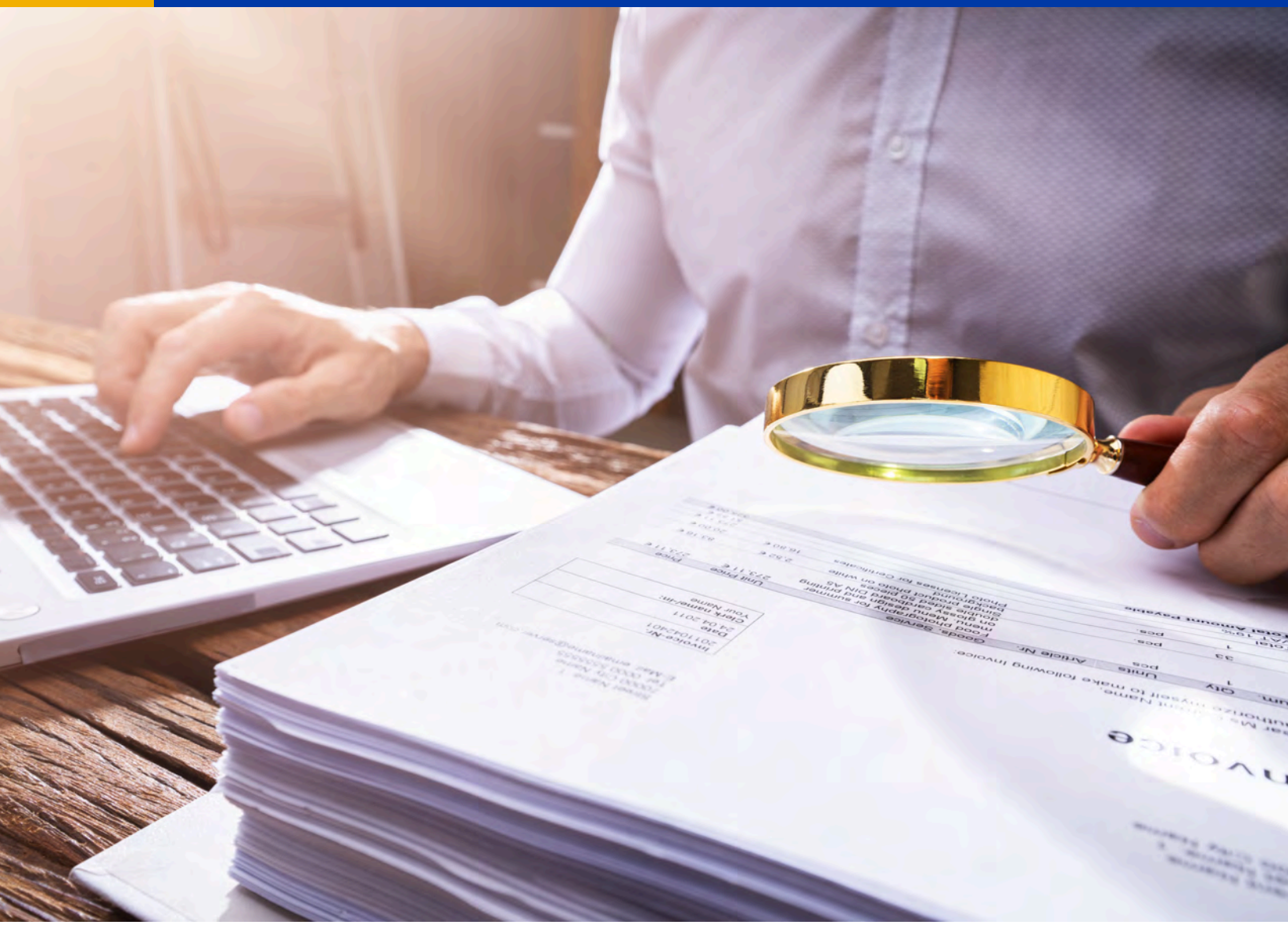
2025

Tax Planning Opportunities

FOR THE CONSTRUCTION INDUSTRY



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FOREWORD

The tax environment for construction contractors continues to shift, with 2025 bringing one of the most consequential legislative changes in recent years: the passage of the One Big Beautiful Bill (OBBB). Signed into law in July, OBBB introduces sweeping reforms that directly affect the construction industry–from permanently extending 100% bonus depreciation and expanding Section 179 expensing limits, to introducing new incentives for industrial development and modifying opportunity zone rules.

These changes offer substantial opportunities for contractors to improve cash flow, accelerate deductions, and strategically plan capital investments. At the same time, revised accounting methods, stricter workforce compliance measures, and evolving IRS guidance demand careful attention. As we approach year-end, CPAs must help construction clients navigate this new terrain with agility and foresight.

This whitepaper highlights key tax planning strategies and considerations for 2025, with a focus on leveraging new provisions under the OBBB while managing ongoing risks. The CICPAC Tax Thought Leadership Committee extends its gratitude to its members for their expertise in compiling this resource, with special thanks to Kathleen Baldwin and Michelle Class for their leadership and coordination.

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ONE BIG BEAUTIFUL BILL (OBBB)

The newly enacted "One Big Beautiful Bill" (OBBB) introduces sweeping tax reforms that will significantly impact the construction industry. This landmark legislation—signed into law on July 4, 2025—includes a dozen key provisions that affect contractors, developers, and construction-focused pass-through entities.

Some of these changes take effect retroactively to the beginning of 2025, while others are scheduled to begin in 2026. As a result, advance planning is essential—not only to optimize tax positions under the new rules but also to accurately estimate and manage 2025 tax payments. The most consequential provisions and what construction businesses should consider now to stay ahead of the curve include:

→ 100% Bonus Depreciation Permanently Extended (Effective 2025)

Construction companies can now fully expense qualifying equipment and property in the year of purchase. This provision is not only retroactive to January 19, 2025, but has also been made permanent, eliminating the previous phase-out schedule.

This change enhances long-term planning certainty, improves cash flow, and encourages capital investment in machinery, vehicles, and other short-lived assets. Because this provision is now permanent, it provides construction firms with the certainty needed to strategically manage capital expenditures over the long term.

→ Section 179 Expensing Expanded

The maximum amount a taxpayer may expense under Section 179 has been increased to $2.5 million, with the phase-out threshold beginning at $4 million. The deduction is reduced dollar-for-dollar by the amount by which the cost of qualifying property exceeds $4 million.

This expansion allows construction firms—especially small to mid-sized businesses—to immediately deduct the full cost of qualifying property, such as equipment, vehicles, and software, up to the new limits. The permanence of this provision offers valuable predictability, enabling firms to confidently plan and execute capital investments without concern for shifting tax treatment.

→ Special Depreciation for Nonresidential Real Property Used in U.S. Production

The new law introduces a special depreciation allowance for qualified production property, allowing full and immediate expensing for certain nonresidential real estate used in manufacturing or production.

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To be eligible, the property must meet all of the following:

- It must be nonresidential real property (e.g., factories, refineries, or production facilities)
- It must be used as an integral part of qualified production activity, such as manufacturing, production, or refining of a qualified product
- Construction must begin between January 19, 2025, and December 31, 2028, and
- The property must be placed in service before January 1, 2031.

This provision provides a powerful incentive for construction firms involved in building or upgrading U.S.-based production facilities. It supports long-term investment in domestic industrial infrastructure and offers immediate tax benefits for qualifying projects. We should anticipate further guidance related to qualification. Query whether a contractor has a new facility built for fabricating components that will be installed pursuant to a construction contract.

→ R&D Expense Deduction Restored (2025–2029)

Taxpayers can now immediately deduct domestic research and experimental (R&E) expenditures paid or incurred after December 31, 2024.

