2024 MID-YEAR CONTRACTOR

TAX PLANNING CHECKLIST

The continued impacts of the Inflation Reduction Act of 2022, the Tax Cut and Jobs Act (TCJA) and CARES Act of 2021, continues to drive an active tax policy environment. This constant change requires continued analysis and proactive planning for CPAs and their contractor clients.

Here is a summary of various tax planning issues potentially impacting the construction industry.

Expiring provisions

As you are preparing for 2024 tax planning, keep in mind the provisions set to expire in the near term.

Provision	2022	2023	2024	2025	2026	2027
Individual rate cuts						
Individual AMT exemption amount						
20% pass-through deduction						
Estate tax doubled exemption						
$10,000 State and local deduction						
100% expensing - effective 9/27/17		Phased	Down by	20%		
Interest deduction 30% of EBITDA	EBIT >					
GILTI deduction at 50%					**37.50%**	
FDII deduction at 37.5%					**21.88%**	
BEAT rate: 10%/11% for banks/dealers						

In Effect **Not in Effect**

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Prepare for the Estate and Gift Tax lifetime exclusion to be cut in half

The TCJA doubled the applicable lifetime gift exclusion for 2018-2025. On Jan. 1, 2026, the exclusion will revert back to approximately half of the current lifetime exclusion. For 2024 the exclusion for each individual Is $13,610,000. The amount if congress lets the current law sunset will be $5,600,000 (adjusted for inflation.) It is an ideal time for clients to meet with their estate and tax planning professionals, to analyze if this area is an issue, and plan accordingly before professional advisors get busier as we near Dec. 31, 2025.

Capitalization of Research Expenses (R&E)

Historically under Internal Revenue Code (IRC) §174, taxpayers had the option to deduct research and experimental costs incurred in a given year. This was the typical default accounting method selected. As part of TCJA, Congress removed the election to deduct these expenditures for all tax years beginning after Dec. 31, 2021. As a result, taxpayers are now required to capitalize all Section 174 expenses and amortize over a five-year period (fifteen years if the research is conducted outside the U.S.) for all tax years beginning after Dec. 31, 2021.

As of mid-August, the IRS has yet to issue proposed regulations regarding the implementation of this new iteration of IRC Section 174. However, in September 2023 IRS issued interim guidance (Notice 2023-63) and in December 2023 released Notice 2024-12, which modifies Notice 2023-63. Basically Notice 2023-63 described proposed guidance that the Treasury Department and IRS intend to include in proposed regulations under IRC Section 174.

Here are the highlights of Notice 2024-12:

- Modifies previously issued interim guidance provided by Notice 2023-63 for determining whether costs paid or incurred for research performed under contract are specified research or experimental (SRE) expenditures under IRC Section 174.
- Relaxes the reliance rules in Notice 2023-63 by no longer requiring that taxpayers rely on all (or none) of the rules in Sections 3 through 9 of Notice 2023-63.
- Clarifies that Section 5 of Revenue Procedure 2000-50 (costs of developing computer software) is obsoleted for amounts paid or incurred in tax years beginning after Dec. 31, 2021.

