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WOUCH MALONEY
CPAs & BUSINESS ADVISORS

415 Sargon Way • Suite J • Horsham, PA 19044
Tel: (215) 675-8364 • Fax: (215) 675-3879
www.wm-cpa.com

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Year-end tax planning: NOLs for contractors

A net operating loss (NOL) may arise if a construction business's *deductible* project costs, overhead and other allowable expenses exceed its income for the year. This can occur because of reduced cyclical demand for certain services, the timing effects of long-term contract accounting, weather-related disruptions, cost overruns, or job-specific conflicts or incidents.

Although inherently negative, NOLs come with a potential silver lining: You may be able to carry them forward and claim a deduction to reduce taxable income in future years.

Ground rules

The tax rules governing NOLs are intended to address inequities that sometimes arise between businesses with typically stable year-to-year income and those with fluctuating income, which is often the case in the construction industry. Essentially, they allow businesses with variable revenue to smooth out their income and losses — and, in turn, their tax liability — over multiple years.

Precisely how you may claim an NOL depends on business structure.

NOLs are generally caused by tax deductions related to your 1) trade or business, 2) rental property, or 3) casualty or theft losses resulting from a qualified disaster. The IRS identifies losses from operating a business as the most common reason for NOLs.

Precisely how you may claim an NOL depends on business structure. Many construction businesses are structured as pass-through entities such as partnerships, S corporations and most types of limited liability companies. An NOL deduction can't be claimed by a pass-through at the entity level. However, partners and shareholder-employees can use their separate shares of the business's income and deductions to calculate their individual NOLs. When doing so, the following are generally *disallowed*:

- Capital losses that exceed capital gains,
- The exclusion for gains from the sale or exchange of qualified small business stock,
- Nonbusiness deductions (for example, charitable contribution deductions, mortgage interest deductions or standard deductions) that exceed nonbusiness income,
- The NOL deduction itself, and
- The Section 199A qualified business income deduction.

Take a wide view of tax planning

When looking to leverage your construction business's net operating losses (NOLs), be sure to account for the interplay with other tax provisions. What might seem like a smart NOL move could end up reducing the benefit of other tax breaks, and vice versa.

For example, say you buy a major piece equipment that qualifies for 100% first-year bonus depreciation. Claiming bonus depreciation may create or increase a current-year loss. If that loss becomes an NOL carryforward, the resulting deduction in a later year may be subject to the 80% taxable-income limitation. (See main article for further details.) In some cases, opting out of bonus depreciation or using another depreciation strategy may produce a better overall tax result.

Bottom line: Work closely with your tax advisor to manage your carryforwards. They can help you improve cash flow and provide a hedge against the income volatility so common in the construction industry. But there may be times when other strategies are more beneficial.

Sole proprietors may also claim NOL deductions on their individual returns.

C corporations may claim NOL deductions at the entity level. For such companies, NOLs are determined without considering 1) dividends-received deductions (calculated without regard to the aggregate limitations that typically apply to the deductions), 2) the deduction for foreign-derived deduction-eligible income, or 3) the NOL deduction itself.

Remember, state NOL rules may differ from the federal rules. This is highly relevant to construction businesses that operate in multiple states.

Recently revised limit

The Tax Cuts and Jobs Act of 2017 significantly revised the NOL rules, and the One Big Beautiful Bill Act of 2025 made those changes permanent. Currently, for NOLs arising after 2020, each deduction is limited to 80% of your taxable income for the year under most circumstances. So, even if you have enough post-2017 NOLs to carry forward and offset all taxable income for a year, the NOL deduction generally can't reduce taxable income below 20% of taxable income calculated before the NOL deduction.

In addition, most NOLs can't be carried back, but they can be carried forward indefinitely. If your NOL "carryforward" isn't fully absorbed in a given year, the unused portion may become an NOL "carryover" applicable to the next eligible year. When multiple NOL carryforwards are available, they usually must be applied in the order incurred, beginning with the earliest.

Sole proprietors and owners of construction businesses structured as pass-through entities may also be subject to the excess business loss limit. This is usually applied at the individual owner level rather than at the entity level. In most cases, the limit means business losses of these noncorporate taxpayers can offset only business-related income or gain up to an inflation-adjusted threshold.