Key Details

- Domestic R&E expenses are fully deductible in the year incurred.
- Foreign R&E expenses must still be capitalized and amortized over 15 years.
- Small businesses with average gross receipts of $31 million or less will generally be permitted to apply this change retroactively to tax years beginning after December 31, 2021, by filing an amended return.
- All other taxpayers that incurred R&E expenditures between December 21, 2021, and January 1, 2025 will be permitted to elect to accelerate the remaining deductions for those expenditures over a one- or two-year period, beginning after December 31, 2024, via a change in accounting method.
- Procedural guidance is expected to be released by the IRS on handling of prior year capitalized expenditures.
- Added complexities may arise with amending partnership returns that are subject to BBA Centralized Partnership Audit Rules.

This change reverses the amortization rules introduced under the TCJA and supports innovation in construction processes and technologies. It provides a strong incentive for firms to invest in productivity-enhancing tools and sustainable practices, with immediate tax benefits—especially for small and mid-sized firms. Taxpayers impacted by this provision should evaluate their remaining estimated tax payments for 2025 to preserve cash flow and plan accordingly.

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→ 20% Deduction Made Permanent for Pass-Through Businesses (S Corporations, Partnerships, Sole Proprietors)

The 20% deduction for Qualified Business Income (QBI)—originally enacted under the Tax Cuts and Jobs Act—was previously set to expire at the end of 2026. The new law makes this deduction permanent for pass-through businesses, including S Corporations, partnerships, and sole proprietors.

This ensures continued tax relief for a broad range of construction firms that operate outside the C Corporation structure. With the deduction now permanently set at 20%, the highest effective federal tax rate for owners of these businesses is reduced from 37% to 29.6%. This helps maintain parity with the 21% corporate tax rate for C Corporations and allows business owners to plan with confidence, reinforcing the long-term viability of pass-through structures in the construction sector.

→ More Interest Expense Now Deductible for Capital-Intensive Businesses

The new law makes a permanent and favorable change to the limitation on business interest expense deductions. Previously, the deduction was limited to 30% of a business's taxable income before interest and taxes (EBIT). Under the new rule, the limitation is now based on 30% of taxable EBITDA—which means businesses can add back depreciation, amortization, and depletion when calculating their deduction threshold.

This change allows businesses to deduct a larger portion of their interest expense, especially those that are capital-intensive and highly leveraged, such as construction firms with significant equipment or real estate investments. By permanently shifting to an EBITDA-based threshold, the law provides greater flexibility and tax relief for firms that rely on financing to grow and operate.

→ Higher SALT Deduction Limit with Phaseout for High-Income Taxpayers

Under prior law, the deduction for state and local taxes (SALT) was capped at $10,000. The new law increases the SALT deduction cap to $40,000, adjusted annually for inflation, for tax years beginning January 1, 2025, through December 31, 2029. Beginning in 2030, the cap will revert back to $10,000. The adopted bill increases the SALT cap and does not attempt to limit or address the various state enacted Pass-Through Entity Tax workarounds (PTET) that taxpayers are currently using to avoid the existing SALT cap.

Phaseout for High-Income Taxpayers

For tax years beginning in 2025, the deduction begins to phase out for taxpayers with modified adjusted gross income (MAGI) over $500,000, also adjusted for inflation. The deduction is reduced

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by 30% of the amount by which MAGI exceeds the threshold, but it can never be reduced below $10,000, ensuring a minimum benefit remains available.

This temporary increase provides meaningful relief for construction business owners and employees in high-tax states. Importantly, with the expanded use of Pass-Through Entity (PTE) tax elections, many taxpayers may now be able to deduct real estate taxes on their homes that were previously limited under the $10,000 cap. This change enhances planning flexibility and may significantly improve after-tax cash flow for eligible taxpayers.

→ Green Energy Credits Have Accelerated Timeline for Terminations

The new law shortens the availability window for several key green energy tax incentives that have been widely used in the construction and real estate sectors.

179D – Energy Efficient Commercial Building Deduction

This deduction is now set to expire for construction that begins after June 30, 2026. This change will significantly impact architects, engineers, and design-build firms that have historically claimed the deduction for their role in designing energy-efficient systems in government and non-profit buildings.

45L – Energy Efficient Home Credit

The 45L credit, which provides incentives for the construction of energy-efficient residential homes, is also on track for termination under the same accelerated timeline.

This will have a direct impact on homebuilders and residential developers, particularly those focused on sustainable housing. These accelerated terminations reduce the runway for planning and executing energy-efficient projects that qualify for federal tax incentives. Construction firms, designers, and developers should evaluate current and upcoming projects to determine eligibility and consider accelerating timelines to preserve access to these credits and deductions.

→ Exception to Percentage-of-Completion Method for Certain Residential Construction Contracts

OBBB introduces a significant expansion to the exception from the percentage-of-completion method (PCM) under Internal Revenue Code §460. This change provides long-awaited relief to developers and contractors engaged in residential construction. The primary focus of this change was to fix the issue with high rise condo development and being forced to use PCM. The expanded definition and corresponding language open the door to some additional opportunities for our

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contractor clients. The amendment is effective for contracts entered into in taxable years beginning after July 4, 2025.

Under prior law, long-term construction contracts were generally required to use the PCM unless an exception applied. One such exception was for home construction contracts, defined in §460(e)(5)(A) as contracts where at least 80% of the total estimated costs were reasonably expected to be attributable to dwelling units in buildings containing four or fewer units. These contracts which are exempt from PCM and AMT could use the completed contract method (CCM) or any other applicable tax accounting method.

In contrast, residential construction contracts—defined in §460(e)(5)(B) as contracts for the construction of dwelling units in buildings with more than four units—were not eligible home construction contracts exempt from AMT and were generally subject to PCM or the percentage-of-completion-capitalized cost method (PCCM).

OBBB expands the home construction contract exception to include residential construction contracts, thereby eliminating the distinction that previously excluded larger-scale residential projects. The revised rules provide two alternative paths to qualify for the PCM exception:

1. Residential Construction Contracts: Contracts for the construction of dwelling units in buildings with more than four units now qualify for the exception without regard to the contractor's gross receipts or the duration of the contract.
2. Small Contractor Exception: Construction contracts (not limited to residential) may qualify if:
    - The contractor's average annual gross receipts for the prior three years do not exceed the threshold under §448(c), which is $31 million for 2025, and
    - The contract is reasonably expected to be completed within three years (an increase from the prior two-year limit).

Additionally, the special rule under §460(e)(4) for residential construction contracts has been repealed, and the AMT exception under §56(a)(3) has been updated to align with the new definition of residential construction contracts. Thus, making residential construction contracts exempt from AMT as well.

Examples of Potentially Qualifying Projects

The following are some examples of projects that may qualify as residential construction contracts under the new rules. Each project must be evaluated individually to determine eligibility:

- Apartment buildings with more than four dwelling units
- Condominium complexes (now including high rise projects)
- Townhouse developments

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- Senior living facilities (if primarily residential in nature)
- Long-term care facilities
- Penitentiaries
- Student housing (if structured as residential units)
- Mixed-use buildings where the residential portion constitutes the majority of construction costs

What Types of Subcontractors May Qualify

Subcontractors whose work is primarily tied to these types of residential projects may also qualify for the exception. Examples of potentially eligible trades include:

- Electrical contractors
- Plumbing and piping contractors
- HVAC and mechanical systems installers
- Framing and drywall contractors
- Roofing and insulation specialists
- Concrete and foundation subcontractors
- Fire protection and sprinkler system installers
- Elevator and lift system contractors
- Finish carpentry and cabinetry trades
- Flooring, tile, and painting subcontractors

As with general contractors, subcontractor eligibility depends on whether at least 80% of their contract costs are attributable to qualifying residential construction activities. A detailed analysis should be performed to confirm applicability.

