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Construction equipment management

DECIDING WHETHER TO RENT, BUY OR LEASE

It's a decades-old quandary for construction businesses, yet it remains relevant: Should you rent the equipment you need for one or more projects, buy it outright, or perhaps sign a lease? The right answer comes down to your circumstances and needs, which can vary throughout the year as you win bids and get to work. There are, however, some major factors to always keep in mind.

Renting: pros and cons

The most obvious appeal of renting equipment is that you don't need to make the large outlay of cash typically required when you buy or lease, whether as a down payment or the full purchase price.

Renting also empowers you to compete with larger construction businesses that may have their own fleets of top-of-the-line equipment. You can pursue big or specialty projects that require assets that would be inefficient, from either a cost or storage perspective, to buy or lease.

In addition, renting allows you to choose the exact piece of equipment needed rather than make do with an owned asset that's not quite right. Plus, you'll be able to use more up-to-date equipment and "test drive" it to see if you'd like to eventually own or lease it.

What's more, many construction businesses are happy to avoid the hassle and cost of equipment maintenance — especially if they don't employ dedicated staff members for this purpose. When a rented asset breaks down, the rental company will typically repair or replace it.

Renting isn't always the best bet, however. It might not be advisable for equipment you'll use for more than a year, as the payments can add up over time. Some contractors charge rental costs back to project owners, but doing so can risk having bids rejected. Renting also leaves you at the mercy of the market — if an item is in heavy demand, you might not be able to get one.

Plus, though you can deduct rental costs as a business expense, you'll lose out on the depreciation-related tax breaks generally available for purchased assets.

Buying: pros and cons

Under the right circumstances, equipment purchases can make sense. Buying may be worthwhile for regularly used assets — such as excavators,

WHAT ABOUT LEASING?

If neither renting nor buying seems right (see main article), leasing represents a sort of hybrid option. Many contractors turn to leasing when they know they'll need a piece of equipment for an extended period (generally, at least a year), but they don't want to incur a substantial down payment or commit themselves to maintaining and storing the asset indefinitely.

Plus, leases can have attractive features. You might love an item so much you decide to buy it. If so, lease payments may be applied toward the purchase price if the agreement allows. Alternatively, you might be able to extend the lease at the now-lower fair market value or upgrade to a newer model.

Leases aren't without risk, though. If a project finishes early and you don't need the equipment anymore, you could have to pay a penalty to break the lease. In addition, some leases limit the number of hours you can use the asset.

Finally, if your construction business follows U.S. Generally Accepted Accounting Principles, a relatively new lease-reporting standard took effect for privately owned companies in 2022. It brings more accounting complexity to maintaining leases. The standard could also affect financial ratios that certain parties, such as lenders and investors, use to assess your construction company.

forklifts and trucks — because you'll likely get a return on investment as long as they're properly maintained. Having must-have equipment on hand also enables you to mobilize quickly and reduces the risk of project delays because of unavailable equipment.

Bear in mind that you're not limited to buying new equipment. Thanks to the internet, it's become much easier to find and purchase used construction equipment, some of which may even come with safety certifications.

And speaking of safety, purchased equipment may have an advantage there, too. Working on unfamiliar rented equipment can lead to injuries, a risk exacerbated by the ongoing skilled labor shortage. When you buy an asset, you can allow time to roll it out and train employees properly.

From a tax perspective, buying equipment may qualify you for those aforementioned depreciation-related tax breaks. For instance, under bonus depreciation, businesses can deduct a sizable percentage of the cost of eligible new or used assets in the year the item is placed in service. For 2024, this percentage is 60%; it will drop to 40% for 2025.

There's also the Section 179 depreciation deduction. It allows many small and midsized construction companies to write off the entire cost of some or all asset purchases on their federal income tax returns. But rules and limitations apply. Ask your CPA for help deciding whether and how to claim either depreciation-related tax break.

You're probably already aware of the biggest downside to buying equipment. It's pricey! There's usually a hefty down payment, which can negatively affect cash flow. And you'll have to deal with storage, maintenance and transportation costs. Rental companies will often deliver equipment to jobsites.

Further, it's worth noting that construction technology is rapidly evolving. You could buy an asset that rapidly becomes obsolete, or at least suboptimal, before you've even finished paying for it.