For 2026, the threshold is $256,000 ($512,000 if married and filing jointly). Any remaining losses are treated as an NOL carryforward applicable to the next tax year. Because excess business losses are subject to the 80% income limitation on NOLs, taxpayers can't fully deduct them.

Glass half full

Contractors work in an industry with tight profit margins, fluctuating cash flow and considerable risk. If your construction business incurs an NOL, look at it as a "glass half full" situation and contact your tax advisor for help determining whether it might benefit you in a future year. ■

Prevent business disruptions with a buy-sell agreement

For construction businesses with more than one owner, continuity might seem to depend solely on keeping backlog strong and current jobs on schedule. But sudden ownership changes can disrupt operations just as much as bad weather or a major equipment breakdown. That's why a well-designed and regularly updated buy-sell agreement is a must.

A legal matter

A "buy-sell" (as it's often called for short) is a formal legal contract among a business's owners that sets terms for the transfer of ownership interests. It gives owners, or the business itself, the right — or even the responsibility — to buy an exiting owner's interest following a triggering event. Such events may include an owner's voluntary departure, loss of a required professional license or certification, divorce, disability, retirement, or death.

Essentially, the agreement creates a market for a withdrawing owner's interest. And by outlining when and to whom interests can be sold, it can help prevent conflicts among remaining owners or with the departing owner's family. A buy-sell also addresses how the price of the interest will be determined, including defining the valuation method and standard of value to be used.

Use of life insurance

Life insurance is used to fund many agreements. When an owner dies, the right coverage can help ensure that the owner's beneficiaries receive the agreed-upon price for the ownership interest in a timely manner. In addition, life insurance can ease the strain on the business's cash flow, reducing the likelihood that it will have to sell assets to pay for the buyout. There are two primary ways of setting up a buy-sell with life insurance:

1. A cross-purchase agreement. Here, each owner takes out a policy on each of the other owners. In the simplest terms, let's say your construction business is a two-person partnership. You'd buy a policy on your partner and vice versa. Should either of you die, the buy-sell would be triggered, and the surviving owner would collect the policy's death benefit to buy the deceased partner's ownership interest from his or her estate.

Assuming your policy remains in force and is large enough, it increases the likelihood that you'll be able to fulfill your obligations under the agreement. In addition, with proper planning, death benefit proceeds are generally excluded from taxable income, and your tax basis in your newly acquired interests will be equal to the purchase price.

But a cross-purchase agreement can be cumbersome when there are multiple owners because of the number of policies required. It can also be unfair if there's a significant disparity in owners' ages or health, leading to substantial variations in policy premiums.

2. A redemption agreement. Under this approach, the business buys the departing owner's interest, with the entity often having a first right or obligation to purchase before the interest can be transferred to a nonowner. Because the business buys the life insurance, only one policy per owner is needed. Death benefit proceeds are generally excluded from the business's taxable income.

One disadvantage of a redemption agreement is that the remaining owners won't receive a "step-up" in basis when the business buys the deceased owner's interest. This can result in higher capital gains taxes when owners sell their interests.

For triggering events other than death, funding may come from disability buyout insurance, cash reserves, installment payments, seller or bank financing, or some combination thereof. This is why your agreement should specify not only the purchase price, but also how and when that price will be paid.

Get in the habit

If your construction business has more than one owner and hasn't yet established a buy-sell, strongly consider doing so. It's a critical risk-management measure. In the event you have one, review it regularly with your legal, tax and financial advisors every two to three years — or whenever a potential ownership change arises — to ensure it still reflects the realities of your business. ■

Protecting the bottom line with project documentation

Like most contractors, you've probably seen a project or two go sideways. In the heat of the moment, your priority is no doubt getting the job moving again. But, later, being able to answer one simple question can make a big difference: Do we have the documentation to show what happened and why?

The answer may be troubling for some construction businesses. A March 2026 survey by infrastructure research and technology company UMIP Inc. found that only 13% of responding commercial construction executives said their asset documentation was mostly complete. Nearly 80% reported significant gaps or scattered records. And a substantial number of respondents agreed that missing records contributed to project delays and financial losses.

Create histories

Strong documentation creates reliable project histories. We're talking about items such as daily

job reports, meeting notes, delivery records, time-tracking logs, videos and photos, formal requests for information and change-order forms. They can help explain what happened, when it occurred, who identified the problem and what corrective steps were taken.