This change allows a broader range of residential construction projects to use more favorable accounting methods like the completed-contract method, enabling greater deferral of income until the project is substantially complete. It provides significant tax planning flexibility and cash flow advantages for developers, builders, and contractors working on larger-scale residential developments.

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→ Overtime Pay Exempt from Federal Income Tax

The new law introduces a temporary above-the-line deduction for qualified overtime compensation, providing targeted relief for workers who regularly exceed 40 hours per week.

Key Details

- **The deduction is capped at $12,500 per individual or $25,000 for married couples filing jointly.**
- **It applies to tax years 2025 through 2028.**
- **The deduction begins to phase out when a taxpayer's modified adjusted gross income (MAGI) exceeds $150,000 (or $300,000 for joint filers), adjusted annually for inflation.**
- **The deduction is only available if the qualified overtime compensation is reported separately on Form W-2 or Form 1099.**

Definition of Overtime Compensation

The bill defines qualified overtime compensation as overtime pay required under Section 7 of the Fair Labor Standards Act of 1938, which is compensation paid in excess of regular rates for hours worked beyond 40 in a workweek.

This provision offers a meaningful tax benefit to employees in labor-intensive industries like construction, where overtime is common. It increases take-home pay, encourages workforce participation during peak periods, and provides a planning opportunity for employers and payroll providers to ensure proper reporting.

→ Permanent Increase in Estate and Gift Tax Exemptions

Beginning in 2026, OBBB raises the lifetime estate and gift tax exemption amounts to:

- **$15 million for single filers**
- **$30 million for married couples**

These amounts will be indexed for inflation starting in 2026.

Impact on Construction Companies

Many construction firms are privately owned, with the majority of owner wealth tied up in closely held stock. These shares often lack liquidity, making it difficult for heirs to cover estate tax liabilities without selling off business assets. The increased exemption thresholds provide welcome relief,

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allowing owners to transfer more wealth without triggering estate tax, thereby supporting business continuity and succession planning.

→ New Floors on Charitable Contribution Deductions

OBBB introduces a minimum threshold—or "floor"—for deducting charitable contributions:

- 0.5% of adjusted gross income (AGI) for individual taxpayers
- 1% of taxable income for C-corporations

Impact Example – Individual Taxpayer

An individual with $1,000,000 in AGI must contribute at least $5,000 (0.5%) before any charitable donations become deductible. If the taxpayer donates $4,000, none of it would be deductible. If they donate $10,000, only $5,000 would be deductible under the new rule.

OBBB SUMMARY

In light of these sweeping changes, construction businesses should act swiftly to assess how the "One Big Beautiful Bill" will affect their operations, tax positions, and cash flow. With several provisions already in effect as of January 1, 2025, and others set to begin next year, proactive planning is essential. Companies should revisit their 2025 estimated tax payments, evaluate entity structures, and consider timing strategies for capital expenditures and project launches. As always, we recommend consulting with your tax advisor to tailor a response that aligns with your specific business goals and financial outlook.

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CONSTRUCTION ACCOUNTING METHODS

In the construction industry, choosing the right accounting method is crucial for contractors to accurately track their finances and comply with IRS regulations. The Internal Revenue Service (IRS) allows contractors to select from several accounting methods, each with unique advantages and limitations. Understanding these methods can help contractors optimize their tax positions and ensure compliance with federal tax laws.

IRS revenue procedures issued in 2018 and later provide that most of the allowable changes in tax accounting methods will be considered automatic. Although automatic changes will still require a submission of Form 3115 to the IRS, the amount of detail and documentation is significantly reduced, user fees of up to $11,500 are not applicable and prior approval by the IRS before adoption is not required so the form can be submitted with the tax return for the year. This provides additional time to analyze the impact of a potential change as well having available the actual year-end numbers that will be affected while performing the analysis.

Since accounting methods only impact the timing of when income or deductions are reported it is considered revenue neutral. The timing changes, however, can result in deferral of tax liabilities. Continued annual review of the various methods and their application to contractors is an important step as scope of work and gross receipts levels vary year to year.

The IRS recognizes several accounting methods suitable for contractors, including:

Overall Accounting Methods

- Cash Method
- Accrual Method

Long-term Contract Methods

- Percentage of Completion Method (PCM)
- Completed Contract Method (CCM)
- Exempt-Contract PCM (EPCM)

Each method has specific criteria and situations where it is most beneficial.

Long term contract: Sec. 460(f) states that "any contract for the building, installation, or construction of property, if such contract is not completed within the taxable year in which such contract is entered into" is considered a long-term contract.

See earlier discussion regarding residential construction contracts in the One Big Beautiful Bill (OBBB) section of this document.

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→ Large Contractors

Large contractors are considered to be those with average annual gross receipts of $31 million and above (for 2025). That limit is adjusted for inflation. Contractors meeting those revenue limits are to use the Accrual Method of accounting as their overall method and the Percentage of Completion Method (with some variations) to account for all long-term contract revenues. However, the IRS issued revenue procedures issued in 2018 that now include the ASC 606 Revenue Recognition Standards as an acceptable percentage of completion method.

The charts on the following pages provide an overview of these new provisions as well the other accounting methods that have not been changed and are allowable for large contractors.

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Accounting Methods Available to Large Contractors, over $31 Million (As Adjusted for Inflation) In Average Annual Gross Receipts, Has Not Changed:

Description of Change	What Contractors May Benefit	Action Steps	Timing	Other Considerations
Percentage of Completion (PCM)	In general, taxable income from a long-term contract is in alignment with the work in progress giving a realistic financial view.	If contractor moves from a defined small contractor to a large contractor due to revenue growth no formal election or method change needed. Apply PCM to the contracts started in the first year of application (cut-off method).	Incorporate into the entity's tax return for the year after exceeding the $31M threshold (as adjusted for inflation), including extensions.	Large contractors will typically be required to apply PCM to long-term contracts. If a contractor moves between large and small under the definition of the $31M (as adjusted for inflation), further consideration should be given.
Percentage of Completion (PCM) - 10% Method	Defer recognition of revenue under PCM until 10% or more of estimated total contract costs are incurred and allocated	Election attached to tax return in the year adopting.	File with entity tax return, including extensions.	Unavailable if the taxpayer elected to utilize the simplified cost-to-cost method for PCM, versus standard "cost-to-cost" method.

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Description of Change	What Contractors May Benefit	Action Steps	Timing	Other Considerations
Percentage of Completion - Capitalized Cost Method (PCCM)	Ability for those contractors with residential construction contractors to report 70% of the contract under PCM, and the remaining 30% under exempt method (e.g. - completed contract).	Requires advance consent of the IRS by filing Form 3115. There is a user fee.	Filed by the last day of applicable tax year.	Definition of residential contract in this regard means building with 4 or more units versus home construction contract which is 4 of fewer. Further definitions are key to review under IRC Section 460(e).
Accrual Excluding Retainages	Defer inclusion in income of retainages withheld by customer until final acceptance by customer occurred as specified in the contract. Contract must be exempt from IRC Section 460 (short-term).	Requires automatic consent of the IRS by filing Form 3115.	File with entity tax return, including extensions.	Must also exclude retainage payable related to same short- term contracts.
Accrual Excluding Retainage Payable	Retainage payable related to long- term contracts are not included in contracts costs until the retainage is payable to the subcontractor as defined in the contract. This slows the percent complete and reduces income recognition.	Requires advance consent of the IRS by filing Form 3115. There is a user fee.	Filed by the last day of applicable tax year	Contract language is key to applicability.

