2024
TAX PLANNING OPPORTUNITIES
for the Construction Industry

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Foreword

The last decade has included some of the most significant tax regulation changes and created many planning opportunities for contractors. Changing entity types, accounting methods, new deductions for qualified businesses, new depreciation alternatives and new tax incentives for qualified investments are just some of the provisions that continue to require careful analysis and proactive planning for CPAs and their contractor clients on an annual basis.

The current tax regulation environment has a wide impact on the construction industry. The Inflation Reduction Act passed in 2022 is a prime example of energy and climate provisions, that were enacted to further promote, expand, and incentivize actions around the design, development, and construction of energy efficient property.

The CICPAC Tax Thought Leadership Committee has compiled an updated summary of those changes potentially impacting our construction clients. In the interest of timing, this document overviews considerations for planning in 2024 and beyond.

Thanks to the members of the Tax Thought Leadership Committee and their collective efforts resulting in this document. We are also grateful to Kathleen Baldwin and Michelle Class for bringing it all together.

2024 Update Committee	
Carlo Ferri, Kreischer Miller | **Chair**	Tim Short, Adams Brown
Eric S. Fletcher, Thompson Greenspon	Christine Ulibarri, BeachFleischman

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Expiring provisions

As you are preparing for 2024 tax planning, keep in mind the provisions set to expire in the near term.

Provision	2022	2023	2024	2025	2026	2027
Individual rate cuts						
Individual AMT exemption amount						
20% pass-through deduction						
Estate tax doubled exemption						
$10,000 State and local deduction						
100% expensing - effective 9/27/17		Phased	Down by	20%		
Interest deduction 30% of EBITDA	EBIT >					
GILTI deduction at 50%					**37.50%**	
FDII deduction at 37.5%					**21.88%**	
BEAT rate: 10%/11% for banks/dealers						

In Effect **Not in Effect**

Construction Accounting Methods

One of the most comprehensive changes included in the TCJA are the variety of tax accounting methods available for contractors. Methods previously only available to smaller contractors are now available for contractors with average annual gross receipts (measured on an income tax basis) of up to an inflation-adjusted ceiling of $30 million for tax year 2024. In addition, IRS revenue procedures issued in 2018 and later provide that most of the allowable changes will be considered automatic.

Although automatic changes will still require a submission of Form 3115 to the IRS, the amount of detail and documentation is significantly reduced, user fees of up to $11,500 are not applicable and prior approval by the IRS before adoption is not required so the form can be submitted with the tax return for the year. This provides additional time to analyze the impact of a potential change as well having available the actual year end numbers that will be affected while performing the analysis.

Since accounting methods only impact the timing of when income or deductions are reported it is considered revenue neutral. The timing changes, however, can result in deferral of tax liabilities. Some amount of deferral or increasing deferrals can result in permanent or at least long-term tax savings to companies: theoretically a win-win for the government and the taxpayers. Continued annual review of the various methods and their application to contractors is an important step as scope of work and gross receipts levels vary year to year.

Large Contractors

As noted above, under pre-TCJA regulations large contractors were considered to be those with average annual gross receipts of $10 million and above. That limit is now raised to $30 million (as adjusted for inflation, see discussion above). Contractors meeting those revenue limits are still required to use the percentage of completion method (with some variations) to account for all long-term contract revenues. However, the IRS issued revenue procedures issued in 2018 that now include the ASC 606 Revenue Recognition Standards as an acceptable percentage of completion method. Contractors will need to analyze the impact of the standards on the timing of their revenues. If the implementation of the new standards for financial statement purposes generally results in reporting revenues later rather than sooner, a switch to this method for taxes also will result in deferred / reduced tax liabilities. An ancillary benefit would also be to minimizes book / tax reconciliation differences.

Revisions to IRC Section 451(b) regarding timing of income recognition and new 451(c) related to advance payments should also be considered.

The charts on the following pages provide an overview of these new provisions as well the other accounting methods that have not been changed and are allowable for large contractors.

Accounting Method Changes for Large Contractors

Description of Change	What Contractors May Benefit	Action Steps	Timing	Other Considerations
Adoption of New Revenue Recognition Standards (ASC 606)	Application of revenue recognition standards for GAAP, may slow or accelerate revenue for reporting purposes, depending on when taxpayer recognizes revenue under new performance obligation model set forth in new standards.	Goes into effect for calendar year 2019, but important to identify during 2018 process, potential impact areas for GAAP reporting and its impact for tax.	Any automatic change can be made in the taxpayer's first, second or third taxable year ending on or before May 10, 2021.	Outside of the current three-year window noted under 'timing', advance consent with the IRS would be required pending further guidance.
Impact of Section 451(b) on Book-Tax Conformity	New rule under TCJA, mandates certain accrual method taxpayers shall recognize gross income for tax purposes no later than taken into account in a taxpayer's applicable financial statement.	This binds closely with new ASC 606 standards above, as its important to understand potential GAAP differences and/or upcoming changes to GAAP revenue reporting. Even if do not elect to follow ASC 606 for tax purposes, 451(b) may require following similar concepts for consistency with financial statement reporting.	No need to file a Form 3115 if any required change (under new tax) is made immediately in the first taxable year after December 31, 2017. Review Rev Proc 2021-34 for modified procedures.	Applies only if accrual method and have a required applicable financial statement (AFS). For closely held contractor clients this would normally mean an audited financial statement. The new rules do not apply to any specific items of gross income where a special method of accounting is used (i.e. - Sec. 460 Long-term contract method). Additional attention should be paid to the accrual less retainage method of accounting.