Invaluable resource

There's no doubt: Every successful construction business needs reliable equipment. The question is and always will be: What's the best way to get it? Again, your CPA can be an invaluable resource in finding the right answer. ■

THE FUNDAMENTALS OF TAX ACCOUNTING FOR CONSTRUCTION COMPANIES

For construction companies, the question of which accounting method to use for tax purposes isn't as straightforward as it is for other types of businesses. Let's review the fundamentals.

Basic options

The IRS requires businesses to choose and consistently apply a tax accounting method that clearly reflects their income. There are two commonly recognized approaches: the cash method and the accrual method.

Under the cash method, a taxpayer:

- Recognizes gross income (whether cash, property or services) in the tax year in which those items are actually or constructively received, and
- Deducts expenditures in the tax year in which they're actually paid.

The primary advantages of the cash method are its simplicity and better timing of cash flow with income tax payments.

> A major benefit of the accrual method is that it provides a more accurate matching of revenue and expenses.

Historically, most companies couldn't use the cash method if they maintained inventory; they had to use the accrual method. However, thanks to the Tax Cuts and Jobs Act, in 2024, taxpayers with $30 million or less in average annual gross receipts for the preceding three tax years are exempt from the required accounting for inventory and

mandated use of the accrual method. So, many more businesses, including construction companies, can now use the easier-to-manage cash method.

Under the accrual method, income is applied to the taxable year only when all the events have occurred that establish the right to receive the income, and the amount of the income can be accurately determined. Some entities, including C corporations and partnerships with a C corporation partner, must use the accrual method. (Your CPA can help determine whether your construction business falls under this requirement.)

A major benefit of the accrual method is that it provides a more accurate matching of revenue and expenses, as both are recorded when incurred, not necessarily when paid. This method can also allow additional tax planning opportunities through year-end accruals.

Long-term contracts

Here's where things get complicated. The IRS requires construction businesses (and others) to handle tax accounting differently for "long-term" contracts — that is, those not completed in the same tax year as started, regardless of the time needed to complete the job.

One option is the percentage-of-completion method. Here you report income according to

the percentage of the contract that's completed during the year. This percentage is most often calculated by comparing costs allocated to the contract and incurred during the year with the estimated total contract costs.

One benefit of this method is a more accurate allocation of income and expenses. However, the IRS requires you to do a separate calculation for tax purposes (often called the "look back method") that may result in interest charges.

Another widely used approach is the completed-contract method. Under it, income isn't reported until you complete a contract, even though you may receive payments in years before completion. Thus, the completed-contract method is advantageous because you can defer taxes.

The downside is that you can't include the cost of supplies or materials you allocated to the contract yet never used as an allocable contract expense. These supplies must remain on the books as an asset until they're used in a project. They may be deducted at the time the project is completed.

Whether you can or should use the completed-contract method depends on the size of your company as measured by gross receipts. In 2024, businesses with average gross receipts over $30 million for the previous three years must use the percentage-of-completion method.

If you have average gross receipts for the previous three years under $30 million this year, you're required to use the completed-contract method only for contracts expected to take longer than two years to complete. However, you may choose to use it for contracts you'll complete in less than two years.

(Note: Alternative minimum tax rules may also require use of the percentage-of-completion method. Also, certain exceptions may apply to homebuilders.)

Accounting complexities

Accounting complexities are all part of the distinctive nature of the construction industry. Work closely with your CPA to choose and execute the right method. ■

OWN A CONSTRUCTION BUSINESS WITH PARTNERS?

Strongly consider a buy-sell agreement

Construction companies with multiple owners will incur many of the same operational risks as entities owned by a single individual. However, they'll have at least one more: The risk of one of the owners suddenly leaving the business.

It's for this very reason that financial and legal advisors typically recommend that companies of every sort, including construction, engage in a careful process to create a buy-sell agreement.

Indispensable tool

A well-crafted "buy-sell," as it's often called for short, is a contract outlining the specific procedures that must take place for an ownership change to occur. It also establishes how, to whom and at what price the departing owner's shares will be transferred.

In fact, one could say the legal purpose of a buy-sell is to create a market for ownership interests and generate the liquidity needed to not only buy out a departing owner, but also fund expenses such as estate taxes. It serves as a layer of protection for anyone who owns a business with other partners, including family businesses, and particularly for contractors who co-own and actively participate in the company's daily operations.