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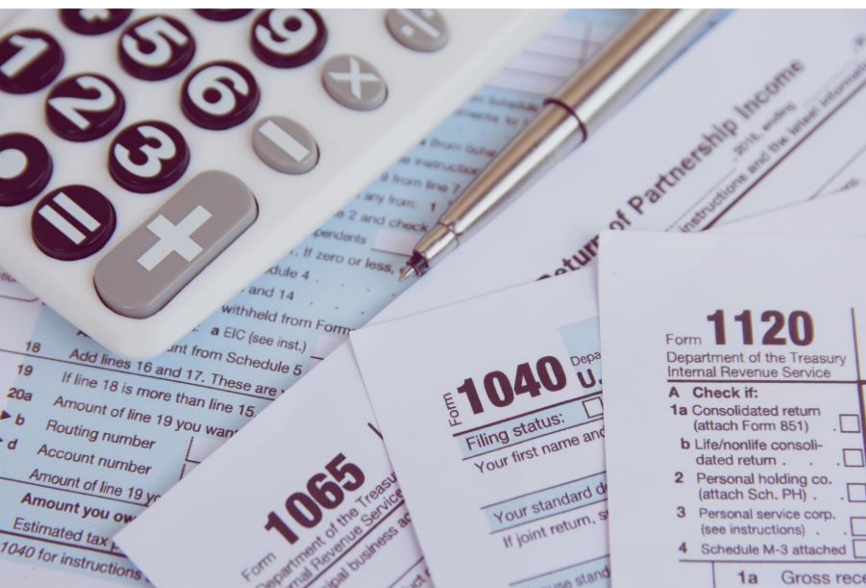
In January 2024, the House passed legislation to repeal this provision of the law. However, in July the Senate failed to pass it. Until Congress enacts new legislation to revise or repeal this section of the law, the plan is to continue to capitalize and amortize research and experimental costs.
For information on the IRS automatic consent procedure for the accounting method change necessary to adopt the new method of accounting refer to Rev. Proc. 2023-8 which can be found at https://www.irs.gov/pub/irs-drop/rp-23-08.pdf.

The amortization of IRC Section 174 expenses impacts the contractor's work in progress schedule. Under Section 19.02 of Rev. Proc. 2023-24, as modified by Rev. Proc. 2024-9, taxpayers can change their method of accounting under Section 460 so that the costs allocable to a long-term contract accounted for using the percentage of completion method (PCM) include amortization deductions of SRE expenditures, rather than the capitalized amount of such expenditures. For purposes of determining the percentage of contract completion, taxpayers may determine estimated total allocable contract costs (i.e., the denominator of the PCM ratio) in one of the following two ways:



- Include all amortization of SRE expenditures that directly benefit or are incurred by reason of the performance of the long-term contract.
- Include only the portion of such amortization expected to be incurred and deducted during the term of the contract.

Business Interest Deduction Limitation

As part of TCJA, IRC §163(j) was expanded to apply to all businesses, with exceptions. Additionally, the maximum deduction allowed for business interest became limited to the sum of:

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- The taxpayer's business interest income for the tax year;
- 30% of the taxpayer's adjusted taxable income (ATI) for the tax year; and
- Floor plan financing interest expense.

Any disallowed interest can be carried forward to succeeding tax years, subject to the provision of IRC §163(j).

For tax years beginning before Jan. 1, 2022, ATI was computed without regard to any depreciation, amortization, or depletion deduction. These deductions were added back to taxable income to determine ATI. For tax years beginning after Dec. 31, 2021, this add-back rule no longer applies for the calculation of ATI. The expiration of the add-back rule could significantly reduce the interest expense deduction limit for business carrying a significant amount of debt.

As noted, there are exceptions to the application of the provisions of IRC §163(j). An exemption is generally available for small businesses. A small business is defined as businesses whose average gross receipts for the preceding three-year period do not exceed a threshold amount ($29 million for 2024 and 2023). For any related businesses you must aggregate gross receipts to determine the threshold amount.

In addition to the small business exemption, taxpayers engaged in any real property trade or business as defined under IRC §469(c)(7)(C) may elect out of the application of the IRC §163(j) business interest limitations. As part of making the election, the taxpayer must agree to use ADS depreciation for all nonresidential real property, residential rental property, and qualified improvement property. ADS depreciation must be used for both existing assets and new acquisitions following the election. The change applies both to property placed in service in current and future years and to assets placed in service prior to the date of the election. Rev. Procedure 2019-8 provides guidance on making the election.

Many construction contractors may meet the definition of a real property trade or business. Taxpayers impacted by the changes in the calculation of ATI can still make an election as provided in US Treasury Regs. §1.163(j)-9.

