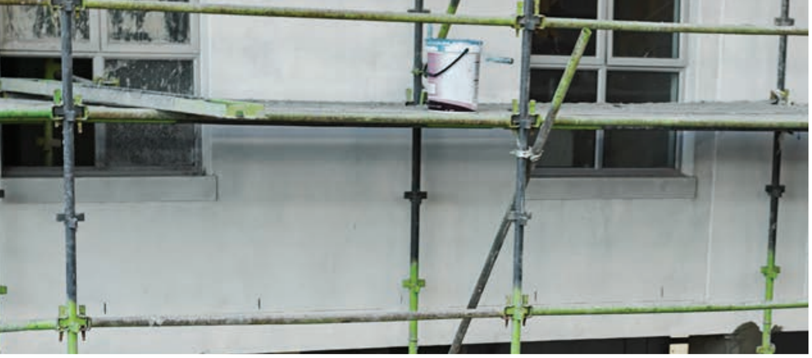

CONTRACTOR

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ACT NOW TO MAXIMIZE DEPRECIATION-RELATED TAX BREAKS FOR 2022

Construction business owners, we're heading into fall. The end of the year will be here before you know it. That makes this a critical time to seriously consider buying any assets you've had your eye on so you can take advantage of potentially hefty depreciation-related deductions when you file your 2022 federal tax return.

Current tax law allows two particularly valuable deductions on purchases of equipment, tools, machinery and other assets essential to construction companies. But you'll need to move fast to make the most of them.

With continuing supply chain issues, labor shortages and other delays, you could face challenges in making the types of purchases that can reap big tax savings — especially with one of the deductions set to begin phasing out in 2023.

Section 179 expensing

Section 179 of the Internal Revenue Code is technically an expensing provision. It allows eligible businesses to deduct 100% of the purchase price of new and used eligible assets for the year in which the assets are put into service. That's one of the reasons why you might want to place orders for certain equipment sooner rather than later. Used assets qualify for the deduction only if they haven't been used by the taxpayer or a predecessor at any time before acquisition.

Eligible assets include:

- Machinery,
- Office and computer equipment,
- Software, and
- Certain business vehicles (for example, heavy construction vehicles).

Under the Tax Cuts and Jobs Act, you can also claim a Sec. 179 deduction for improvements to nonresidential real property — including roofs as well as systems related to HVAC, fire protection and security.

The maximum Sec. 179 deduction for 2022 is $1.08 million. It begins phasing out on a dollar-for-dollar basis when your qualifying property purchases exceed $2.7 million. In other words, you can't take the deduction if the cost of your Sec. 179 property placed in service during the year is $3.78 million or more.

Your maximum deduction is also limited to the amount of income from business activity. Any cost not deductible in the first year because of this limit can be carried over to the next year for an unlimited number of years. You must, however, deduct carried-over costs from the earliest year before you deduct costs from the next year.

The Sec. 179 deduction isn't automatic. You must elect it on an asset-by-asset basis on IRS Form 4562, "Depreciation and Amortization (Including Information on Listed Property)."

ACCELERATED DEPRECIATION ISN'T ALWAYS BEST

Taking accelerated depreciation tax breaks such as Section 179 expensing and bonus depreciation (see main article) provides some clear advantages for construction businesses making asset purchases. But, in some situations, taking standard depreciation could prove preferable.

For example, you might want to skip accelerated depreciation if you claim the qualified business income (QBI) deduction for pass-through entities such as partnerships and limited liability companies. The amount of the deduction is limited by your taxable income, and depreciation reduces such income. The QBI deduction is set to expire after 2025, so it might make more sense to take this tax break while you can.

Other tax breaks also hinge on taxable income. Expiring net operating losses, charitable contributions or credit carryforwards might suggest a different approach.

Last, you might have second thoughts about Sec. 179 and bonus depreciation if you expect to land in a higher tax bracket in the future. The value of any deduction is based on how much it can cut your tax bill — therefore, a deduction is worth more when you face a higher tax rate.

Bonus depreciation

An additional first-year depreciation deduction provided under Section 168(k) of the tax code has long been called "bonus depreciation." And it's still available. Most businesses can apply this form of depreciation to eligible purchases that exceed Sec. 179 limits. Bonus depreciation isn't subject to any limits or phaseouts.

For 2022, you can deduct 100% of the cost of new and used (subject to certain conditions) eligible property, assuming it's placed in service by year-end. That percentage will begin to fall in 2023, dropping 20% each subsequent year. Absent congressional action, bonus depreciation will be eliminated entirely in 2027.

You can take advantage of bonus depreciation by buying assets such as computer systems, software, vehicles, machinery, equipment and office furniture. It's also available for qualified improvement property — generally, interior improvements to nonresidential real property — placed in service this year.

Note: A provision in the Coronavirus Aid, Relief, and Economic Security Act enacted in 2020 retroactively made qualified improvement property eligible for bonus depreciation. If you made such improvements in 2018 or 2019, you can claim a tax refund for the missed deduction.