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→ Small Contractors

The small contractor exception requiring the use of the percentage completion method applies to contractors with average annual gross receipts of less than $31 million (as indexed for inflation) for 2025. Average gross receipts are calculated based upon receipts reported for tax purposes. Contractors not exceeding the $31 million (as adjusted for inflation) limitation and previously using the percentage completion method to account for revenues from long-term contracts now have broad range of choices for tax accounting methods.

In addition, IRC Section 448 has also been expanded to allow the cash method of accounting for companies with receipts of less than $31 million (as adjusted for inflation). Revisions to IRC Section 471 eases accounting for inventories also allowing the cash basis for smaller companies.

Previously, changes in accounting for long-term contracts would require advance notification and approval by the IRS. Changes for contractors no longer meeting the requirements for percentage completion or accrual basis of accounting requirements are now considered automatic. Form 3115 is still required for a change in the overall method of accounting but is submitted with the tax return for the year of change, no user fees apply, and the information required is significantly reduced. Changes from the percent complete method are made on the cut-off method so revenues from contracts in progress prior to the year of change will still be accounted for under the old method. No form 3115 is required for this change. Changes in overall methods, i.e., from accrual to cash, are made through a 481(a) adjustment. The effect of the change in the accounting method is determined at the beginning of the year of change and taken into income over four years if a positive adjustment and deducted in the year of change if negative.

Keep in mind that changes to PCM by a small contractor not required to change due to the gross receipts test (Average gross receipts under $31 million) is still a change required advanced consent by the IRS and a $11,500 user fee.

The chart on the following pages provides an overview of these provisions.

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Accounting Method Changes for Small Contractors

Description of Change	What contractors may benefit	Action Steps	Timing	Other Considerations
Other Methods Available when not required to use percentage of completion:				
Completed Contract: Revenues and costs for each contract is deferred until the job is at least 95% complete	Income is not recognized until contract is complete. No need to estimate project progress.			For non-C Corporation entities - beware of AMT issues on taxable income difference between method and percent complete income. Not suitable for long-term projects.
Cash: Revenue is recognized when cash is received and are deductible when paid.	Easy to implement and understand. Flexibility of managing income and expense timing. Income is only reported when cash is received.			May not accurately reflect long-term financial performance.
Accrual: Revenues recorded as available to be billed, Costs recorded based on economic performance occurs	Reflects true financial status by matching income and expenses.			
Overall Method Change from Accrual to Cash Method: The gross receipts threshold requirement to use the accrual method of accounting from $31 million (as adjusted for inflation)	Contractors with revenues less than $31 million (as adjusted for inflation) currently on the accrual method can switch to cash.	Completion and submission of Form 3115 under automatic change provisions	By due date of the return including extensions	Conversion made through 481(a) adjustment determined at beginning of the year of change with negative adjustment applied in the year of change and positive adjustment taken into account ratably over 4 years

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Description of Change	What contractors may benefit	Action Steps	Timing	Other Considerations
Accounting for Inventories: The IRS no longer requires accrual method of accounting if company revenues are less than $31 million (as adjusted for inflation); inventory is non-incidental material and supplies, or accounting treatment is consistent with applicable financial statement				

→ Other Points on Adoption of an Accounting Method

- Use of the method in at least two consecutive tax returns is considered an adoption of an accounting method
- Filing Form 3115 is needed to change an accounting method
- An Automatic Change in method, the Form 3115 can be filed as late as the date the taxpayer files the original return for the year of change
- A taxpayer has not adopted a method of accounting if it erroneously indicates a choice of a particular method on a tax return
- Once an accounting method is adopted, even if the method is not permissible, it cannot be changed without IRS consent (Filing a Form 3115)
- Except as otherwise provided in the List of Automatic Changes and a few other exceptions, a taxpayer cannot request an automatic consent in method change if the taxpayer, within any of the last five tax years, changed or applied for consent to change its overall method of accounting.
- If the taxpayer no longer qualifies as small business, then the prior election does not count for the 5 years restriction so the next year, they don't qualify they can switch back. And the same exception applies if they once again qualify as a small business.

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SECTION 199A

The Tax Cuts and Jobs Act (TCJA), enacted in 2017, introduced Section 199A, a provision designed to provide tax relief to certain businesses, including many construction contractors. Section 199A allows for a Qualified Business Income (QBI) deduction, which can be a significant benefit for taxpayers engaged in construction activities. This provision was previously set to expire at the end of 2026. Under OBBBA, this deduction was made permanent. The Act also made an enhancement of the deduction for QBI. Effective for tax years beginning after December 31, 2025, the Act sets the minimum deduction for active QBI at $400. It also provides that an applicable taxpayer must have a minimum of $1,000 QBI to claim the deduction. An active qualified trade or business" means any qualified trade or business of the taxpayer in which the taxpayer "materially participates," as defined in Code Section 469(h).

→ What Is Section 199A?

Section 199A provides a tax deduction of up to 20% of qualified business income (QBI). This deduction is available to businesses such as sole proprietorships, partnerships, LLCs, and S Corporations. The goal of Section 199A is to level the playing field between pass-through businesses and C Corporations, which receive a reduced tax rate of 21% under the TCJA.

→ Who Is Eligible?

- Sole Proprietors: If you operate your construction business as a sole proprietor, you are eligible for the 199A deduction, subject to the limitations discussed below.
- Partnerships and LLCs: If your construction business operates as a partnership or LLC, you can pass the QBI to the individual partners or members, who may then claim the deduction, subject to the limitations discussed below.
- S Corporations: If your construction business is structured as an S Corporation, the shareholders can claim the deduction on their share of the QBI, subject to the limitations discussed below.

For construction contractors, the majority of income will typically be eligible for the QBI deduction, but certain conditions and limitations must be considered, especially if your income exceeds certain thresholds.

→ How is "Qualified Business Income" Defined?

Per IRC Sec. 199A(c), qualified business income (QBI) means the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. QBI does not include any qualified REIT dividends or qualified publicly traded partnership income. Qualified items of income, gain, deduction, and loss mean items of income, gain, deduction and loss to the extent such items are effectively connected with the conduct of a trade or business within the United States and included or allowed in determining taxable income for the taxable year (Sec.

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199A(c)(3)(A)).

For construction contractors, QBI generally includes:

- Revenue from construction services (labor, materials, subcontracts, etc.)
- Profits from real estate development and property management activities (if part of the business)

It does not include:

- Wages earned as an employee or guaranteed payments to a partner/member
- Capital gains, dividends, and interest income
- Income from certain investment activities

→ How Much QBI Deduction Can Contractors Claim?

Basic Calculation

The general rule is that construction contractors can claim a deduction of up to 20% of their qualified business income. However, several factors can influence this deduction:

1. Income Thresholds: The deduction is subject to certain limitations for individuals with taxable income above certain thresholds. For 2025, these thresholds are:

   - $197,300 for single filers and married individuals filing separately
   - $394,600 for married couples filing jointly

   If your taxable income exceeds these amounts, your ability to claim the full 20% QBI deduction may be limited based on other factors such as the wages paid to employees and the value of qualified property as well as the type of business you operate.

2. Wages and Property Limitation: For high-income earners, the QBI deduction may be limited if you exceed the above income threshold, and you do not pay significant wages to employees or own significant property used in the business. If you exceed the applicable income threshold, your QBI deduction is capped at the greater of:

   - 50% of the wages you pay to employees, or
   - 25% of wages plus 2.5% of the unadjusted basis of qualified property (like equipment or real estate).