Description of Change	What Contractors May Benefit	Action Steps	Timing	Other Considerations
Impact of Section 451(c) on Advance Payments	New rule under TCJA, mandates accrual method taxpayer must include advance payments in income when received, unless elected to defer for tax purposes to the first year only following receipt.	Identify if taxpayer receives advance payments and determine if any current inconsistencies between GAAP and tax reporting, and if the deferral on those payments exceeds 12 months.	No need to file a Form 3115 if any required change (under new tax law) is made immediately in the first taxable year after December 31, 2017. Review Rev Proc 2021-34 for modified procedures.	This section largely tracks existing Revenue Procedure 2004-34, which allowed the deferral of advance payments in a similar manner pretax reform. Service contracts should be reviewed to determine whether any deferral opportunity exists.

Accounting Methods Available to Large Contractors, Over $30 Million (As Adjusted For Inflation) **In Average Annual Gross Receipts, Has Not Changed:**

Description of Change	What Contractors May Benefit	Action Steps	Timing	Other Considerations
Percentage of Completion (PCM)	In general, taxable income from a long-term contract is determined under PCM.	If contractor moves from a defined small contractor to a large contractor due to revenue growth no formal election or method change needed. Apply PCM to the contracts started in the first year of application (cut-off method).	Incorporate into an entity tax return, including extensions.	Large contractors will typically be required to apply PCM to long-term contracts. If a contractor moves between large and small under the definition of the $30M (as adjusted for inflation), further considerations should be given.

Description of Change	What Contractors May Benefit	Action Steps	Timing	Other Considerations
Percentage of Completion (PCM) - 10% Method	Defer recognition of revenue under PCM until 10% of estimated total contract costs are incurred and allocated	Election attached to tax return in the year adopting.	File with entity tax return, including extensions.	Unavailable if the taxpayer elected to utilize the simplified cost-to-cost method for PCM, versus standard "cost-to-cost" method.
Percentage of Completion - Capitalized Cost Method (PCCM)	Ability for those contractors with residential construction contractors to report 70% of the contract under PCM, and the remaining 30% under exempt method (e.g. - completed contract).	Requires advance consent of the IRS by filing Form 3115. There is a user fee.	Filed by the last day of applicable tax year.	Definition of residential contract in this regard means building with 4 or more units versus home construction contract which is 4 of fewer. Further definitions are key to review under IRC Section 460(e).
Accrual Excluding Retainages	Defer inclusion in income of retainages withheld by customer until final acceptance by customer occurred as specified in the contract. Contract must be exempt from IRC Section 460 (short-term).	Requires automatic consent of the IRS by filing Form 3115.	File with entity tax return, including extensions.	Must also exclude retainage payable related to same short-term contracts.
Accrual Excluding Retainage Payable	Retainage payable related to long-term contracts are not included in contracts costs until the retainage is payable to the subcontractor as defined in the contract. This slows the percent complete and reduces income recognition.	Requires advance consent of the IRS by filing Form 3115. There is a user fee.	Filed by the last day of applicable tax year	Contract language is key to applicability.

Small Contractors

The small contractor exception requiring the use of the percentage completion method has been expanded from contractors with average annual gross receipts of less than $10 million to $30 million (as indexed for inflation) for 2024. Average gross receipts are calculated based upon receipts reported for tax purposes. Contractors not exceeding the $30 million (as adjusted for inflation) limitation and previously using the percentage completion method to account for revenues from long-term contracts now have broad range of choices for tax accounting methods.

In addition, IRC Section 448 has also been expanded to allow the cash method of accounting for companies with receipts of less than $30 million (as adjusted for inflation). Revisions to IRC Section 471 eases accounting for inventories also allowing the cash basis for smaller companies.

Previously, changes in accounting for long-term contracts would require advance notification and approval by the IRS. Changes for contractors no longer meeting the requirements for percentage completion or accrual basis of accounting requirements are now considered automatic. Form 3115 is still required but is submitted with the tax return for the year of change, no user fees apply, and the information required is significantly reduced. Changes from the percent complete method are made on the cut-off method so revenues from contracts in progress prior to the year of change will still be accounted for under the old method. Changes in overall methods, i.e., from accrual to cash, are made through a 481(a) adjustment. The effect of the change in the accounting method is determined at the beginning of the year of change and taken into income over four years if a positive adjustment and deducted in the year of change if negative.

Keep in mind that changes to PCM by a small contractor not required to change due to the gross receipts test (Average gross receipts under $30 million) is still a change required advanced consent by the IRS and a $11,500 user fee.

The chart on the following pages provides an overview of these provisions.

Accounting Method Changes for Small Contractors

Description of Change	What contractors may benefit	Action Steps	Timing	Other Considerations
Accounting for Long Term Contracts TCJA increased the exemption for requirements to use the percentage completion method of accounting for long term contracts for taxpayers with less than $10 million in average annual gross receipts to less than $30 million (as adjusted for inflation) in average annual gross receipts	Contractors with revenues less than $29 million (as adjusted for inflation) currently using the % completion method	Completion and submission of Form 3115 under automatic change provisions	By due date of the return including extensions	Conversion applied on the cut-off method for contracts entered into after December 31 in the year of change.
Other Methods Available:				Application may be made concurrent with other changes available under TCJA provisions
Completed Contract Revenues and costs for each contract is deferred until the job is at least 95% complete				For non-C corporation entities - beware of AMT issues on taxable income difference between method and percent complete income
Cash Revenue is recognized when cash is received and are deductible when paid.				