The IRS automatically applies bonus depreciation to eligible property, but you can opt out. See "Accelerated depreciation isn't always best" above for details on why you might, under some circumstances, want to do so. If you elect to opt out, the election will apply to all qualified property in the same property class (for example, all five-year MACRS property) that's placed in service that taxable year.

The best path forward

The total amount you're allowed to deduct for depreciation of an asset is the same whether or not you accelerate under Sec. 179 or bonus depreciation. What's important is that you and your leadership team discuss which assets you really need to buy (don't make any purchase only for tax purposes) and, if you decide to move forward, which depreciation method is best. Your CPA can help you choose the best path forward. ■

NEED BETTER BENEFITS?

Look into a pooled employer retirement plan

Just like any other type of business, construction companies typically need to offer a solid benefits package to full-time employees. Failing to do so could mean falling behind in the race for talent in today's tight job market.

Yet construction businesses tend to operate under much more difficult cash-flow strains than other kinds of companies. This makes offering top-tier benefits difficult. The good news is, thanks to the Setting Every Community Up for Retirement Enhancement Act of 2019, a new type of retirement benefits plan is now available. It's called a pooled employer plan (PEP).

Strength in numbers

PEPs are a relatively new variation on an existing retirement plan model: multiple employer plans (MEPs). A MEP is a defined contribution retirement plan, typically a 401(k), maintained by two or more employers. The plan sponsor may be one of the participating employers or a third party, such as a trade association or professional employer organization.

> PEPs are treated like single employer plans for reporting, audit and other compliance purposes.

MEPs offer several advantages. Group purchasing power and other economies of scale tend to lower the overall cost of sponsoring the plan. Also, participating employers avoid time-consuming and often disruptive administrative tasks. Plus, they can shift some — though not all — of their fiduciary duties and liability exposure to the MEP sponsor.

That MEP sponsor is responsible for plan design and day-to-day management. It coordinates with various third-party service providers, handles compliance issues, and oversees annual audit and reporting requirements. The sponsor can also provide participating employers with access to expertise and advanced technology that the participants might otherwise be unable to afford.

Not all sunshine and roses

However, traditional MEPs have drawbacks. For one thing, to be treated as a single employer plan for reporting, audit and administrative purposes, a MEP must be "closed." That is, its members must share some "commonality of interest," such as being in the same industry or geographical location.

Employers that join "open" MEPs, which don't require a commonality of interest, are treated as if they maintained separate plans with their own reporting, audit and other compliance responsibilities. (Note: Certain smaller plans — generally, those with fewer than 100 participants — aren't subject to audit requirements.)

Another drawback of traditional MEPs is the "one bad apple" rule. Under that rule, a compliance failure by one participating employer can expose the entire MEP to the risk of disqualification.

The promise of PEPs

A properly designed PEP avoids both the commonality-of-interest requirement and the one bad apple rule. PEPs are treated like single employer plans for reporting, audit and other compliance purposes — even if they allow unrelated employers to join. One participating employer's compliance failure won't jeopardize a PEP's qualified status so long as the plan contains certain procedures for dealing with a participant's noncompliance.

PEPs are available from "pooled plan providers" (PPPs), which include financial services companies, insurers, third-party administrators and other firms that meet certain requirements. For example, PPPs must:

- Register with the U.S. Departments of Labor and the Treasury,
- Sign a written acknowledgement that they're the PEP's named fiduciary and plan administrator, and
- Ensure proper bonding of those who serve as fiduciaries or handle plan assets.

Although PEPs eliminate some of the obstacles that make traditional MEPs impractical for many companies, they're not without disadvantages. For instance, PEPs have limited flexibility to customize plan designs or investment options to meet the needs of specific employers and their employees.

Also, while one of the advantages of PEPs is cost savings, they may increase costs for participating

employers in one area. That's because small employers aren't subject to annual audit requirements, but PEPs are. So, small employers that join a PEP will have to bear annual audit costs they otherwise wouldn't, though these costs are spread out among participants.

Due diligence demanded

Does a PEP sound like a potentially good fit for your construction company? If so, be sure to do plenty of due diligence before joining one. Your legal, financial and benefits advisors can all help you make a sensible decision. ■

BABA GUIDANCE ADDRESSES INFRASTRUCTURE PROJECTS

Earlier this year, the federal Office of Management and Budget published guidance regarding the implementation of the Build America, Buy America (BABA) provisions of the Infrastructure Investment and Jobs Act (IIJA). The BABA provisions took effect May 14, requiring federally funded infrastructure projects to use iron, steel, manufactured products and construction materials produced in the United States.

The guidance was meant to help federal agencies apply BABA requirements and waiver processes for all federally funded infrastructure projects — not just those funded by the IIJA. However, construction companies intending to pursue federal infrastructure jobs should take note of them as well.

Important definitions

The guidance broadly defines "infrastructure." Under the provisions, the term refers to, at minimum, structures, facilities and equipment for U.S. roads, highways and bridges; buildings and real property; public transportation; and dams, ports, harbors and other maritime facilities.

Also covered are intercity passenger and freight railroads; freight and intermodal facilities; airports; water systems, including drinking water and wastewater systems; broadband infrastructure; utilities; and electrical transmission facilities and systems. In addition, agencies will treat as infrastructure the facilities and equipment that generate, transport and distribute energy — including electric vehicle charging.