3. Specified Service Trade or Business (SSTB): For high-income earners that perform services in the fields of Health, Law, Accounting, Actuarial Sciences, Performing Arts, Consulting, Athletics, Financial or Brokerage Services, or any trade or business where the principal asset of such trade

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or business is the reputation or skill of one or more of its employees or owners, the QBI deduction is phased-out starting at the above income thresholds and fully phased-out at:

- $247,300 for single filers and married individuals filing separately
- $494,600 for married couples filing jointly

The good news is that construction businesses do not typically fall under the SSTB classification.

4. Taxable Income Limitation: The amount of the QBI deduction is limited to the taxpayer's taxable income less its net capital gain.

The following examples illustrate the application of the 199A deduction in various scenarios.

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→ How Do We Apply the 199A?

Income Above Threshold Amounts – Wage-Intensive Business

	Business Other than Specified Service Business	Specified Service Business
Partner's Share of Qualified Business Income	$ 1,000,000	$ 1,000,000
Partner's Share of W-2 Wages	$ 200,000	$ 200,000
Partner's Share of Unadjusted Basis of Qualified Property	$ 10,000	$ 10,000
20% of Partner's Share of Qualified Business Income	$ 200,000	$ 200,000
Deduction (Apply 50% of W-2 wage limit)	$ 100,000	$ 0

Income Above Threshold Amounts – Capital-Intensive Business

	Business Other than Specified Service	Specified Service Business
Partner's Share of Qualified Business Income	$ 1,000,000	$ 1,000,000
Partner's Share of W-2 Wages	$ 50,000	$ 50,000
Partner's Share of Unadjusted Basis of Qualified Property	$ 1,000,000	$ 1,000,000
20% of Partner's Share of Qualified Business Income	$ 200,000	$ 200,000
Deduction (Apply 25% of W-2 / 2.5% unadjusted basis limit)	$ 37,500	$ 0

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→ Wage Limitation

Wages play a major role in the calculation of the 199A deduction. Below are three scenarios:

	A	B	C
Wages (including owners)	$ 400,000	$ 200,000	$ 300,000
Taxable income	$ 600,000	$ 800,000	$ 700,000
20% of QBI	$ 120,000	$ 160,000	$ 140,000
50% of wages	$ 200,000	$ 100,000	$ 150,000
199A Deduction	$ 120,000	$ 100,000	$ 140,000

In Scenario A (most construction companies) – the deduction is limited to 20% of QBI. Therefore, reducing owner's wages and increasing QBI will increase the deduction. Consider paying quarterly estimates instead of a bonus to pay safe harbor amounts. If the owner reduces his wages by $100,000, and takes a distribution instead, the deduction is increased by $20,000. Please remember to watch reasonable compensation.

In Scenario B (possible for construction management and A&E firms) – the deduction is limited to 50% of the wages. Therefore, increasing owner's wages will increase the deduction. As with any planning technique, consider the cost of increasing payroll expenses versus the benefit of increasing the 199A deduction.

In Scenario C – this is close to the optimum wage to QBI percentage, 50% of wages approximates 20% of the QBI.

Another area relating to wages are leased employees, if you have a developer who maintains a separate partnership for all projects but uses one entity for payroll, the payroll can be allocated to the end users of the payroll, thus increase the 199A deductions.

Subcontracting is very common in the construction industry and subcontractor fees do not qualify as wages. If your company heavily relies on subcontracting, you may want to consider who you can include on payroll to maximize your 199A deduction.

→ Property Limitations

Another limit of the deduction is 2.5% of unadjusted basis on qualifying property plus 25% of wages. Property no longer qualifies after 10 years from the original placed in-service date or the last day of last full year in the applicable recovery period determined under section 168. If this factors into the 199A deduction, it should factor into property replacement decisions.

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→ Aggregation Rules

A taxpayer can potentially choose to aggregate businesses for the deduction if the taxpayer operates multiple businesses in coordination with each other, shares resources, and are commonly controlled. How a taxpayer groups or doesn't group businesses for purposes of applying the passive activity loss rules doesn't affect how the taxpayer can aggregate or not aggregate businesses for purposes of applying the QBI deduction rules. After a taxpayer chooses to aggregate two or more businesses for QBI deduction purposes, he or she must continue to aggregate the businesses in all subsequent tax years.

→ Other Considerations

If the business income does not qualify for the 199A deduction consider additional wages to reduce the income to an amount under the threshold and look at other deductions such as bonus depreciation, Section 179 depreciation, and retirement or SEP contributions. Conversely some taxpayers may need to reduce the amount of deductions to optimize their 199A deduction.

In summary, Section 199A can provide a tax benefit but how to best derive that benefit can be vastly different taxpayer by taxpayer. It is highly recommended you consult the CICPAC group and your tax advisor to discuss any planning needs on an annual basis.

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OTHER OPPORTUNITIES / CONSIDERATIONS

→ Excess Business Losses

The TCJA brought in some unfavorable rules around the deductibility of business losses. As indexed for inflation, the 2025 threshold amount of allowed business losses is $626,000 for joint filers and $313,000 for single filers. These rules apply at the taxpayer level for pass-through business income (or schedule C business income) and do not apply to C Corporations. Excess losses are carried forward to future years as Net Operating Losses.

Although A last-minute change to the Inflation Reduction Act included an extension of the Excess Business Loss limitation through 2028, this provision has been made permanent under OBBBA.

OBBBA also modified the inflation adjustment calculation for the $250,000 amount; "2024" has been substituted for the "2016" in Code Sec 1(f)(3)(A)(ii).

The change under OBBBA making permanent the excess business loss limit is effective for tax years beginning after December 31, 2026. The change to the calculation of the inflation adjustment is effective for tax years beginning after December 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 December 31, 2021. Under TCJA, taxpayers were required to capitalize all IRC §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 December 31, 2021. OBBBA enacted new Section 174A, which permanently allows taxpayers to fully expense domestic research or experimental (R&E) expenditures paid or incurred in taxable years beginning after December 31, 2024. OBBBA also provides transition rules permitting taxpayers to deduct unamortized domestic R&E expenditures paid or incurred in 2022 through 2024. The legislation has broad implications, including technical considerations for partnerships, state and local tax (SALT) compliance and planning. Understanding key provisions, including amendments to Section 41 and Section 280C(c) for taxpayers claiming or planning to claim the research credit, and transition rules for small businesses, is essential for timely decision-making.

While OBBBA restores the full expensing for domestic R&E expenditures, foreign R&E expenditures must still be capitalized and amortized over 15 years.

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The Act also allows taxpayers to accelerate any remaining Section 174 deductions by electing to amortize them in full in the first taxable year beginning after December 31, 2024, or alternatively, amortize them ratably over the 2-taxable year period beginning with the first taxable year beginning after December 31, 2024.

For tax years beginning after December 31, 2024, under Section 174A(a), taxpayers may immediately deduct domestic R&E expenditures that are paid or incurred during the taxable year; alternatively, they may elect to capitalize domestic R&E expenditures and amortize them ratably over a period of no less than 60 months, beginning with the month in which the taxpayer first realizes the benefits of the research in its trade or business under Section 174A(c). As another alternative, conforming amendments made to Section 59(e) permit taxpayers to deduct domestic R&E expenditures ratable over 10 years, beginning with the taxable year in which the expenditures were made. The election is made on an annual basis, which distinguishes it from the more permanent nature of an election under Section 174A(c).

Applying Section 174A for domestic R&E expenditures is a change in method of accounting implemented on a cut-off basis for amounts paid or incurred in taxable years beginning after Dec. 31, 2024. Taxpayers with a short taxable year beginning after Dec. 31, 2024, and ending before July 4, 2025, must implement the method change on a modified cut-off basis with a Section 481(a) adjustment, taking into account only the unamortized domestic R&E expenditures paid or incurred during the short taxable year.