Description of Change	What contractors may benefit	Action Steps	Timing	Other Considerations
Accrual Revenues recorded as available to be billed, Costs recorded based on economic performance occurs				
Overall Method Change from Accrual to Cash Method TCJA increased the gross receipts threshold for the requirement to use the accrual method of accounting from $5 million to $30 million (as adjusted for inflation)	Contractors with revenues less than $30 million (as adjusted for inflation) currently on the accrual method	Completion and submission of Form 3115 under automatic change provisions	By due date of the return including extensions	Conversion made through 481(a) adjustment determined at beginning of the year of change with negative adjustment applied in the year of change and positive adjustment taken into account ratably over 4 years
Accounting for Inventories TCJA no longer requires accrual method of accounting if company revenues are less than $30 million (as adjusted for inflation); inventory is non-incidental material and supplies, or accounting treatment is consistent with applicable financial statement				

What is Section 199A and Who Is Eligible?

The Tax Cuts and Jobs Act (TCJA), enacted in 2017, introduced Section 199A, a provision designed to provide tax relief to certain businesses, including many construction contractors. Section 199A allows for a Qualified Business Income (QBI) deduction, which can be a significant benefit for taxpayers engaged in construction activities. Be aware that the QBI deduction sunsets 12/31/2025 under current law.

What Is Section 199A?
Section 199A provides a tax deduction of up to 20% of qualified business income (QBI). This deduction is available to businesses such as sole proprietorships, partnerships, LLCs, and S corporations. The goal of Section 199A is to level the playing field between pass-through businesses and C corporations, which receive a reduced tax rate of 21% under the TCJA.

Who Is Eligible?

- **Sole Proprietors**: If you operate your construction business as a sole proprietor, you are eligible for the 199A deduction, subject to the limitations discussed below.
- **Partnerships and LLCs**: If your construction business operates as a partnership or LLC, you can pass the QBI to the individual partners or members, who may then claim the deduction, subject to the limitations discussed below.
- **S Corporations**: If your construction business is structured as an S corporation, the shareholders can claim the deduction on their share of the QBI, subject to the limitations discussed below.

For construction contractors, the majority of income will typically be eligible for the QBI deduction, but certain conditions and limitations must be considered, especially if your income exceeds certain thresholds.

How is "Qualified Business Income" Defined?

Per IRC Sec. 199A(c), qualified business income (QBI) means the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. QBI does not include any qualified REIT dividends or qualified publicly traded partnership income. Qualified items of income, gain, deduction, and loss mean items of income, gain, deduction and loss to the extent such items are effectively connected with the conduct of a trade or business within the United States and included or allowed in determining taxable income for the taxable year (Sec. 199A(c)(3)(A)).

For construction contractors, QBI generally includes:

- Revenue from construction services (labor, materials, subcontracts, etc.)
- Profits from real estate development and property management activities (if part of the business)

It **does not** include:

- Wages earned as an employee or guaranteed payments to a partner/member
- Capital gains, dividends, and interest income
- Income from certain investment activities

How Much QBI Deduction Can Contractors Claim?

Basic Calculation

The general rule is that construction contractors can claim a deduction of up to 20% of their qualified business income. However, several factors can influence this deduction:

1. **Income Thresholds:** The deduction is subject to certain limitations for individuals with taxable income above certain thresholds. For 2024, these thresholds are:

    - $191,950 for single filers and married individuals filing separately
    - $383,900 for married couples filing jointly

If your taxable income exceeds these amounts, your ability to claim the full 20% QBI deduction may be limited based on other factors such as the wages paid to employees and the value of qualified property as well as the type of business you operate.

2. **Wages and Property Limitation:** For high-income earners, the QBI deduction may be limited if you exceed the above income threshold, and you do not pay significant wages to employees or own significant property used in the business. If you exceed the applicable income threshold, your QBI deduction is capped at the greater of:

    - 50% of the wages you pay to employees, or
    - 25% of wages plus 2.5% of the unadjusted basis of qualified property (like equipment or real estate).

3. **Specified Service Trade or Business (SSTB):** For high-income earners that perform services in the fields of Health, Law, Accounting, Actuarial Sciences, Performing Arts, Consulting, Athletics, Financial or Brokerage Services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, the QBI deduction is phased-out starting at the above income thresholds and fully phased-out at:

    - $241,950 for single filers and married individuals filing separately
    - $483,900 for married couples filing jointly

The good news is that construction businesses do not typically fall under the SSTB classification.

4. **Taxable Income Limitation:** The amount of the QBI deduction is limited to the taxpayer's taxable income less its net capital gain.

The following examples illustrate the application of the 199A deduction in various scenarios.

How Do We Apply the 199A?

