

# 10 tax tips for the construction industry

Contractors are coming off what has to be one of the most dramatic decades in history. Bookended by 9/11 and a severe recession, with boom years in the middle, the past 10 years have challenged the resources of even the most financially solid and best-run companies. Recently enacted stimulus bills offer new tax-saving opportunities, while current budget deficits and the change of administration portend tax increases. Contractors need to do what they can to maximize cash by effectively managing their tax burdens and protecting themselves against tax increases and assessments. With 2010 ushering in a very uncertain tax climate, construction contractors should keep in mind the following tax tips:



## 1. Make the most of your net operating loss deduction.

Recent tax legislation opens up opportunities for taxpayers of all sizes to choose an extended carryback period for net operating losses (NOLs). This provision allows contractors who have NOLs to choose a five-year, four-year or three-year carryback period (increased from the normal two-year rule) for NOLs incurred in a tax year beginning or ending in 2008 or 2009. Keep in mind, however, that only a single year can qualify for this enhanced carryback period. Taxpayers with NOLs in two or three qualifying years need additional analysis to maximize their cash refunds.

**2. Take a hard look at bonus depreciation deductions.** As an incentive for investment in equipment, taxpayers are allowed to deduct half of the cost of 2009 qualifying property in the first year of use, and then depreciate the remaining half of the asset over its normal useful life. For five-year equipment (the most common tax life for construction equipment), this allows a deduction of 60 percent of the asset's cost in the first year of its life. For contractors in a tax-loss position, this deduction increases NOL carryback opportunities. However, pass-through entities such as S corporations or LLCs should be aware that significant individual income tax increases are possible, which may make depreciation deductions worth more in the future. Careful planning is required to make sure this deduction is right for you.

**3. Analyze the business structure.** For decades, tax experts have advised their contractor clients to organize as pass-through entities. Alignment of corporate and individual tax rates, combined with the ability of an individual investor to minimize capital gains on the sale of a business, made this a solid tax strategy. However, current deficits and potential tax changes may alter this landscape. In the current tax climate, significant future individual tax increases are very possible, while corporate rate increases are unlikely. As a result, contractors should look at their business structure with an eye toward potential restructuring. The benefits of restructuring may include reducing taxes, reducing liability risks and aligning structure with business profit drivers.

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#### **4. Consider future capital gains and dividend tax rate**

**increases.** Under current law, capital gains and qualified dividends are taxed at a favorable 15 percent federal income tax rate. This preferential treatment is scheduled to expire at the end of 2010 and individuals (absent a law change) will face higher taxes on these items in 2011. Taxpayers with significant capital gains transactions should work with tax advisers to analyze whether accelerating capital gains and dividends into 2010 is a prudent tax move.

#### **5. Take full advantage of capital asset expensing deductions.**

Rules originally intended for small businesses were significantly expanded to allow contractors to expense up to \$250,000 of 2009 fixed asset costs, provided less than \$800,000 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.

#### **6. Determine whether the 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.

#### **7. 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 methods.

**8. Review deferred compensation plans.** Contractors who struggle with profitability often cannot revert to past practices of awarding large bonuses to retain key employees. This is the time to look at additional benefits besides profit-sharing and 401(k) plans. Nonqualified plans can give employers the ability to pick and choose which employees to cover. Often limited to key employees, a properly drafted plan can provide incentives that align with a contractor’s strategic plan and provide employees a powerful incentive to remain with the company.

**9. 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.

**10. Consider not deferring income.** The traditional wisdom of deferring income for tax purposes deserves another look. With many government entities looking for increased tax revenues, new tax policies and rate increases are very possible. At the current time, individual taxpayers are a target. With tax increases scheduled for 2011, taxpayers would be well-advised to consider whether deferring taxable income is still the most cash-efficient option.

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#### **Contact information**

**Todd Taggart**  
National Construction  
Practice Leader  
T 612.677.5193  
E Todd.Taggart@gt.com

**Alvin Wade**  
National Managing Partner,  
Construction, Real Estate and  
Hospitality practice  
T 214.561.2340  
E Alvin.Wade@gt.com

[www.GrantThornton.com](http://www.GrantThornton.com)

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