Transition rules provide taxpayers with options to account for any remaining unamortized domestic R&E expenditures paid or incurred in taxable years beginning after Dec. 31, 2021, and before Jan. 1, 2025. Taxpayers may continue to amortize such unamortized amounts over the remaining five-year period; alternatively, they may elect to deduct any remaining unamortized domestic R&E expenditures either entirely in the first tax year beginning after Dec. 31, 2024, or ratably over two taxable years (e.g., 2025 or ratably in 2025 and 2026).

Partnerships also should be aware of potential impacts at both the entity and the partner level for the change to Section 174A. Partner-level limitations may prevent partners from utilizing the distributive share of any accelerated deduction of unamortized costs, and consideration should be given to tax distributions that have been made based on 2025 estimates that do not include the impact of various elections and opportunities under OBBBA.

OBBBA also modified several key provisions related to the research credit under Sections 41 and 280C(c). For taxable years beginning after Dec. 31, 2024, taxpayers claiming the gross research credit must reduce their domestic R&E expenditures by the amount of the gross research credit. Alternatively, taxpayers may elect to claim the reduced research credit on a timely filed return (including extensions). These options are consistent with pre-TCJA rules under Section 280C(c). Section 41(d) also was amended and now requires that expenditures be treated as domestic R&E expenditures under Section 174A to be qualified research expenditures eligible for the research

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credit. This change could significantly impact a taxpayer's ability to include certain costs in the research credit.

Taxpayers with average annual gross receipts of less than $31 million (the Section 448(c) gross receipts test) computed for the first taxable year beginning after Dec. 31, 2024, can elect to retroactively apply Section 174A to domestic R&E expenditures paid or incurred in taxable years beginning after Dec. 31, 2021. To do so, they must amend the tax returns for each affected taxable year. Small business taxpayers that elect to retroactively apply Section 174A also must retroactively apply the conforming amendments to Section 280C(c) (discussed previously), including the making or revoking of any such election on the originally filed tax return. Therefore, small business taxpayers electing retroactive application of Section 174A must either reduce their domestic R&E expenditures by the gross research credit or otherwise claim the reduced research credit.

Small business taxpayers must file the amended returns for each affected taxable year by July 6, 2026, to elect retroactive application of Section 174A, which may be treated as a change in method of accounting. Additionally, small business taxpayers must file amended returns to make or revoke the Section 280C(c) election.

On August 28, 2025, the IRS issued guidance (Revenue Procedure 2025-28) on how to make various elections, file amended returns or change accounting methods for research or experimental expenditures as provided under OBBBA. It also grants an extension of time for taxpayers to file superseding 2024 Federal income tax returns. Revenue Procedure 2025-28 can be found at https://www.irs.gov/pub/irs-drop/rp-25-28.pdf.

Partnerships subject to the centralized partnership audit regime introduced by the Bipartisan Budget Act of 2015 that are small businesses and eligible for retroactive application of Section 174A may be required to make the election on an Administrative Adjustment Request. The additional deductions that arise from the retroactive application would be pushed out to the current year partners, and the tax effect of the adjustments would be reported on the partner's tax return for the year in which the AAR is filed (2025 or 2026). There can be some strategic planning around when an AAR is filed to ensure the partners realize a benefit from the adjustments, and a BBA partnership should consider discussing a modeling exercise with its partners to ensure any benefit from an election won't be lost when the tax effect of the adjustments is reported at the partner level.

SALT considerations are essential for comprehensive tax planning. Taxpayers should begin by identifying the states most relevant to their tax profile and assessing whether these states conform to or decouple from TCJA Section 174 or new Section 174A.

The conformity question may be particularly challenging to analyze, because states have taken a variety of inconsistent and complex approaches with respect to the treatment of this deduction. For example, a substantial number of states, including Illinois and New York, conform to new Section 174A because they consistently follow the current Internal Revenue Code. About a third of states,

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including Florida and North Carolina, currently conform to TCJA Section 174, and as such, do not yet follow Section 174A. Still yet, a few other states, including California, currently conform to pre-TCJA Section 174, which allows for full expensing of both domestic and foreign R&E expenditures. Several states allow taxpayers flexibility to elect particular versions of Section 174 or potentially Section 174A.

Further complicating matters is that some states might change these policies prior to the 2025 tax filing season through special or general legislative sessions. Taxpayers also must evaluate whether elections, such as elective capitalization of domestic R&E expenditures under Section 174A(c), are available at the state level when not made federally, and conversely, whether federal elections are recognized in states that have decoupled. Given this significant change in the treatment of R&E expenditures, regulatory guidance from the state tax authorities is expected in the coming months.

Careful planning is needed for 2025 to evaluate the impact IRC §174 may have on a Contractors' taxable income, cash flow, financial statements, and estimated tax payments. For example, taxpayers may not benefit from immediate expensing of domestic R&E expenditures in 2025 if immediate expensing increases an existing loss or generates a large net operating loss (NOL) that would be limited to 80% of taxable income in future years or limited currently due to excess business losses. Taxpayers expecting to generate income in future years may elect to capitalize and mortise 2025 domestic R&E expenditures under Section 174A(c) or Section 59(e) as a strategy for matching future amortization deductions against current income.

→ 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:

- 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 January 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. Starting with tax years beginning after December 31, 2021 and ending with tax years beginning before January 1, 2025, this add-back rule stopped applying for the calculation of ATI. OBBBA brings back and makes permanent the computation of ATI without regard to depreciation, amortization or depletion for tax years beginning after Dec. 31, 2024. Many businesses should benefit from the return to a tax basis EBITDA-based computation of ATI because it will generally increase the amount of interest deductible in any given year for companies with depreciation, amortization or depletion.

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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 ($31 million for 2025 and $30 for 2024). 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.

→ Extension and Enhancement of Increased Estate and Gift Tax Lifetime Exclusion Amounts

The TCJA doubled the applicable lifetime gift exclusion for 2018-2025. The lifetime exclusion for 2025 is set at $13.99 million per individual. The doubled lifetime exclusion amount was due to sunset at the end of 2025. Sunsetting would have caused it to revert back to the pre-TCJA $5 million limit (adjusted for inflation) per individual. OBBBA permanently extends the lifetime exclusion and raises it to $15 million per individual in 2026. This provision does not sunset, but rather continues to increase for inflation adjustments going forward, beginning in 2027. This enhanced exemption creates significant planning opportunities for the owners of closely held construction companies.

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REVIEW RETIREMENT PLAN OPTIONS: SECURE AND SECURE 2.0

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 2024 in addition to exploring plan enhancement options for 2025.

On December 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 January 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 January 1, 2024, Roth accounts in qualified employer retirement plans will also be exempt from RMD requirements like Roth IRAs.
- Beginning January 1, 2025, individuals aged 60 to 63 will be able to make "super catch up" annual catch-up contributions up to the greater of $11,250 (inflation indexed amount for 2025) or 150% of the standard catch-up contribution for the year to an employer retirement plan. This "super catch up" provision is not a mandatory plan provision.
- The catch-up contribution amount for individuals 50 and older is $7,500 for 2025.
- A provision that was supposed to begin January 1, 2024 required plan participants earning more than $145,000 in the prior calendar year (indexed for inflation) to make all catch-up contributions to a Roth account in after-tax dollars. The implementation of this provision has been delayed to January 1, 2026, in order to allow plan providers with a transition window. 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.
- Roth matching contributions (effective 2023) - SECURE 2.0 provides the option for plan participants to have employer matching or nonelective contributions designated as Roth contributions.

