewsdaily.com, reports that, “with reduced taxes, we could see the Federal Reserve Bank raise interest rates and try to offload some accrued assets that it has accrued since the financial crisis... The corporate tax reform is going to be positive, but the Fed can have an overwhelmingly negative role.”

Meanwhile, a Bloomberg View article, bloomberg.com, suggests that companies suffering through “near-death experiences” during the financial crisis are going to have to take big charges against earnings as the value of their “deferred tax assets”—that is, past losses used to defray future tax bills—declines with the corporate tax rate.

Effects on our markets
Some say the new cap on the Mortgage Interest Deduction and on state and local taxes will de-incentivize potential home buyers and/or depress home prices nationwide. But, as home-search website Zillow, zillow.com, elaborates, “people choose to buy—or not buy—a home for a whole host of reasons, not just what their tax bill looks like in April... If the tax bill puts more money in their pockets, they may lean more toward buying.” Also, it stands to reason that, because the Act also doubles the standard deduction, fewer people will claim the MID and SALT deduction anyway. The greatest impact may be geographically limited to coastal states with high taxes and expensive housing markets.

In terms of remodeling spending, many in our industry are concerned. The Act eliminates deductions for interest on home equity loans, which are frequently used to replace windows and doors with energy-efficient replacements.

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