

***Advice for Construction Companies:
Stimulus Act's Tax Breaks Can Work
For Contractors***



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The Economic Stimulus Act has been popularly perceived as a boon for consumers. American households are receiving checks of \$600 and more, which Congress hopes will revive a sluggish economy.

The act also offers business incentives with real value to the construction industry. The law nearly doubles the amount of deductions for equipment under the Internal Revenue Code Section 179 for 2008 and also provides for bonus depreciation for those purchases.

Both provisions offer great opportunities for contractors. However, you must plan carefully or you may be surprised with some tax consequences. Here's how these incentives are designed to work:

Code Section 179 expensing: Before the new law, businesses could expense up to \$128,000 of the cost of qualifying equipment in 2008, as long as the cost of all equipment placed in service during the year is \$510,000 or less. If the cost exceeds that ceiling, the deduction is reduced by the amount over the limit. Under the new law, a business can expense up to \$250,000 of the cost of qualifying property, and the \$510,000 ceiling jumps to \$800,000.

The act makes no changes to the general rule for the types of equipment purchases that are eligible for expensing. Generally, the asset must be tangible personal property that's actively used in the contractor's business and for which a depreciation deduction would be allowed.

For mid-sized and small contractors, the expanded expensing benefit provides an opportunity to invest in equipment while deducting all the investment in the first year.

The downside is that this deal is for one year only. For a contractor that's a calendar-year taxpayer, the tax year starts January 1, so all qualified purchases during 2008 could be eligible for the deduction. For fiscal-year taxpayers, qualified purchases after the start of the year in 2008 and up to the end of the fiscal year in 2009 could be eligible for the enhanced deduction.

A company whose fiscal year starts on April 1 can't utilize the enhanced deduction on equipment placed in service in March of this year but can take the additional deduction for purchases made as late as March 2009.

Fiscal-year flow-through entities, such as S corporations, limited liability companies, and partnerships need to be extra careful. The activity from a fiscal-year S corporation, LLC, or partnership that begins in 2008 will flow through on a K-1 form to the individual shareholder/member's 2009 tax return. So, even though the company can deduct up to \$250,000 for equipment purchases, the individual shareholder/member faces a \$128,000 limit. This is still beneficial if the company has many owners and none owns more than 50% of the company.

For a majority shareholder, the deduction will be limited and the excess will be lost, so careful planning is a must for fiscal-year companies.

Bonus depreciation: The other incentive from the stimulus act is bonus depreciation. The law provides qualifying taxpayers 50% first-year bonus depreciation of the adjusted basis of the equipment. This provision is substantial, providing U.S. businesses with an estimated \$44 billion in additional deductions in 2008. There is no dollar limit on the amount of eligible property placed in service, so this provision will especially benefit large construction firms.

To claim the bonus depreciation, the equipment must be classified as:

- Eligible for the modified accelerated cost-recovery system, with a depreciation period of 20 years or less (this could include land improvements, paving, signs, carpeting, etc.);
- Water-utility property;
- Off-the-shelf computer software; or
- Qualified leasehold property.

The equipment generally must be contracted, purchased and placed in service during 2008, which could be a small window of time for large machinery purchases.

As an example, a highway contractor that buys a \$2.5 million asphalt plant this year could depreciate half the total. Before the stimulus act, the limit was \$500,000. The additional \$750,000 deduction can produce first-year tax savings of \$322,000. Under new and old laws, the balance is written off over five years, but the stimulus act will free up capital for other purposes.

The new law's expensing and bonus depreciation provisions can be used in tandem. For a business that purchases equipment totaling \$750,000, for example, the expensing provision permits a first-year write-off of \$250,000, and the balance can be eligible for 50% bonus depreciation.

Even though the federal government is generous with the bonus depreciation, individual states most likely will not be.

North Carolina's position on bonus depreciation is not finalized. However, the state is proposing to add back 85% of the bonus deduction to income in the first year and spread out the deduction over the next five years. This add-back could be quite significant with larger contractors. That means careful consideration must be given or the taxpayer could face a significant liability for N.C. taxes.

South Carolina also does not comply with the federal deduction. It will add back 100% of the deduction and won't allow deductions in later years.

The stimulus act offers plenty of opportunities for contractors, but the assistance of a tax professional may be needed to optimize its benefits.