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Depreciation

Contractors have gotten familiar over the last few years of the ability to take 100% bonus depreciation on new and used fixed assets put into place by the Tax Cuts and Jobs Act (TCJA). Under existing law, bonus depreciation will continue to phase down from 80% in 2023 to 60% in 2024 and 40% for 2025. Section 179 may also be a good alternative depending on the dollar amount of additions. For 2024 the section 179 deduction limit is $1,220,000 and limits the total amount of equipment purchased to $3,050,000, with a dollar-for-dollar phase from $3,050,000 to $4,270,000 of total purchases.

IRS Interest Rates Impact on Underpayment

Over recent years, many taxpayers have become complacent about estimated tax. The interest charged by the IRS for underpayments was historically low, and as such the disincentive for underpayment was small. Due to changes in interest rates, interest charged on underpayments is now much more significant and renewed emphasis should be placed on the necessity of estimated tax planning.

Currently for both corporate and non-corporate underpayments, the interest rate is 8%. More details on IRS interest rates can be found here: https://www.irs.gov/payments/quarterly-interest-rates#2024

It is also important to note that increased interest rates also impact many estate planning strategies. Some tools may be adversely impacted (intrafamily-loans and installment sales to intentionally defective grantor trusts) while some are enhanced in a higher interest rate environment (qualified personal residence trusts and charitable remainder trusts). Careful consideration of these issues should be included as part of any succession planning or estate planning engagement.

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Review Retirement Plan Options

The **Setting Every Community Up for Retirement Enhancement (SECURE) Act** was signed into law in December 2019. The Act has favorably changed the deadline for employers to adopt a qualified retirement plan. Employers now have until the business' income tax return deadline, including extension, to adopt a plan and may treat it as adopted at 12/31 of the prior year. There may still be time to adopt a qualified retirement plan for 2023 in addition to exploring plan enhancement options for 2024.

On Dec. 29, 2022, President Biden signed the SECURE 2.0 Act of 2022 building upon the changes from the SECURE Act and further revising rules regarding retirement plans. Some of the key highlights for business owners are as follows:

- Starting Jan. 1, 2023, the age at which owners of retirement accounts must start taking RMDs is increased from 72 to 73 years of age. The age at which RMDs must start will be pushed back further to 75 years of age beginning January 1, 2033.
- Starting in 2023, the penalty for failure to take an RMD will decrease to 25% of the missed RMD, down from 50% currently. The IRS still provides for the waiver of these penalties where the account owner establishes that the shortfall in the distribution was due to reasonable error and that reasonable steps are being taken to remedy the shortfall.
- Beginning Jan. 1, 2024, Roth accounts in employer retirement plans will also be exempt from RMD requirements like Roth IRAs.
- Starting Jan. 1, 2025, individuals aged 60 to 63 will be able to make annual catch-up contributions up to the greater of $10,000 (indexed for inflation) or 150% of the standard catch-

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up contribution for the year to an employer retirement plan. The catch-up amount for individuals 50 and older is currently $7,500 for 2024.

- Beginning Jan. 1, 2024 plan participants earning more than $145,000 in the prior calendar year must make all catch-up contributions to a Roth account in after-tax dollars. Plan providers who currently do not offer a Roth option in their retirement plan should make changes to their plan in order to provide participants with the continued opportunity to make catch-up contributions.
- Historically, all employer contributions to 401(k) plans have been required to be made as pre-tax contributions. Under SECURE 2.0, employers may permit employees to elect that employer matching and non-elective as Roth contributions in after-tax dollars.
- Under SECURE 2.0, any 401(k) or 403(b) plan established after the date of enactment (Dec. 29, 2022) must contain an automatic enrollment provision. Unless the employee affirmatively opts out, they must be enrolled at a contribution rate of at least 3 percent, but not more than 10 percent. Further, after each year in which a participant has completed a year of service, the contribution percentage must automatically increase by 1 percent until the contribution is at least 10 percent but no more than 15 percent.
- Starting Jan. 1, 2024, defined contribution retirement plans can add an emergency savings account that is a designated Roth account. Non-highly compensated employees (defined in 2024 as those earning up to $150,000) will be eligible to contribute up to $2,500 annually to this emergency savings account. Contributions may be eligible for matching contributions. The first 4 withdrawals in a year will not be subject to any withdrawal fees to the employee.
- Beginning Jan. 1, 2024, employers will be able to make additional matching contributions to retirement plans based on employee student loan payments.