Income Above Threshold Amounts – Wage-Intensive Business

	Business Other than Specified Service Business	Specified Service Business
Partner's Share of Qualified Business Income	$ 1,000,000	$ 1,000,000
Partner's Share of W-2 Wages	$ 200,000	$ 200,000
Partner's Share of Unadjusted Basis of Qualified Property	$ 10,000	$ 10,000
20% of Partner's Share of Qualified Business Income	$ 200,000	$ 200,000
Deduction (Apply 50% of W-2 wage limit)	$ 100,000	$ 0

Income Above Threshold Amounts – Capital-Intensive Business

	Business Other than Specified Service	Specified Service Business
Partner's Share of Qualified Business Income	$ 1,000,000	$ 1,000,000
Partner's Share of W-2 Wages	$ 50,000	$ 50,000
Partner's Share of Unadjusted Basis of Qualified Property	$ 1,000,000	$ 1,000,000
20% of Partner's Share of Qualified Business Income	$ 200,000	$ 200,000
Deduction (Apply 25% of W-2 / 2.5% unadjusted basis limit)	$ 37,500	$ 0

Wage Limitation

Wages play a major role in the calculation of the 199A deduction. Below are three scenarios:

	A	B	C
Wages (including owners)	$ 400,000	$ 200,000	$ 300,000
Taxable income	$ 600,000	$ 800,000	$ 700,000
20% of QBI	$ 120,000	$ 160,000	$ 140,000
50% of wages	$ 200,000	$ 100,000	$ 150,000
199A Deduction	$ 120,000	$ 100,000	$ 140,000

In Scenario A (most construction companies) – the deduction is limited to 20% of QBI. Therefore, reducing owner's wages and increasing QBI will increase the deduction. Consider paying quarterly estimates instead of a bonus to pay safe harbor amounts. If the owner reduces his wages by $100,000, and takes a distribution instead, the deduction is increased by $20,000. Please remember to watch reasonable compensation.

In Scenario B (possible for construction management and A&E firms) – the deduction is limited to 50% of the wages. Therefore, increasing owner's wages will increase the deduction. As with any planning technique, consider the cost of increasing payroll expenses versus the benefit of increasing the 199A deduction.

In Scenario C – this is close to the optimum wage to QBI percentage, 50% of wages approximates 20% of the QBI.

Another area relating to wages are leased employees, if you have a developer who maintains a separate partnership for all projects but uses one entity for payroll, the payroll can be allocated to the end users of the payroll, thus increase the 199A deductions.

Subcontracting is very common in the construction industry and subcontractor fees do not qualify as wages. If your company heavily relies on subcontracting, you may want to consider who you can include on payroll to maximize your 199A deduction.

Property Limitations

Another limit of the deduction is 2.5% of unadjusted basis on qualifying property plus 25% of wages. Property no longer qualifies after 10 years from the original placed in-service date or the last day of last full year in the applicable recovery period determined under section 168. If this factors into the 199A deduction, it should factor into property replacement decisions.

Aggregation Rules

A taxpayer can potentially choose to aggregate businesses for the deduction if the taxpayer operates multiple businesses in coordination with each other, shares resources, and are commonly controlled. How a taxpayer groups or doesn't group businesses for purposes of applying the passive activity loss rules doesn't affect how the taxpayer can aggregate or not aggregate businesses for purposes of applying the QBI deduction rules. After a taxpayer chooses to aggregate two or more businesses for QBI deduction purposes, he or she must continue to aggregate the businesses in all subsequent tax years.

Other Considerations

If the business income does not qualify for the 199A deduction consider additional wages to reduce the income to an amount under the threshold and look at other deductions such as bonus depreciation, Section 179 depreciation, and retirement or SEP contributions. Conversely some taxpayers may need to reduce the amount of deductions to optimize their 199A deduction.

In summary, Section 199A can provide a tax benefit but how to best derive that benefit can be vastly different taxpayer by taxpayer. It is highly recommended you consult the CICPAC group and your tax advisor to discuss any planning needs on an annual basis.

Other Opportunities / Considerations Under TCJA

Excess Business Losses

The TCJA brought in some unfavorable rules around the deductibility of business losses. As indexed for inflation, the 2024 threshold amount of allowed business losses is $610,000 for joint filers and $305,000 for single filers. These rules apply at the taxpayer level for pass-through business income (or schedule C business income) and do not apply to C corporations. Excess losses are carried forward to future years as Net Operating Losses.

A last-minute change to the Inflation Reduction Act includes an extension of the Excess Business Loss limitation through 2028.

Capitalization of Research Expenses (R&E)

Historically under Internal Revenue Code (IRC) §174, taxpayers had the option to deduct research and experimental costs incurred in a given year. This was the typical default accounting method selected. As part of TCJA, Congress removed the election to deduct these expenditures for all tax years beginning after December 31, 2021. As a result, taxpayers are now required to capitalize all IRC §174 expenses and amortize over a five-year period (fifteen years if the research is conducted outside the U.S.) for all tax years beginning after December 31, 2021.

In September 2023, the IRS issued interim guidance (Notice 2023-63) and in December 2023 released Notice 2024-12, which modifies Notice 2023-63. Basically, Notice 2023-63 described proposed guidance that the Treasury Department and IRS intend to include in proposed regulations under IRC §174. Notice 2023-63 can be found at https://www.irs.gov/pub/irs-drop/n-23-63.pdf and Notice 2024-12 can be found at https://www.irs.gov/pub/irs-drop/n-24-12.pdf.

Here are the highlights of Notice 2024-12:

- Modifies previously issued interim guidance provided by Notice 2023-63 for determining whether costs paid or incurred for research performed under contract are specified research or experimental (SRE) expenditures under IRC §174.
- Relaxes the reliance rules in Notice 2023-63 by no longer requiring that taxpayers rely on all (or none) of the rules in Sections 3 through 9 of Notice 2023-63.
- Clarifies that Section 5 of Revenue Procedure 2000-50 (costs of developing computer software) is obsoleted for amounts paid or incurred in tax years beginning after December 31, 2021.

For information on the IRS automatic consent procedure for the accounting method change necessary to adopt the new method of accounting refer to Rev. Proc. 2023-8 which can be found at https://www.irs.gov/pub/irs-drop/rp-23-08.pdf.

