Strategic Tax Planning for Construction Business Owners

How to position yourself for success in 2024

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As the new year unfolds, construction business owners must pivot their focus to a critical task: tax planning. The landscape for 2023 was shaped by legislative updates from the last few years that may still substantially influence tax obligations. It is essential for construction business owners to engage in comprehensive discussions with their tax advisors to navigate complex tax laws.

Typically, year-end tax planning provides an opportunity not only to discuss tax matters but also to consider broader financial implications stemming from non-tax developments. This is particularly relevant as we enter an election year and as the details of potential legislative changes remain uncertain.

Looking Ahead

Several key provisions of the Tax Cuts and Jobs Act (TCJA) are set to expire or "sunset" after 2025, and business leaders should be cognizant of these timelines. Now is the time to understand those implications and consider strategies to help mitigate the potential tax risks. Some of the key provisions expiring include the following: individual tax rates reset to higher rates, the standard deduction reset to a lower amount, and the gift and estate tax exemption reset to a significantly lower amount.

Due to the increase in tax rates and lower standard deduction, contractors may want to consider accelerating income to take advantage of the lower tax brackets and higher standard deduction. In an effort to mitigate potential tax risks, contractors whose estates exceed the existing exemption amount ($12.92 million for 2023) should pay particular attention to estate planning strategies.

2023 & 2024 Pressing Issues

While it is important to look ahead, several pressing issues face business owners regarding the 2023 and 2024 tax years. These include optimizing bonus depreciation for property, conducting cost segregation studies, understanding the expanded 45L energy tax credit and the 179D commercial buildings energy-efficiency tax deduction, reviewing accounting methods for contracts, and understanding the IRS' focus on the employee retention tax credit (ERTC).

Bonus Depreciation for Property

The TCJA allowed for 100% bonus depreciation for various construction-related assets, such as heavy machinery, equipment, furniture and certain vehicles with a recovery period of 20 years or less. In 2023, the bonus depreciation decreased to 80%, and will decline 20% each year after. Therefore, in 2024, the bonus depreciation will be 60%. Capitalizing on these available deductions calls for detailed cost segregation studies to ensure maximum tax benefits.

Taxpayers stand to benefit from cost segregation more than ever, which allows them to assign assets properly to their class life. This allows for higher deductions when assets are designated to lower-class lives based on their appropriate qualification, because additional assets qualify for bonus depreciation.

Cost Segregation Studies

Cost segregation studies dissect property


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components to assign specific tax lives, leading to accelerated depreciation benefits. Instead of depreciating commercial property over 39 years, this study will break down the building into subcomponents, reclassifying 39-year property into property classes with depreciable lives of 15 years or less. These studies are particularly valuable now given the phased-out reduction of the bonus depreciation. Conducting a study can be advantageous for properties acquired or modified in the last few years.

45L Energy Tax Credit

The Inflation Reduction Act (IRA) introduced an expansion of Section 45L — new energy efficient home credit — that is available to qualifying owners and builders of single-family, multifamily and manufactured homes. The updated and expanded 45L program makes the credit available to a greater number of taxpayers by eliminating the restriction to properties not higher than three stories. The expansion also increased the amount of the credit available per unit from $2,000 to $5,000 starting in 2023. Contractors can qualify for the credit in the year an apartment is constructed or sold as a residence as long as that property is certified under one of the Energy Star or Zero Energy Ready Home programs.

179D Commercial Buildings Energy-Efficiency Tax Deduction

The IRA bolstered the 179D deduction for commercial buildings. Prior to the IRA, this deduction offered owners and developers of commercial buildings a deduction of up to $1.80 per square foot if they qualified based on energy efficiency criteria. Post-IRA, the 179D deduction increased to $5 per square foot. To qualify for the 179D deduction, prevailing wages and apprenticeship requirements must be met along with energy standards.

Accounting Method Changes

Most contractors file under IRC 460, which addresses long-term contracts and primarily reports on the percent of completion (POC) accounting method. However, contracts should be looked at individually to determine if other beneficial reporting methods exist for tax purposes, and IRC 460 has multiple exceptions. It is imperative to address this sooner rather than later, as many exceptions require filing a request for accounting method change with the IRS. Home construction contracts and residential contractors are examples of the exceptions.

IRS Announcements Concerning the ERTC

The IRS has increased scrutiny over ERTC claims due to widespread abuse. For construction businesses that may have been misled into filing inaccurate claims, the IRS offers a withdrawal process to avoid potential penalties and interest. A proactive review of ERTC claims is recommended to maintain compliance.

It is time to reflect on the successes and learning experiences of 2023. Identifying the strategies that yielded positive outcomes and pinpointing areas for improvement are critical steps in preparing for the remainder of 2024. With the right planning and professional advice, construction business owners can position themselves for continued growth and success in the new year. ▲