In short, a buy-sell ensures an orderly transfer of ownership and minimizes disputes following "triggering events" such as death, disability, retirement, termination or most any other circumstance that would prompt an owner to leave the business. Such events must be named in the agreement, however.

A buy-sell is, thereby, an indispensable tool to facilitate a smooth transition of ownership under normal circumstances (say, someone's retirement), as well as to protect businesses and their owners during crises (for instance, if an owner is permanently disabled). And yet, in an industry where contracts are commonplace, many construction companies either procrastinate on creating a buy-sell or don't keep the one they have updated.

Valuation provision

Therein lies an important point: Buy-sell agreements should never be signed and filed away in a drawer to be forgotten about. As circumstances surrounding your business or industry shift, adjustments to the buy-sell may be needed to accurately reflect those changes.

For example, as you well know, the value of a construction business can rise and fall precipitously depending on its ownership, management and good fortune. That's why the cornerstone of any buy-sell is its valuation provision. This clause determines the purchase price of an owner's shares, which helps to mitigate potential conflicts and litigation over share value. A carefully worded valuation provision provides clarity on how the business will be appraised following a triggering event.

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Some agreements may require an independent valuation professional's opinion, while others specify a predetermined formula. The choice between these approaches requires periodic reassessment to ensure it aligns with your construction company's current philosophy and strategic objectives. Adding qualifiers, such as "either" and "or," to the contract language may provide flexibility.

Key role

If your construction business has multiple owners, a buy-sell agreement should more than likely play a key role in your risk management strategy as well as in your ongoing contingency planning and succession planning. Your professional advisors, including your CPA and attorney, can help you create a buy-sell and keep it regularly updated. ■

5 EXCITING FEATURES OF TODAY'S TELEMATICS SYSTEMS

Telematics has become a transformative force on construction jobsites, providing contractors with valuable, real-time information about vehicles and heavy equipment. Under this technology, sensors installed in the assets transmit data about the item's location, status and usage.

Initially, there was fluctuating demand in the construction industry for the sheer amount of data provided by telematics. Recent market trends, however, indicate growing interest. Here are five exciting features of today's telematics systems that could benefit your construction company:

1. Artificial intelligence (AI) for advanced analytics. Telematics systems are evolving with advanced analytics capabilities, incorporating AI subsets such as machine learning. These predictive tools can help spot maintenance issues long before a breakdown, as well as generate simulations for driver training and testing. AI-driven telematics can also help plan routes based on traffic patterns and weather forecasts, identify risky driving behaviors, provide drivers with real-time feedback, and more. Given the rising power of generative AI, the possibilities are endless!

2. Electric vehicle (EV) adoption and eco-routing. The push for sustainability and reduced carbon footprint is being felt in both the automotive and construction industries. For evidence, one need look no further than the growing popularity of EVs and even electrically powered construction equipment. Telematics systems can play a crucial role in helping construction companies and fleet owners manage challenges related to EV adoption, such as mapping charging logistics. Plus, managers and dispatchers can use telematics for eco-routing — planning optimized routes that minimize emissions and fuel consumption.

3. Enhanced safety and accident prevention. Safety remains a top priority in construction and fleet operations. Today's telematics systems are incorporating advanced driver assistance systems and collision avoidance technologies to ensure immediate driver awareness and response to critical events. Real-time driver coaching, proactive vehicle maintenance alerts and accident assistance — all driven by telematics — can contribute to a safer operational environment.

4. Integration with "smart city" infrastructure. As towns and cities become more digitally connected, or "smarter," telematics can seamlessly and usefully integrate with infrastructure. For example, today's advanced fleet management and vehicle tracking systems are able to access real-time data on traffic, road conditions and accidents, so routes can be optimized for efficiency and safety.

5. Automotive biometric vehicle access systems. Telematics can incorporate biometrics — such as fingerprint recognition, iris scan, and facial and voice recognition — to enhance antitheft protection, offering a user-friendly alternative to traditional keys. With some experts warning of estimated losses from construction-site theft reaching $1 billion or even more annually, biometric access may be the solution to protecting high-priced vehicles and equipment. ■

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- We develop **relationships with lenders and bonding agents** and understand how to present your financial picture in their preferred format.
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- 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.