Strategic Tax Planning for Contractors in 2024

Marcum's Brian Marron on building a solid financial foundation

by Brian Marron

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As 2023 financial statements and tax returns are finalized, it's time for contractors to shift their focus to the current tax year of 2024 and beyond. In a competitive industry like construction, it's crucial to adapt continuously to ensure your company is in the best possible position for current and future success. By having the right software and technology for accurate data interpretation, implementing a solid succession plan and strategizing income tax planning to reduce taxes, you'll build a solid foundation for your company's success and take charge of your financial future.

Tax Planning & Credits

Accounting for Long-Term Contracts

When considering year-to-date company profits for quarterly tax projections, it's essential to discuss your current accounting method with your tax accountant to better understand the potential methods or exceptions that can better help your tax position. The construction industry is unique, and the tax code allows very specific treatment of certain long-term contracts, with many exceptions to the primary percentage of completion (POC) reporting method. Many contractors are unaware that some of these tax options may be available. By maximizing the tax position of contracts, you can help improve cash flow and keep cash on hand for better use within the company. It is imperative that your accountant has experience with the construction industry, as the tax code has many intricacies in this area. Experienced accountants will understand that the code allows for the filing of a request for an accounting method change with the IRS and the potential impact of the alternative minimum tax (AMT).

179D Deduction

179D is a deduction for energy-efficient construction or building improvements to commercial buildings. As of Jan. 1, 2023, the maximum deduction is $1.8 per square foot, but it can now be a maximum of $5 per square foot if prevailing wage and apprenticeship requirements are met. This is a significant opportunity for many contractors. For example, a 100,000-square-foot project may yield a contractor an additional $500,000 deduction.

Understanding this and knowing how to obtain this credit is critical. For contractors that can address energy efficiency on their projects, 179D likely represents a significant advantage.

R&D Tax Credit

Construction companies may be eligible for research and development-related credits if they perform design-build contracts or continuously experiment to improve processes and techniques. Under current law, the IRS requires capitalizing research and development (R&D) expenses over five years. Still, if the Tax Relief for American Families and Workers Act of 2024 passes, those R&D expenses will no longer need to be capitalized through Dec. 31, 2025. This is a tax credit on items the contractor has already paid for, and provided the contractor qualifies, they can use this credit to apply to taxes owed on the company's profit.

Bonus Depreciation vs. Section 179 Expense

The phase-out of bonus depreciation, which started at 100% depreciation deduction after the Tax Cuts and Jobs Act (TCJA) of 2017, dropped to 80% in 2023. Any fixed assets placed in service from Jan. 1, 2024, through Dec. 31, 2024, will now only be eligible for 60% bonus depreciation. As this bonus phase-out continues, it is even more important to determine if the section 179 expense should be used as an alternative to the bonus. The section 179 expense for eligible assets remains at 100%. However, there are limitations on how much is allowed in 2024 ($1,220,000 with a capital purchase limit of $3,050,000), and the 179 expense can only be utilized to the extent of taxable income. Because bonus depreciation is not subject to these limitations, it may make sense in specific scenarios to still use the bonus. Before making any assumptions, an analysis should be done to consider all state tax implications of each option.

Also, remember that an extension of the 100% bonus depreciation has not been completely ruled out, and is another item included in the Tax Relief for American Families and Workers Act of 2024.

Estate & Succession Planning

Most companies have formal business plans, but few have an equally important succession plan, especially if a retirement-age leader is at the helm and a successor has yet to be identified. Determining a succession plan, how to implement it and when to start the transition are all decisions that must be made in advance. If the current leader plans to sell, there are several approaches to structure a sale that best fits the new and old leadership alike.

Buy-sell agreements, private annuities and self-canceling installment notes are just a few ways to structure sales. Sometimes, family-owned businesses may want to transition leadership to the next generation. Even if the next generation does not have the skills required to take over the company immediately, there are ways to gift or sell that hand over the reins gradually as the new appointee becomes more comfortable managing the business independently. With the lifetime estate exemption still high ($13,610,000 for a single individual) in 2024, gifting business interest outright or using trusts could be one way to maximize the value from an estate planning and succession perspective. The 2024 exemption of $13,610,000 is set to expire at the end of 2025, so it is crucial to take advantage of the current exemption. The intent and goals of every business owner are unique for each company.

Business owners should seek assistance from their accountant or other professional advisors to determine the best fit for their situation.

Assess Technology & Software

It is no secret that technology is constantly improving; most technologies or software programs that were brand-new to the market just a few years ago are getting leapfrogged by the next latest and greatest versions. Whether these technologies are used by your internal accounting team or in the field, they can significantly impact decision-making and analysis compared to outdated technologies or processes. The most important software for internal operations is an enterprise resource planning (ERP) solution. ERPs should integrate all aspects of your business processes and applications, from accounting and inventory/equipment tracking to supply chain operations and performance management. In the field, project management software exists for time tracking, equipment utilization and live reporting of crucial information to make on-site decisions. These scratch the surface of the options available to construction companies in today's market.

It is hard to know what you could benefit from if you are unaware of the available tech. As you read this, you may be thinking of a report or data you lack today that you wish you had available for decision-making and analysis; there is a good chance that it can be done with the right tools. Speaking with someone who understands your business and the available technologies is a great way to assess your current position and what could help your competitive outlook.

These strategies serve as critical pieces of a comprehensive approach to proactive tax planning for contractors. Each element, though distinct, contributes to a construction company's overall financial well-being and operational efficiency. While it is still early in the year, addressing these issues will leave enough time to design and implement any changes by year-end.

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