Under the proposed guidance in Section 8 of Notice 2023-63, the treatment of IRC §174 expenditures can impact the contractor's work in progress schedule. Under Section 19.02 of Rev. Proc. 2023-24, as modified by Rev. Proc. 2024-9, taxpayers can change their method of accounting under Section 460 so that the costs allocable to a long-term contract accounted for using the percentage of completion method (PCM) include amortization deductions of SRE expenditures, rather than the capitalized amount of such expenditures. For purposes of determining the percentage of contract completion, taxpayers may determine estimated total allocable contract costs (i.e., the denominator of the PCM ratio) in one of the following two ways:

- Include all amortization of SRE expenditures that directly benefit or are incurred by reason of the performance of the long-term contract.
- Include only the portion of such amortization expected to be incurred and deducted during the term of the contract.

In January 2024, the House passed legislation to repeal the TCJA requirement to capitalize all IRC §174 SRE expenditures. However, in July the Senate failed to pass it. Until Congress enacts new legislation to revise or repeal this section of the law, the plan is to continue to capitalize and amortize research and experimental costs.

Careful planning is needed for 2024 to evaluate the impact IRC §174 may have on a Contractors' taxable income, cash flow, financials, and estimated tax payments.

Business Interest Deduction Limitation

As part of TCJA, IRC §163(j) was expanded to apply to all businesses, with exceptions. Additionally, the maximum deduction allowed for business interest became limited to the sum of:

- The taxpayer's business interest income for the tax year;
- 30% of the taxpayer's adjusted taxable income (ATI) for the tax year; and
- Floor plan financing interest expense.
- Any disallowed interest can be carried forward to succeeding tax years, subject to the provision of IRC §163(j).

For tax years beginning before January 1, 2022, ATI was computed without regard to any depreciation, amortization, or depletion deduction. These deductions were added back to taxable income to determine ATI. For tax years beginning after December 31, 2021 this add-back rule no longer applies for the calculation of ATI. The expiration of the add-back rule could significantly reduce the interest expense deduction limit for business carrying a significant amount of debt.

As noted, there are exceptions to the application of the provisions of IRC §163(j). An exemption is generally available for small businesses. A small business is defined as businesses whose average gross receipts for the preceding three-year period do not exceed a threshold amount ($30 million for 2024 and $29 for 2023). For any related businesses you must aggregate gross receipts to determine the threshold amount.

In addition to the small business exemption, taxpayers engaged in any real property trade or business as defined under IRC §469(c)(7)(C) may elect out of the application of the IRC §163(j) business interest limitations. As part of making the election, the taxpayer must agree to use ADS depreciation for all nonresidential real property, residential rental property, and qualified improvement property. ADS depreciation must be used for both existing assets and new acquisitions following the election. The change applies both to property placed in service in current and future years and to assets placed in service prior to the date of the election. Rev. Procedure 2019-8 provides guidance on making the election.

Many construction contractors may meet the definition of a real property trade or business. Taxpayers impacted by the changes in the calculation of ATI can still make an election as provided in US Treasury Regs. §1.163(j)-9.

Prepare for the Estate and Gift Tax lifetime exclusion to be cut in half

The TCJA doubled the applicable lifetime gift exclusion for 2018-2025. At 1/1/2026 the exclusion will revert back to approximately half of the current lifetime exclusion. For 2024 the exclusion for each individual Is $13,610,000. The amount if congress lets the current law sunset will be $5,600,000 (adjusted for inflation.) It is an ideal time for clients to meet with their estate and tax planning professionals, to analyze if this area is an issue, and plan accordingly before professional advisors get busier as we near 12/31/2025.

Review Retirement Plan Options

The **Setting Every Community Up for Retirement Enhancement (SECURE) Act** was signed into law in December 2019. The Act has favorably changed the deadline for employers to adopt a qualified retirement plan. Employers now have until the business' income tax return deadline, including extension, to adopt a plan and may treat it as adopted at 12/31 of the prior year. There may still be time to adopt a qualified retirement plan for 2023 in addition to exploring plan enhancement options for 2024.

On December 29, 2022, President Biden signed the SECURE 2.0 Act of 2022 building upon the changes from the SECURE Act and further revising rules regarding retirement plans. Some of the key highlights for business owners are as follows:

- Starting January 1, 2023, the age at which owners of retirement accounts must start taking RMDs is increased from 72 to 73 years of age. The age at which RMDs must start will be pushed back further to 75 years of age beginning January 1, 2033.
- Starting in 2023, the penalty for failure to take an RMD will decrease to 25% of the missed RMD, down from 50% currently. The IRS still provides for the waiver of these penalties where the account owner establishes that the shortfall in the distribution was due to reasonable error and that reasonable steps are being taken to remedy the shortfall.
- Beginning January 1, 2024, Roth accounts in employer retirement plans will also be exempt from RMD requirements like Roth IRAs.
- Starting January 1, 2025, individuals aged 60 to 63 will be able to make annual catch-up contributions up to the greater of $10,000 (indexed for inflation) or 150% of the standard catch-up contribution for the year to an employer retirement plan. The catch-up amount for individuals 50 and older is currently $7,500 for 2024.
- Beginning January 1, 2024 plan participants earning more than $145,000 in the prior calendar year must make all catch-up contributions to a Roth account in after-tax dollars. Plan providers who currently do not offer a Roth option in their retirement plan should make changes to their plan in order to provide participants with the continued opportunity to make catch-up contributions.
- Historically, all employer contributions to 401(k) plans have been required to be made as pre-tax contributions. Under SECURE 2.0, employers may permit employees to elect that employer matching and non-elective as Roth contributions in after-tax dollars.