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Mobile Workforce Reminder

With the increasing mobility of the Contractor's workforce, a few changes and reminders for consideration for 2024:

- For all of 2024 the IRS increased the standard business mileage rate to 67 cents per mile. Up from a rate of 65.5 effective from July 1, 2023 through Dec. 31, 2023.
- Contractors should continue to monitor and follow the U.S. General Services Administration per diem rates which are reset each fiscal year starting Oct. 1.
- Business meals are 50% deductible for tax years 2023 and forward. In 2021 and 2022 for some business meals were qualified as 100% deductible.

IRS Releases "Dirty Dozen" Tax Scams for 2024

In March, the IRS released its annual "Dirty Dozen" tax scams for 2024, including areas such as aggressive promoters who dupe taxpayers into making questionable ERC claims, false fuel tax credit claims, offer in compromise "mills" that falsely claim their services are necessary to resolve IRS debt to name a few. More details on these areas of IRS interest can be found here: https://www.irs.gov/newsroom/dirty-dozen

Pass-Through Entity (PTE) Tax Environment

On an individual basis, state and local governments have enacted a pass-through entity (PTE) tax as a potential work around to the Tax Cuts and Jobs Act's (TCJA) $10,000 state and local tax deduction limitation. As of May 2024, a total of 36 states along with one locality (New York City) have adopted the PTE tax. Reviewing applicability of this process for the multi-state contractor can be key in determining if any benefit exists. States vary on their timing, eligibility, and formality of their PTE tax program.

Eligibility and application of the PTE tax varies from state to state at both the entity and individual level. Care should be taken to evaluate all the applicable rules to determine the impact. For example, some states do not allow resident taxpayers to include PTE taxes paid on their behalf in calculating the credit for taxes paid to other states. For taxpayers in these taxing jurisdictions, the PTE tax paid to a non-resident state could result in a dollar-for-dollar state tax liability in exchange for up to a $.37 federal tax deduction.

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Information on states with enacted or proposed pass-through entity level tax statutes can be found here: https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/56175896-pte-map.pdf

Review Contractor Specific Accounting Methods

The Tax Cut and Jobs Act (TCJA) signed into law in late 2017 made some of the most significant tax regulation changes in decades and created many new planning opportunities for contractors. Specifically, various tax accounting methods available to contractors will require ongoing careful analysis and proactive planning, due to the volume of methods and impact this can have on tax liability and cash flow.

For a more detailed refresher on tax accounting methods and planning opportunities such as IRC §199A, access the 2023 Tax Planning Opportunities whitepaper.

Excess Business Loss/Net Operating Loss/Business Interest

The CARES Act passed in 2020 provided a reprieve from various loss limitations initially implemented in 2018 as part of the TCJA. However, in 2021, these limitations went back into effect such as the excess business loss limitation, inability to carryback a net operating loss, and the excess business interest limitation. These limitations continue to exist in 2024 filings and should be carefully considered and revisited as part of the 2024 planning process.

A last-minute change to the Inflation Reduction Act includes an extension of the limitation of an individual's ability to use net operating losses.

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This limitation, which was included as part of the TCJA, was scheduled to terminate in 2026. The limitation will now apply through 2028.

Excess Business Losses occur when a taxpayer's aggregate trade or business losses exceed trade or business income for the year.

Trade or business income includes income or loss from any source including Schedule C and Schedule F in addition to any passthrough trade or business income or loss reported on Schedule E. The ability to deduct losses in excess of income is limited to $289,000 ($578,000 for joint filers) and $305,000 ($610,000 for joint filers) for 2023 and 2024, respectively.

