Seven PATH Act Tax Breaks for Contractors

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Late last year, Congress passed the Protecting Americans from Tax Hikes (PATH) Act, reviving and extending several key provisions that directly or indirectly affect construction businesses.

The changes help bring more certainty and permanency to year-end income tax planning. They also provide more opportunities to use credits and incentives to ease your company's tax burden. Here's an overview of seven PATH breaks to consider:

1. **Section 179 expensing.** Under this provision of the Internal Revenue Code, you can choose to currently deduct the cost of qualified property placed in service during the year. For 2016, a generous maximum deduction of $500,000 is permanently preserved and will be indexed for inflation in later years.

When the total cost of the property exceeds $2 million, however, the deduction is phased out on a dollar-for-dollar basis. The $2 million threshold will also be indexed after 2016. Also, the deduction can't exceed your business income for the year.

This provision gives contractors plenty of leeway. It doesn't matter when during the year you place qualified new or used equipment or machinery into service. You can wait until late in the year and still benefit from the full year deduction.

2. **Bonus depreciation.** The law also provides a complementary tax break for the cost of acquiring business property. For qualified new — but not used — property placed in service during 2016, you can claim a 50% bonus depreciation for any cost remaining after the Section 179 election. Unlike the Section 179 provision, however, bonus depreciation isn't permanent. It will be phased out under the following schedule:

- 50% through 2017,
- 40% in 2018, and
- 30% in 2019.

After 2019, bonus depreciation will expire, unless it's extended again.

The PATH Act also enhances bonus depreciation by accelerating the use of alternative minimum tax (AMT) credits that may be claimed in place of bonus depreciation. This increases the amount of unused AMT credits that may be used; modifies the rules to include qualified investment property; and permits bonus depreciation for certain trees, vines and plants bearing fruits or nuts. As with the Sec. 179 deduction, property may be placed in service at year end.

3. **Building improvements.** Usually it takes 39 years to recoup the cost of business building improvements, though deductions may be front-loaded under complicated rules. The PATH Act makes permanent a faster straight-line write-off period of 15 years for:

- **Qualified leasehold improvement property** — any improvement to an interior portion of a nonresidential building made more than three years after the building was placed in service,
- **Qualified restaurant property** — any Section 1250 property that's a building (new or existing) or improvement to a building if more than 50% of the square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals, and
- **Qualified retail improvement** — any improvements to an interior portion of nonresidential real estate more than three years after the building was placed in service, as long as it's a retail establishment where goods are sold to the public.

The ability to claim faster write-offs may spur property owners into contracting with construction companies.

4. **Energy-efficient buildings.** The PATH Act extends several incentives for energy improvements. One tax break that may indirectly benefit contractors is the deduction for energy-efficient buildings, which was extended through 2016.

A tax deduction of $1.80 per square foot is available to owners of new or existing buildings who make energy-based improvements either to the HVAC, hot water or interior lighting systems, or the building's envelope. The modifications must trim the building's total energy and power cost by 50% or more when compared to certain minimum standards.

In addition, a deduction of $0.60 per square foot may be claimed by building owners where individual lighting, building envelope or heating and cooling systems meet levels that would reasonably contribute to an overall building savings of 50% if additional systems were installed.

The deduction is available mainly to building owners, though tenants may be eligible. This may turn into a good selling point to prospective clients who can claim the tax benefits. But keep in mind that the deduction is currently scheduled to expire after this year.

5. **Work Opportunity Tax Credit (WOTC)**. A construction company may qualify for a tax credit for hiring workers from several target groups. Technically, the WOTC expired after 2014, but it was reinstated for 2015 and extended through 2019. The PATH Act also added a new target group of long-term unemployment beneficiaries, beginning in 2016.

Generally, the maximum WOTC is $2,400 for each full-time worker from a target group. In addition, if your business needs extra help during the summer, it may qualify for a special maximum credit of $750 per worker for hiring certain youths from empowerment zones or enterprise communities.

Now is a good time to hire workers who will qualify for either the regular credit or the special summertime credit. What's more, transitional rules allow you to claim the WOTC for qualified workers for 2015. But you must act fast: The deadline is June 30, 2016.

6. **Research credit.** This credit generally equals 20% of the excess of qualified research expenses for the year over a base amount. Your construction business may claim a simplified credit equal to 14% of the amount by which qualified expenses exceed 50% of the average for the three preceding tax years.

The PATH Act permanently preserves the research credit with a couple of important enhancements that take effect in 2016:

A qualified small business (one with $50 million or less in gross receipts) may claim the credit against AMT liability, and

A qualified startup (one with less than $5 million in gross receipts) may claim the credit against up to $250,000 in FICA taxes annually for up to five years.

The credit is especially valuable to construction companies that also do design work. Check with your tax adviser to see whether your costs will qualify.

7. **Qualified small business stock.** If you invest in qualified small business stock (QSBS) in your company, the tax law allows you to exclude 100% of any gain from the sale of the QSBS after five years as long as certain other requirements are met. This now-permanent tax break is a powerful incentive for contractors to invest in their own businesses. It may also be an advantageous method of securing more working capital from outside investors. (The QSBS tax break isn't limited to business owners.)

For more information on how your firm can benefit from these tax breaks, consult with your advisers.

About Robert Aceituno
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Robert is a senior manager at CBM. He advises closely-held businesses and their owners on financial, accounting, and tax matters.

Robert serves a wide range of clients including real estate developers and operators, construction contractors, hotel and hospitality service entities, and retail and wholesale distribution companies.

He is a frequent speaker to business and financial accounting and tax groups and chairs the Tax Committee of the Greater Washington Society of CPAs.

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