- Under SECURE 2.0, any 401(k) or 403(b) plan established after the date of enactment (December 29, 2022) must contain an automatic enrollment provision. Unless the employee affirmatively opts out, they must be enrolled at a contribution rate of at least 3 percent, but not more than 10 percent. Further, after each year in which a participant has completed a year of service, the contribution percentage must automatically increase by 1 percent until the contribution is at least 10 percent but no more than 15 percent.
- Starting January 1, 2024, defined contribution retirement plans can add an emergency savings account that is a designated Roth account. Non-highly compensated employees (defined in 2024 as those earning up to $150,000) will be eligible to contribute up to $2,500 annually to this emergency savings account. Contributions may be eligible for matching contributions. The first 4 withdrawals in a year will not be subject to any withdrawal fees to the employee.
- Beginning January 1, 2024 employers will be able to make additional matching contributions to retirement plans based on employee student loan payments.

Employee Retention Credits (ERC)

The deadline to file refund claims for 2020 has passed, but taxpayers have until April 15, 2025, to file claims for 2021. However, the IRS has announced a moratorium on claims received after September 14, 2023.

In June 2024 the IRS announced that it was in the process of denying tens of thousands of improper high-risk claims while resuming the processing lower-risk claims. Many taxpayers have already received notice that their claim was denied. We have been hearing that the IRS is disallowing valid claims. If this happens, the taxpayer can appeal the denial.

That announcement, and links to additional IRS guidance related to the ERC can be found at:

https://www.irs.gov/newsroom/irs-enters-next-stage-of-employee-retention-credit-work-review-indicates-vast-majority-show-risk-of-being-improper

An important reminder regarding the ongoing ERC process for many Contractors, is if a Taxpayer claims the credit, the corresponding reduction of the deduction (income recognition) related to the salaries which the credit is based takes place in that given 2020 or 2021 tax year. This can typically result in the Taxpayer generating additional income tax while waiting on the refund of any claimed credit.

Keep in mind that the IRS has extended the statute of limitations to 5 years for claims filed for 3rd and 4th quarter 2021. If a taxpayer claims the ERC for those quarters, their application remains open for audit possibilities for 5 years. If the ERC is disallowed and the regular tax return statute of limitations (3 years) has passed, the taxpayer loses the ability to go back and deduct those salaries. Additionally, AON recently released a risk alert noting that CPAs may be asked to prepare original or amended payroll and/or business tax returns reflecting ERC. As such, CPAs may face a future professional liability claim if a client's ERC is disallowed by the IRS, even if they did not calculate the ERC.

Link to the full article is here:

https://www.cpai.com/Education-Resources/my-firm/Tax-Services/Risk-Alert-Aggressive-Employee-Retention

Choosing Between S CORP Versus C CORP

The TCJA brought about a myriad of changes to C Corp and S Corp tax rules. Over the past 40 years, tax practitioners have seen the effective corporate tax rates increase relative to personal income tax rates.

The TCJA brought a significant reduction of the federal corporate tax rate and not quite the same reductions in personal tax rates. It is easy to see why a corporate tax structure is a much easier tax pill to swallow and may be the most tax efficient entity type if a large portion of earnings are not being distributed to owners but are being retained in the company for growth and / or debt repayment.

- Highest effective tax rates of S-Corp net income – 37% (29.6% with full section 199A deduction)
- Highest effective tax rates of C-Corp net income – 21% (plus 15% or 23.8% on dividend distributions)

For newly formed entities, using a C corporation could provide access to deferral of up to $10,000,000 of gain on the eventual sale of the stock under Section 1202 for shareholders of qualifying businesses that meet all the requirements.

Considerations to Keep in Mind for Converting from an S-CORP to a C-CORP:

- Is the entity/Are the owners eligible for QBI deduction?
- If change from S to C, how are historical earnings taxed leaving a C-Corp?
- Per 1371(e)(1) during the post-termination transition period (PTTP) the corporation is allowed distributions tax free to the extent of AAA. These distributions decrease the owner's basis in the stock. Note – lack of clarity what happens to unused AAA if re-elect S status down the road.
- After PTTP closes, distributions are treated as pro-rata coming from AAA and E&P for an eligible S-Corp (same ownership proportions as S-Corp when C-Corp).
- PTTP generally ends on later of one year after S-election revocation or due date for filing the final S-Corp return including extensions.
- Plan for future cash distributions to owners (beware, second layer of tax).
- Future plan to exit the business (beware, second layer of tax).
- Must remain C-Corp for five tax years.
- Must consider built-in-gains tax consequences for 5 years post re-electing S-Corp status.

Below is a chart comparing the pre and post TCJA impact of an S- and C-Corporation:

		S-Corporation		C-Corporation	
		Pre-Tax Law	**Post-Tax Law**	**Pre-Tax Law**	**Post-Tax Law**
Qualified Business Income		$1,500,000	$1,500,000	$1,500,000	$1,500,000
DPAD	**9.0%**	(135,000)		(135,000)	
199A Deduction	**20.0%**		(300,000)		
Net Taxable Income		$1,365,000	$1,200,000	$1,365,000	$1,500,000
Tax Rates		39.6%	37.0%	34.0%	21.0%
Tax Expense		$540,540	$444,000	$464,100	$315,000
Tax on Distribution of Income/Dividend				$207,180	$237,000
Total Tax		$540,540	$444,000	$671,280	$522,000
Effective Tax Rate		36.0%	29.6%	44.8%	36.8%

Note: The Trump administration has floated the idea of further reducing the corporate income tax rate. Discussions indicate the new rate could be as low as 15%. These are just proposals at this time.