The guidance defines "project" as the construction, alteration, maintenance or repair of infrastructure in the United States.

Materials sourcing

As mentioned, the BABA provisions mandate use of domestic materials. This includes:

Construction materials. All manufacturing processes for construction materials must occur in the United States. For iron and steel specifically, this applies to everything from the initial melting stage to the application of coatings.

Tools, equipment and supplies brought to the jobsite and removed at or before completion aren't subject to the provisions.

Manufactured products. A product must be manufactured in the United States. Furthermore, the cost of its components that are mined, produced or manufactured in the United States must be at least 55% of the total cost of all components. An exception may apply if another standard for determining the minimum amount of domestic content of the manufactured product has been established under applicable law or regulation.

Exempt items and waivers

Tools, equipment and supplies brought to the jobsite and removed at or before project completion aren't subject to the BABA provisions. Also excluded are equipment and furnishings — such as movable chairs, desks and portable computer components — that aren't an integral part of or permanently affixed to the structure.

What's more, waivers for some materials can be issued under certain circumstances. Requests must be in writing and will be available for public comment for at least 15 days. The guidance lists three types of waivers:

1. Public interest. This waiver could apply when the domestic content procurement "preface" is inconsistent with the public interest. In other words, important policy goals can't be achieved because of the BABA requirements. Several examples are provided, including international trade obligations.

2. Nonavailability. This one might apply when materials aren't produced in sufficient and reasonably available quantities or to a satisfactory quality.

3. Unreasonable cost. This waiver could apply when domestically made materials will increase the cost of the overall project by more than 25%.

Consider costs, logistics

If your construction company intends to bid on a federal infrastructure project, be sure that you and your leadership team familiarize yourselves with the BABA provisions. From there, carefully consider the cost and logistical impact of procuring the required materials.

BECOMING MORE CAPABLE AT DATA CAPTURE

Construction might not be as data driven as some other industries, but contractors still process plenty of information. And the speed and quality of your work depends on its accuracy and accessibility. For this reason, "data capture" has become a critical yet often overlooked capability of construction companies.

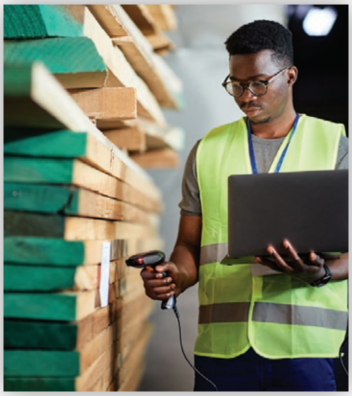
What's data capture?

Simply put, data capture is the process of extracting information from a physical source and converting it into a digital format. Digitization allows you to store, organize, search, retrieve and share information quickly, if not in real time.

In construction, recording project data and tracking progress and costs was traditionally a tedious, manual and error-ridden task. Pitfalls included double entries, lost or misfiled paperwork, and misinformation attributable to illegible handwriting.

Fortunately, most job-related information has become digital in the form of e-documents, PDFs, forms and templates, timecards, emails, and so forth. Electronic formats make it quick and easy to collect information using internet-enabled mobile apps.

In fact, you can choose from many solutions that automate data capture. Bar codes and QR codes, for example, help contractors manage inventory and equipment usage — especially if you can scan with a smartphone.



Another example is signature capture technology. It enables electronic signatures to authorize and track approvals, allowing for contactless delivery tickets that have become more widely used during the pandemic.

Meanwhile, cloud-based solutions allow remote users to view drawings, plans and specifications. Smartphones can take pictures and video, which can be quickly uploaded to project management websites. Unmanned aerial vehicles (commonly called "drones") can inspect jobsites and take pictures and videos, too.

How should you do it?

When it comes to data capture, what works for one construction company might not work for another. First, identify your mission-critical data and the documents where that information is recorded. These can include timecards, daily reports, work in progress reports or schedules, financial statements, equipment inspection reports, and safety checklists.

Next, train and equip the appropriate team members to optimally capture data. As mentioned, the right software and mobile apps can enable your employees to grab data as it's generated, record the information and share it while still on the jobsite.

Be careful not to "silo" data; that is, make it accessible only to a few people. Doing so can inadvertently create bottlenecks that lead to miscommunication and bad decisions. At the same time, you must secure your data so hackers and unauthorized users can't corrupt, steal or kidnap it in a ransomware attack.

Ready to get better?

The good news about data capture is you're already doing it! However, you've got to recognize the importance of this tech-related task and continuously improve at it. ■

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- We develop **relationships with lenders and bonding agents** and understand how to present your financial picture in their preferred format.
- We assist you in **keeping a close eye on debt, cash flow, profit margins** and other measures of financial health.
- We prepare **contracts in progress** schedules that management can understand which clearly illustrate gross profit, job costing and over/under billings per job.
- We have highly trained staff with **expertise in construction accounting** who are detail oriented, but who do not lose sight of the larger goal which is to provide our clients with quality services to meet their many financial needs.

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