Documentation is especially valuable when many small job changes accumulate. One minor adjustment may not seem worth noting, but multiple undocumented revisions can affect labor and materials use, scheduling, and billing. Without clear records, you may not know when a project has crossed the tipping point from profitable to breakeven — or even to a loss.

There's also the ever-present threat of disputes and claims. Human memory is notoriously unreliable. Verbal agreements may be misinterpreted. A jobsite decision that seemed to make sense at the time can be questioned weeks or months later. Simply put, the party with the clearest, most comprehensive documentation is usually in a stronger position.

Make better decisions

Thorough records also provide critical information for optimizing financial management. You get clearer snapshots of factors such as labor productivity, materials costs, delays and change order activity that affect performance. In turn, this visibility can improve estimating, job costing, cash flow planning and the work-in-progress schedules used to support your financial statements.

Over time, robust documentation can help you identify long-term trends. Maybe certain types of work are consistently more profitable than others. Perhaps recurring — but fixable — delays are shrinking your margins, or certain estimating assumptions need to be adjusted. Such insights support better strategic decisions about pricing, staffing, project selection and growth opportunities.

Develop a process

Excellent documentation comes from a well-developed, regularly followed process. If you don't already have one, start by defining what must be documented, who's responsible for each item, where records are stored and how they're secured. Your process may not need to be complicated. In fact, the best ones are usually a straightforward checklist that both your office team and work crews can easily follow.

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Naturally, project managers and field supervisors should take the lead. Train them to understand that documentation isn't about assigning blame. It's about clarifying what really happened, protecting everyone involved and giving management the information it needs to grow the business.

Keep the bottom line in mind

No one likes paperwork — especially in a "hands-on" industry such as construction. But best-in-class documentation can prove invaluable to both risk management and financial performance. Contact your financial advisor for help improving your record-keeping practices with the bottom line in mind.

Is your construction business safe from ransomware?

In construction, every day is a race against time as you try to complete projects on schedule. Now imagine getting hit by a ransomware attack that locks you out of your digital systems. You're probably going to lose that race — and potentially a substantial amount of money.

Reviewing the concept

Ransomware is a type of malicious software (or "malware") that typically infiltrates a computer network in various ways. These may include phishing emails or texts (phony messages that fool employees), downloads from fake websites, compromised login credentials, or removable devices (such as flash drives).

After malware encrypts its target's data, cyberattackers demand a ransom payment in exchange for the decryption key. Sometimes they threaten to publicly release or destroy sensitive data if the ransom isn't paid.

Following best practices

A good place to start preventing ransomware attacks is by conducting periodic assessments that evaluate your exposure and eliminate vulnerabilities. Maintain an inventory of your hardware, software, internet connections and data to identify potentially exploitable entry points.

Also, create secure backups to help you resume operations quickly if a ransomware attack encrypts or destroys your data. Your backup system should be encrypted and physically or digitally segregated from the systems it's supporting.

Implement protective software, too. One example is an email filtering program that flags malicious messages and prevents them from reaching their targets. In addition, ensure every computer and mobile device used for business purposes has the latest updates and security patches.

Watch out for third-party risks as well. Do vendors or other stakeholders (such as architects, engineers or subcontractors) have access to your systems? If so, be sure they follow your protocols.

Last, train and regularly remind employees to spot and avoid phishing emails and other threats. Require staff to use strong passwords, multifactor authentication and other techniques to prevent unauthorized access. If possible, restrict the use of personal devices on your network.

Checking out cyber insurance

For added peace of mind, consider cyber insurance. The right coverage can help pay for data recovery and system restoration, legal expenses, and even business interruption losses.

Many insurers also provide resources, such as incident response teams or ransom negotiation support, to help covered businesses defend against ransomware and other threats. But these policies tend to be expensive, and underwriters may require certain internal controls to be in place, so shop carefully.

Maintaining your defenses

Ransomware is more than a technology issue. It's an operational and financial threat that can stall projects, jeopardize sensitive data and create costly delays. Work with your leadership team and professional advisors to keep your defenses strong. ■

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www.wm-cpa.com

About Wouch, Maloney & Co., LLP

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Serving the Construction Industry

Wouch, Maloney & Co., LLP prides itself on its niche practice in the construction industry. The majority of our clients are involved in construction and we are adept at recognizing and solving problems common to that industry. For over thirty years, we have represented contractors along with commercial and home builders in Pennsylvania, New Jersey and Florida.

- 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.
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