

# Tax tips for the construction industry

The flurry of recent tax legislation and the lingering effects of the economic downturn make this tax planning environment one of the most challenging in recent memory. Contractors need to do what they can to improve cash flow by effectively managing their tax burdens and leveraging any available new tax incentives. Tax planning over the next two years will require thoughtful and nimble analysis. Construction contractors should keep in mind the following tax tips:

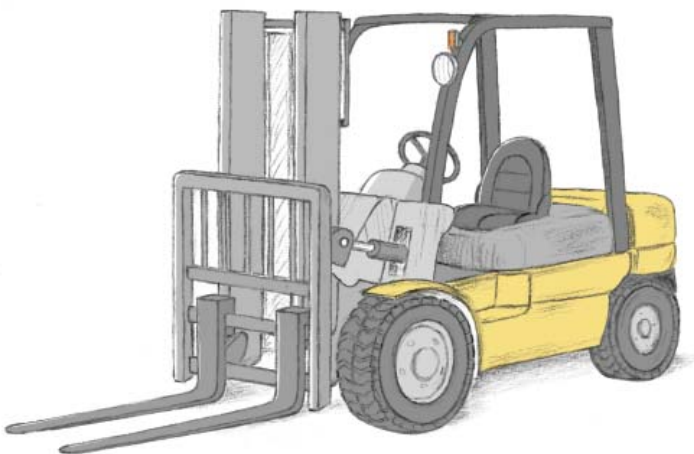
**1. Double bonus depreciation – full expensing!** Lawmakers have extended and doubled bonus depreciation, allowing full expensing for many assets placed into service through 2011. Property qualifying for bonus depreciation that is placed in service after Sept. 8, 2010, and through the end of 2011 will be eligible

for full 100 percent expensing. Property placed in service in 2012 (or in 2010 before Sept. 9) will be eligible for 50 percent bonus depreciation, which allows a deduction for half of the cost of qualifying property in the first year of use, and then depreciation for the remaining half of the asset over its normal useful life. New property with a depreciable life of 20 years or less generally qualifies for bonus depreciation, so five-year construction equipment (the most common tax life for construction equipment) will qualify.

**2. Review deferred compensation plans.** Most contractors are struggling to remain profitable in this difficult environment. If your company cannot afford large bonuses to retain key employees, now is the time to re-visit alternative compensation arrangements. Nonqualified deferred compensation plans give employers the ability to pick and choose which employees to cover, but must comply with a strict set of rules under Section 409A or risk substantial penalties. These plans are often limited to key employees, and when properly drafted can provide incentives that align with a contractor's strategic plan and provide employees a powerful incentive to remain with the company.

**3. Certain S corporations should consider taking gains in 2011.** If you converted to S corporation status in 2004 or 2005, consider sales of "gain" property in 2011. S corporations are pass-through entities that are normally subject to only a single level of tax. But C corporations that convert to S status will normally pay a second corporate level of tax on built-in gain property that they sell during their first 10 years as an S corporation. Special provisions enacted over the last two years provide a reduced seven-year period for sales that take place in 2009 or 2010 and a five-year period for sales of property during 2011. So C corporations that converted to S status during the period from Jan. 1, 2004, through Jan. 1, 2006, can avoid the second layer of tax on built-in gains through asset sales in 2011.

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#### 4. Take full advantage of capital asset expensing deductions.

Rules originally intended for small businesses were significantly expanded to allow contractors to expense up to \$500,000 of 2010 fixed asset costs, provided less than \$2 million of assets were placed in service throughout the year. Unlike bonus depreciation, this applies to new or used assets. However, this deduction cannot be taken if a contractor is already in a tax-loss position.

Also, a new aspect of this deduction was introduced for 2010 and 2011, whereby certain real property can be included electively. Be aware, however, that making this election increases the possibility that some or all of the expensing deduction can be phased out.

#### 5. Determine whether your company can lower property taxes.

A property tax review can ensure that real and intangible property is excluded from the personal property tax base. In addition, there may be opportunities to lower the property tax valuations on real property. The review would not only generate savings in the first year, but also in future years.

#### 6. Examine capital asset depreciation methods and lives.

Depreciating fixed assets is one of the most complex aspects of tax law. Understanding and properly applying these rules can accelerate income tax deductions, and these deductions often add significantly to the current tax flow. For contractors who have underreported prior depreciation, recent IRS guidance allows “catch-up” deductions with an automatic change in accounting method.

**7. Consider establishing a separate entity to own and lease fixed assets used in the business.** Often referred to as leasing or procurement companies, these entities help manage assets and may significantly reduce sales and use tax, which is collected and remitted regardless of whether a company is profitable.

**8. Maximize Section 199 deductions.** The Section 199 domestic production activities deduction is a unique tax incentive available to most contractors. This incentive allows taxpayers to deduct nine percent of qualifying production activities, which includes the construction or substantial renovation of domestic real property. A full nine percent deduction can reduce your effective federal tax rate by about three points, from a maximum of 35 percent to 32 percent. However, it is a complex area of tax law and the IRS has elevated the issue to its highest level of scrutiny. Check with a trusted tax adviser to make sure that you are taking full advantage of this deduction within the allowable guidelines.

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