Key features:

- Pre-tax versus after-tax: Traditionally, all employer matches were made on a pre-tax basis. With this change, employees can choose to receive contributions on an after-tax basis, meaning they pay income tax upfront.

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  - Implications for employees: Paying taxes upfront on these employer contributions means that both the contributions and any earnings are tax-free upon withdrawal in retirement.
  - Immediate vesting required: If designated as Roth, the employer contributions must be 100% vested when they are made to the plan.
  - No FICA/FUTA withholding: Employer matching and nonelective contributions that are designated as Roth are not subject to withholding for Social Security or Medicare taxes.
  - Form 1099-R reporting: These contributions are reported on a Form 1099-R for the year they are allocated to the individual's account.

- Under SECURE 2.0, any 401(k) or 403(b) plan established after the date of enactment (December 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 January 1, 2024, defined contribution retirement plans can add an emergency savings account that is a designated Roth account. Non-highly compensated employees (defined in 2025 as those earning up to $155,000) will be eligible to contribute up to $2,500 annually to this emergency savings account. Contributions may be eligible for matching contributions. The first four withdrawals in a year will not be subject to any withdrawal fees to the employee.
- Beginning January 1, 2024 to help employees struggling with student loan debt, employers will be able to make additional matching contributions to retirement plans based on employee's qualified student loan payments (QSLPs). Employee QSLPs for the employee, spouse, or dependent count towards the company match calculation.
  - Encourages retirement savings: This provision helps employees who might otherwise forgo retirement savings to pay off their student loans. It allows them to receive the valuable employer match while addressing their debt.
  - How it works:
    - Employers can offer this feature in their 401(k), 403(b), or SIMPLE IRA plans, but it is not a requirement.
    - Employees must annually certify that they have made QSLPs.
    - Matching contributions must follow the same vesting schedule and rate as regular matching contributions.
    - The amount of QSLPs that can be matched is subject to the annual elective deferral limit.

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→ 2025 Tax Act/One Big Beautiful Bill (retirement savings for minors)

The One Big Beautiful Bill, now referred to as the "2025 Tax Act" was signed into law in July 2025 by President Trump. Under this bill, a new form of retirement savings for minors under new Code Section 530A was established, effectively referred to as "Trump Accounts".

- **Beginning after July 4, 2026, up to $5,000 can be contributed to an account formed for the benefit of a minor child (must be under 18)**
- **Contributions are not tax-deductible, earnings grow tax deferred, and account converts to a Traditional IRA upon the minor reaching age 18.**
- **Employers can contribute up to $2,500, however any employer contribution counts towards the annual $5,000 contribution limit**

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EMPLOYEE RETENTION CREDITS (ERC)

The deadline to file refund claims for 2020 and 2021 has passed. The IRS is slowly processing the remaining outstanding ERC claims, with estimations of a couple hundred thousand claims still not reviewed.

Contractors have been receiving a mix of refunds checks, denial letters, and requests for additional information to support the credit. If you receive a denial request and believe your claim is valid, an appeal can be filed to challenge the IRS assertion of an invalid claim. Pay close attention to the dates however, as the appeal process does not extend the two-year statute to file a claim for refund even with a pending appeal filed.

An important reminder regarding the ongoing ERC process for many Contractors. If a Taxpayer claims the ERC 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. Income tax returns generally have a three-year statute of limitations, which for the 2020 and 2021 tax years is likely to be closed as of this publication.

Some Taxpayers have taken the approach to not file the 2020 and 2021 amended income tax returns to reduce the wage deduction until they have received the ERC claim refund. In March 2025, the IRS updated Frequently Asked Questions (FAQ) to address this approach and to also provide additional guidance regarding the income tax statute of limitations and the IRS delay in processing the ERC claims.

In these FAQs under the "Income tax and ERC" section, which are linked below, the IRS addressed the requirement to disallow the wage deduction for 2020/2021, and acknowledged the statute of limitations to file an amended return was likely closed. The IRS approach in the FAQ's is to use the tax benefit rule, thus stating that if a Taxpayer receives the ERC in a subsequent year and they did not disallow the wage deduction in 2020/2021, that they should include the ERC as income in the year it is received.

Conversely, if a Taxpayer has an ERC application denied in a subsequent year, and they previously amended 2020/2021 to disallow the wage deduction, the FAQ guidance indicates that the Taxpayer is allowed to deduct the previously disallowed wages in the year the ERC is denied and the Taxpayer ceases to contest the denial.

The March FAQ's do not address the interplay between ERC, wage expense included in contract costs for purposes of computing the percentage-of-completion method under Section 460, and the tax benefit rule.

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Keep in mind that the IRS has extended the statute of limitations to 5 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.

Below is a link to IRS Frequently Asked Questions regarding ERC:
https://www.irs.gov/coronavirus/frequently-asked-questions-about-the-employee-retention-credit

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CHOOSING BETWEEN S CORP VERSUS C CORP

The TCJA brought about a myriad of changes to C Corp and S Corp tax rules. Over the past 40 years, tax practitioners have seen the effective corporate tax rates increase relative to personal income tax rates.

The TCJA brought a significant reduction of the federal corporate tax rate and not quite the same reductions in personal tax rates. It is easy to see why a corporate tax structure is a much easier tax pill to swallow and may be the most tax efficient entity type if a large portion of earnings are not being distributed to owners but are being retained in the company for growth and / or debt repayment.

- **Highest effective tax rates of S-Corp net income – 37% (29.6% with full section 199A deduction)**
- **Highest effective** tax rates of C-Corp net income – 21% (plus the applicable tax rate on dividend distributions)

S Corporations (S Corps) and C Corporations (C Corps) are both legal corporate structures that provide limited liability protection to their owners, but they differ significantly in their tax treatment and ownership rules. A corporation is, by default, a C Corp for tax purposes unless it files IRS Form 2553 to elect S Corp status.

The main difference is how they are taxed: C Corps have double taxation, where profits are taxed at the corporate level and again when distributed as dividends to shareholders, while S Corps have pass-through taxation, meaning profits and losses are passed through to the owners' personal income and taxed only once.

C Corps offer greater ownership flexibility with unlimited shareholders and multiple stock classes, making them better for seeking outside investment, whereas S Corps are limited to 100 shareholders who must be U.S. citizens or residents and can only have one class of stock.

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→ Taxation

The primary difference between an S Corp and a C Corp is how the business is taxed at the federal level. See taxation summary chart below.

Feature	S Corp	C Corp
Federal Income Tax	Pass-through taxation: Profits and losses pass through to the owners' personal tax returns and are taxed only at the individual level. The corporation files an informational return (Form 1120S) but does not pay federal income tax itself.	Corporate tax: The corporation is a separate taxable entity. It pays a flat 21% corporate income tax on its profits using Form 1120.
Dividend Taxation	Distributions of profits to shareholders are generally not subject to additional income tax, avoiding double taxation.	Double taxation: Dividends paid to shareholders are taxed twice. First, the corporation pays income tax on its profits. Second, shareholders pay personal income tax on the dividends they receive.
Self-Employment Tax	S Corp owner-employees must pay themselves a "reasonable salary," which is subject to FICA taxes (Social Security and Medicare). However, additional profits paid out as distributions are not subject to these taxes, which can result in tax savings.	All profits taken as salary are subject to FICA taxes, and there is no comparable self-employment tax benefit.
Employee Benefits	S Corps offer fewer tax-deductible employee benefits for shareholders who own more than 2% of the company.	C Corps can offer more tax-deductible employee benefits, such as health insurance, which can be a tax advantage for the business.

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→ Ownership and Investors

The type of investors you need and your growth strategy are key factors in choosing between an S Corp and a C Corp. See ownership summary chart below.