Tax Planning Tips Around Net Operating Losses, Bonus Depreciation, and Section 179

NOL Changes

The Tax Cuts and Jobs Act significantly changed the way NOLs generated in 2018 and beyond are treated. NOLs generated in 2018 are only able to be carried forward indefinitely. Also, NOLs can only offset 80% of taxable income. The CARES Act passed in 2020, updated the Net Operating Loss rules, by allowing a 5-year carryback and removing the 80% of Taxable Income Rule. This applies to NOLs only from 2018, 2019 or 2020.

After 2020 and moving forward, the treatment of net operating losses reverts to the rules provided by TCJA for which NOLs can only be carried forward and carry backs are not allowed. Additionally, an NOL can only offset 80% of taxable income for losses carried over from post 2017 tax years. This includes remaining losses generated in 2018-2020. This means that you cannot shelter 100% of your regular taxable income.

Bonus Depreciation Changes

The TCJA brought some major changes to the treatment of bonus depreciation. First, the bonus depreciation amount increased from 50% to 100% acquired after September 27, 2017, through 2022 and will phase down to zero over a 5-year period after that. Secondly, the TCJA removed the requirement that the original use of qualified property must commence with the taxpayer. In other words, new AND used assets are eligible for bonus depreciation. Bonus depreciation is 60% for 2024 and drops to 40% for 2024. It is also important to consider varying state treatment for bonus depreciation as many states have decoupled from the federal law for these deductions.

Section 179 Changes

Section 179 is still allowed on both new and used property. The maximum deduction increased from $500,000 to $1,000,000 (indexed for inflation). Plus, the phase-out threshold increased from $2,000,000 to $2,500,000 (indexed for inflation). **The maximum deduction is $1,220,000 and the deduction begins to phase out at $3,050,000** and is fully phased out at $4,270,000 for 2024. It is also important to consider varying state treatment for increased Section 179 limits as many states have decoupled from the federal law for these deductions.

Tax Planning Tip: Since Congress heavily expanded the use of bonus depreciation, we foresee many taxpayers having a very high tax depreciation expense. In many circumstances, the use of bonus depreciation will likely cause a taxable loss, therefore generating a net operating loss. Since NOLs can no longer be carried-back and can only offset 80% of future taxable income, we recommend using Section 179 as a tool to limit the NOL generation and generate a section 179 expense carry forward. Section 179 expense carry forward will offset future taxable income dollar for dollar, while the NOL may only offset 80% of taxable income.

Pass-Through Entity (PTE) Tax Elections

On an individual basis, state and local governments have enacted a pass-through entity (PTE) tax as a potential work around to the Tax Cuts and Jobs Act's (TCJA) $10,000 state and local tax deduction limitation. More than 35 states along with one locality (New York City) have adopted the PTE tax. Reviewing applicability of this process for the multi-state contractor can be key in determining if any benefit exists. States vary on their timing, eligibility, and formality of their PTE tax program.

Eligibility and application of the PTE tax varies from state to state at both the entity and individual level. Care should be taken to evaluate all the applicable rules to determine the impact. For example, some states do not allow resident taxpayers to include PTE taxes paid on their behalf in calculating the credit for taxes paid to other states. For taxpayers in these taxing jurisdictions, the PTE tax paid to a non-resident state could result in a dollar-for-dollar state tax liability in exchange for up to a $.37 federal tax deduction.

Information on states with enacted or proposed pass-through entity level tax statutes can be found here: https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/56175896-pte-map.pdf

Inflation Reduction Act of 2022

In July 2022 the Inflation Reduction Act was enacting promoting investment in clean energy, reductions in carbon emissions and extends popular Affordable Care Act premium reductions. The bill is being paid for through the implementation of a 15% corporate minimum tax, budget increases to bolster the IRS to close the 'tax gap', excise tax on stock buybacks, and changes to Medicare rules. No new business taxes were proposed on pass-through entities or families making less than $400,000.

A few additional proposed details of interest to Contractors are that the corporate minimum tax would go into effect for tax years beginning in calendar year 2023 and would equal 15% of the corporation's 'adjusted financial statement income' for the tax year. The tax would only apply to covered corporations with average annual adjusted financial statement income in excess of $1 billion for the three prior tax years. A covered corporation is a corporation whose stock is traded on an established securities market. This would not apply to S-Corporations.

The Investment Tax Credit (ITC)

The Contractor should continue to monitor opportunities arising from clean energy, climate change and tax credit space of the bill. Specifically impacting the Contractor, the Act expands two key Federal energy efficient tax incentives currently in existence, the **179D Energy-Efficient Commercial Building Deduction** and **45L Energy-Efficient Home and Multifamily Tax Credit,** with expanded credits and applicability starting in 2023. It is vital for the Contractor to review the applicability on these incentives with the work performed. Congress has provided further signals that opportunities in the construction industry from the Inflation Reduction Act will directly evolve around the energy and climate provisions of the legislation, to further promote, expand, and incentivize actions around the design, development and construction of energy efficient property.

The Investment Tax Credit is available to those who install qualified energy property, such as solar panels or geothermal heat pumps. The credit is a percentage of the qualified energy property basis, or 6% at the base rate. If the project meets prevailing wage & apprenticeship requirements or generates less than 1 MW of electricity, the credit increases to a bonus rate of 30%. Additional value (base = 2%/bonus = 10%) can be added on for meeting domestic content, energy community, or low-income community requirements. If a project meets all requirements, a maximum credit of 70% can be achieved.

