

Law Aimed at Helping Manufacturers Has HIDDEN TAX BENEFITS FOR CONSTRUCTION FIRMS

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The American Jobs Creation Act of 2004 has created some new tax benefits that are available for contractors, engineers and architects.

Section 199 of that legislation, aimed at helping domestic manufacturers compete with their foreign counterparts, incorporates real estate construction (both new and substantial renovations) and associated architectural and engineering services related to the contracts in the U.S.

For 2005, the deduction is 3% of the lesser Qualified Production Activities Income or the adjustable gross income and cannot exceed 50% of W-2 wages for the year. The deduction will stay at 3% in 2006 and will rise to 6% in 2007, 2008 and 2009, topping out at 9% for 2010.

Construction receipts can count as revenue for more than one contractor, a significant bonus. For example, if the owner of a commercial building site hires a general contractor to construct the building, the revenues received by the contractor would qualify for the deduction. The various subcontractors deriving income from the project would find that those receipts qualify as well.

New construction, under the Act, is defined as the erection of residential or commercial buildings on real property and all associated subcontracting, including clearing and grading activities. Permitted renovation must involve a major component or a substantial structural part of real property that materially increases its value, extends its useful life or adapts it for a new or different purpose.

If all this sounds complicated, an example may help. Assume a homebuilder earns an annual net profit of \$200,000 and that all of the company's gross income qualifies as construction receipts. Under this scenario, the contractor's Section 199 deduction will be limited to 3% of net income or \$6,000 ($\$200,000 * .03$) for 2005 and 2006. If the homebuilder is an S Corporation and the shareholder is in the 35% bracket, the deduction saves him \$2,100 in federal taxes in both of those years. Utilizing the same facts in 2009, when the rate is 9%, the tax savings will be approximately \$6,300.

While the deduction is initially modest, it is still worth pursuing now because of the time needed to put the appropriate tax and accounting tracking procedures in place, procedures that once implemented, will have to be reviewed and likely tweaked annually. The best advice therefore for management is to appoint a team and install the necessary measurement tools to accurately determine the qualified production income from construction projects. When it comes time to file your taxes next winter, you will be glad you did.

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