The limitation is taken into account at the owner level and calculated after the outside basis, at-risk and passive loss limitations are applied. Losses suspended under the excess loss limitation rules are carried forward to future years as NOL carryovers.

Employee Retention Credits (ERC)

The deadline to file refund claims for 2020 has passed, but taxpayers have until April 15, 2025, to file claims for 2021. However, the IRS has announced a moratorium on claims received after Sept. 14, 2023.

In June 2024 the IRS announced that it was in the process of denying tens of thousands of improper high-risk claims while resuming the processing lower-risk claims. Many taxpayers have already received notice that their claim was denied. We have been hearing that the IRS is disallowing valid claims. If this happens, the taxpayer can appeal the denial.

That announcement, and links to additional IRS guidance related to the ERC can be found at: https://www.irs.gov/newsroom/irs-enters-next-stage-of-employee-retention-credit-work-review-indicates-vast-majority-show-risk-of-being-improper

An important reminder regarding the ongoing ERC process for many contractors, is if a taxpayer claims the credit, the corresponding reduction of the deduction (income recognition) related to the salaries which the credit is based takes place in that given 2020 or 2021 tax year. This can typically result in the Taxpayer generating additional income tax while waiting on the refund of any claimed credit.

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Keep in mind, the IRS has extended the statute of limitations to five years for claims filed for 3rd and 4th quarter 2021. If a taxpayer claims the ERC for those quarters, their application remains open for audit possibilities for 5 years. If the ERC is disallowed and the regular tax return statute of limitations (three years) has passed, the taxpayer loses the ability to go back and deduct those salaries. Additionally, AON recently released a risk alert noting that CPAs may be asked to prepare original or amended payroll and/or business tax returns reflecting ERC. As such, CPAs may face a future professional liability claim if a client's ERC is disallowed by the IRS, even if they did not calculate the ERC.

Inflation Reduction Act of 2022

In late July of 2022, a deal to revive a scaled back reconciliation bill was reached resurrecting some concepts previously brought forth from the prior year during the Build Back Better proposals. The Inflation Reduction Act of 2022 provides investment in clean energy, promotes reductions in carbon emissions and extends popular Affordable Care Act premium reductions. The bill is being paid for through the implementation of a 15% corporate minimum tax, budget increases to bolster the IRS to close the 'tax gap', excise tax on stock buybacks, and changes to Medicare rules. No new business taxes were proposed on pass-through entities or families making less than $400,000.

A few additional proposed details of interest to Contractors are that the corporate minimum tax would go into effect for tax years beginning after 2022 and would equal 15% of the corporation's 'adjusted financial statement income' for the tax year. The tax would only apply to covered corporations with average annual adjusted financial statement income more than $1 billion for the three prior tax years. A covered corporation is a corporation whose stock is traded on an established securities market. This would not apply to S-Corporations.

A potential impact on accounting standards and Taxpayer decision making will be an interesting by product of this as a corporation's 'adjusted financial statement income' is the amount of net income or loss a corporation reports on its applicable financial statement. The Contractor should continue to monitor opportunities arising from the clean energy, climate change and tax credit space of the bill. Specifically impacting the Contractor, the Act expands two key Federal energy efficient tax incentives currently in existence, the **179D Energy-Efficient Commercial Building Deduction** and **45L Energy-Efficient Home and Multifamily Tax Credit,** with expanded credits and applicability that continue into 2024 and 2025. It is vital for the Contractor to review the applicability on these incentives with the work performed.

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The contractor should review their underlying contracts as the tax benefits may now be allocated to the contractor directly from the State, Municipality and tax-exempt agency. Congress has provided further signals that opportunities in the construction industry from the Inflation Reduction Act will directly evolve around the energy and climate provisions of the legislation, to further promote, expand and incentivize actions around the design, development and construction of energy efficient property.

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