The Inflation Reduction Act also introduced new rules that allow government and tax-exempt entities to benefit from this tax incentive. These entities can claim the credit through the direct pay method, which would allow them to receive a check from the Treasury in the amount of the credit. In addition, these credits can be transferred or sold to eligible buyers.

Energy Efficient Commercial Buildings Deduction (Section 179D)

The Energy Efficient Commercial Buildings Deduction is a tax deduction available to those who install HVAC and hot water, interior lighting, or building envelope systems into new or existing commercial buildings. The Section 179D program is eligible for a base rate of $0.50 – $1.00 per square foot. If prevailing wage and apprenticeship requirements are met on the project, the deduction increases to $2.50 – $5.00 per square foot. The deduction amount is determined through an energy modeling analysis, which compares the building to a baseline standard as outlined in ASHRAE 90.1-2007. An alternative method was introduced by the IRA, which determines a deduction based on a before-and-after look of a building that underwent an energy-efficient retrofit.

Section 179D is available to taxpayers who newly construct or renovate their existing properties. Architects, engineers, and contractors can also claim this deduction for work performed on government or tax-exempt buildings.

Prevailing Wage & Apprenticeship Requirements

Prevailing wage & apprenticeship requirements impact many of the incentives included in the Inflation Reduction Act. Complying with these requirements means significantly larger incentives. To comply, all laborers and mechanics employed by the taxpayer, or their contractors, must be paid prevailing wages in the location of the project. For the ITC, this includes alteration or repair projects that occur 5 years after the initial project.

In addition, all eligible projects must participate in registered apprenticeship programs. A percentage of the total labor hours should be worked by qualified apprentices. The total apprentice labor hours in 2023 should equal 12.5% or more of the total hours. This percentage increases to 15% for projects begun in 2024 or later.

It's important to identify potential projects early to maximize the benefit from these incentives. Taxpayers and their CPAs should be discussing future plans to implement new construction or energy efficient projects. Cost segregation studies or clean energy loans, such as C-PACE, are good indicators that other incentives may be available to claim. Involve a trusted tax incentive specialist early who can further identify eligible projects and educate the team on the requirements. In the case of Section 179D other licensed individuals, such as a Professional Engineer, are required to certify the tax deduction. Having an experienced team of professionals will ensure a smooth and compliant tax incentive process.

Section 45L, the new energy efficient home credit, is a valuable tax incentive available to eligible contractors who construct energy efficient homes. 45L was originally enacted in the Energy Policy Act of 2005 but expired at the end of 2021. Thankfully the Inflation Reduction Act recently extended and enhanced the expired 45L credit, allowing taxpayers to claim up to $5,000 per dwelling unit through the end of 2032.

See the *Inflation Reduction Act Incentives* blog found at www.cicpac.com for additional details on who qualifies for the 45L tax credit, what projects are eligible, how much can be claimed, and the requirements to claim the 45L Tax Credit.

Mobile Workforce Considerations

With the increasing mobility of the Contractor's workforce, a few changes, and reminders for consideration for 2023:

- For 2024, the IRS increased the standard business mileage rate to 67 cents per mile.
- Contractors should continue to monitor and follow the U.S. General Services Administration per diem rates which are reset each fiscal year starting October 1st.
- Business meal expense provided by a restaurant, that were 100% deducible in 2021 and 2022, revert back to 50% deductible in 2023.

For a more detailed reminder on current mobile workforce considerations and best practices, please see the CICPAC issued *Mobile Workforce Guidelines* whitepaper found at www.cicpac.com.

Opportunity Zones

The Opportunity Zone Program is an effort by the Federal Government to spur new or increased investments in low-income communities. It is based on 25% of the census tracts identified as 'Low Income Communities' by the Community Development Financial Institutions Fund (CDFI Fund), a division of the US Department of the Treasury.

The program offers a tax incentive for investors by allowing them to contribute their capital gains within 180 days of the sale into Opportunity Funds. Under the program, if a capital gain is invested in a Qualified Opportunity Fund within 180 days of realizing the gain, then the gain is not included in income until the investment is sold, or December 31, 2026, whichever is sooner. There are three potential separate tax benefits – (1) temporary deferral, (2) permanent exclusion of either 10% or 15%, or (3) permanent exclusion of post-acquisition appreciation.

The investor can contribute their capital gain in a Qualified Opportunity Fund within 180 days of the sale, then the tax due on the gain can be deferred for as long as eight years, decreasing the gain by up to 15% and escaping tax on future appreciation if held at least 10 years. There are roughly 8,700 opportunity zones throughout the United States.

Requirements:

- Must be certified by the US Treasury Department.
- Must be organized as a corporation or partnership for the purpose of investing in Qualified Opportunity Zone Property.
- Must hold at least 90% of their assets in Qualified Opportunity Zone Property.

- Qualified Opportunity Zone property includes newly issued stock, partnership interests, or business property in a Qualified Opportunity Zone business.
- Opportunity Fund investments are limited to equity investments in businesses, real estate, and business assets that are located in a Qualified Opportunity Zone.
- Loans are not eligible for tax incentives.
- Opportunity Fund investments are subject to a substantial rehabilitation requirement.

Although the permanent exclusion benefits have lapsed, the permanent exclusion of post-acquisition gain is still available for qualifying investments in Opportunity Zone through the expiration of the program in 2026.

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