Feature	S Corp	C Corp
Number of Shareholders	Capped at 100 shareholders.	No limit on the number of shareholders.
Shareholder Eligibility	Owners must be U.S. citizens or permanent residents. Most entities, including corporations, partnerships, and many LLCs, cannot be shareholders.	Owners can be individuals, other corporations, partnerships, and foreign investors.
Classes of Stock	Limited to one class of stock, though shares can have different voting rights. This restricts flexibility for structuring investment deals.	Can issue multiple classes of stock (e.g., common and preferred stock), which is more appealing to venture capital and other institutional investors.
Capital Raising	The shareholder and stock limitations can restrict the ability to raise significant outside capital from a broad range of investors.	Offers greater flexibility for attracting a diverse base of investors, including venture capital firms, and is a better choice for businesses planning an IPO.

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→ When to choose each entity structure

Your business goals will determine which structure is the better fit.

Choose an S Corp if:

- You are a small, closely held company with fewer than 100 U.S. citizen or resident owners.
- Your primary goal is to avoid double taxation and reduce self-employment tax.
- You don't need a complex ownership structure with different classes of stock.
- You do not plan on raising capital from a large number of investors or going public.

Choose a C Corp if:

- You plan to seek large-scale outside investment, such as from venture capital firms.
- You plan to have more than 100 shareholders, foreign investors, or other business entities as owners.
- You need the flexibility to offer multiple classes of stock.
- You plan to reinvest most profits back into the business rather than distributing them as dividends

→ Considerations to Keep in Mind for Converting from an S-CORP to a C-CORP:

- Is the income from the entity eligible for QBI deduction?
- If change from S to C, how are historical earnings taxed leaving a C-Corp?
- Per 1371(e)(1) during the post-termination transition period (PTTP):
    - The corporation is allowed distributions tax free to the extent of AAA.
    - These distributions decrease the owner's basis in the stock.
    - Note – lack of clarity what happens to unused AAA if re-elect S status down the road.
    - After PTTP closes, distributions are treated as pro-rata coming from AAA and E&P for an eligible S- Corp (same ownership proportions as S-Corp when C-Corp).
    - PTTP generally ends on later of one year after S-election revocation or due date for filing the final S- Corp return including extensions.
- Plan for tax considerations on future distributions of earnings (dividends) and future business exit/transition
- Must remain C-Corp for five tax years.
- Must consider built-in-gains tax consequences for 5 years post re-electing S-Corp status.

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Below is a chart comparing S-Corporation vs C-Corporation under law as it currently stands/was extended under the 2025 Tax Act:

		S-Corp Current Law	C-Corporation (No Law Changes)
	Business Income	1,000,000	1,000,000
	Section 199A Deduction (a)	(200,000)	-
	Taxable Income	800,000	1,000,000
	Federal Tax Rate (b)	37.00%	21.00%
	Federal Tax	296,000	210,000
[A]	Total Taxes Before Distribution/Dividend	296,000	210,000
	Cash Available for C-Corp Dividend	-	790,000
	Shareholder Tax on Dividend		
	Federal Qualified Dividend Tax (plus NIIT) - 23.8% (c)	-	188,020
[B]	Total Shareholder Dividend Tax	-	188,020
	Effective Rate for [A] - Income Taxes	29.60%	21.00%
	Combined Effective Rate of [A] + [B]	29.60%	39.80%

(a) S-Corp - assume all income eligible for 20% Qualified Business Income Deduction

(b) S-Corp tax rate assumes that Taxpayer is already in the highest marginal tax bracket

(c) C-Corp Dividends presumed subject to 20% LTCG rate + 3.8% Net Investment Income Tax

** Note that this illustration does not take into account the impact of any state-level imposed income taxes

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→ Qualified Small Business Stock

For newly formed entities, using a C Corporation could provide access to deferral of up to $15,000,000 of gain on the eventual sale of the stock under Section 1202 for shareholders of qualifying businesses that meet all the requirements.

This Section 1202 exclusion was expanded on by the 2025 Tax Act (OBBB). For QSBS stock acquired after July 4, 2025, a tiered gain exclusion was introduced from 50% exclusion after 3 years of ownership up to 100% after 5 years of ownership. Total eligible exclusion was also increased to up to $15,000,000, subject to requirements and limitations.

→ Pass-Through Entity (PTE) Tax Elections

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. More than 35 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 vary 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.

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

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MOBILE WORKFORCE CONSIDERATIONS

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

- **For 2025, the IRS increased the standard business mileage rate to 70 cents per mile.**
- **Contractors should continue to monitor and follow the U.S. General Services Administration per diem rates which are reset each fiscal year starting October 1st.**
- **Business meal expenses remain at 50% deducible. For job related meals, consider itemizing on invoices to customers for potential full deduction.**

For a more detailed reminder on current mobile workforce considerations and best practices, please see the CICPAC issued *Mobile Workforce Guidelines* whitepaper found at www.cicpac.com.

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OPPORTUNITY ZONE PROGRAM (UPDATED UNDER OBBB)

The Opportunity Zone Program is a federal initiative designed to spur new and increased investments in economically disadvantaged communities. Originally enacted under the Tax Cuts and Jobs Act of 2017, the program was extended and made permanent by the One Big Beautiful Bill (effective July 4, 2025).

The program designates certain census tracts as Qualified Opportunity Zones (QOZs). Under the OBBB, governors will designate a new round of zones by July 1, 2026, which will take effect beginning January 1, 2027, and each designation will remain in place for ten years.

Tax Incentives

Investors may contribute capital gains into Qualified Opportunity Funds (QOFs) or, under the new law, into Qualified Rural Opportunity Funds (QROFs) to receive favorable tax treatment.

- Legacy Investments (through December 31, 2026):
    - Capital gains invested within 180 days into a QOF may be deferred until the earlier of (a) sale of the QOF investment or (b) December 31, 2026.
    - A 10% basis step-up is available for QOF investments held at least 5 years; an additional 5% step-up applies if held 7 years before December 31, 2026 (total of 15%).
    - Post-acquisition appreciation on QOF investments held at least 10 years may be permanently excluded from tax.

- New Regime (investments on or after January 1, 2027):
    - The program is permanent—there is no sunset for new investments.
    - Deferred gain is postponed for up to 5 years from the date of QOF investment (replacing the fixed 180-day rule).
    - A 10% basis step-up is available if the investment is held for at least 5 years.
    - The 7-year / 15% step-up benefit is eliminated.
    - Appreciation on QOF investments held at least 10 years remains eligible for permanent exclusion, but basis step-up is capped at fair market value on the 30th anniversary of the investment.
    - The OBBBA mandates stricter reporting and compliance standards for QOFs, including annual disclosures on investment activities and community impact metrics.
- Rural Opportunity Funds (QROFs):
    - QROFs must hold at least 90% of their assets in rural opportunity zone businesses or property.
    - QROF investors receive an enhanced 30% basis step-up after 5 years.
    - Substantial improvement rules are relaxed for certain rural properties (improvements must exceed 50% of basis, rather than higher thresholds elsewhere).

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Requirements

- Funds must be certified by the U.S. Treasury Department.
- They must be organized as corporations or partnerships for the purpose of investing in Qualified Opportunity Zone property.
- They must hold at least 90% of their assets in Qualified Opportunity Zone property (QOFs) or rural zone property/businesses (QROFs).

Qualified Property

- Includes newly issued stock, partnership interests, or tangible business property located in a Qualified Opportunity Zone.
- Investments are limited to equity interests; loans and other debt instruments are not eligible.
- Most investments must meet a "substantial improvement" test, unless exceptions for rural properties apply.

Key Notes

- The old program rules apply through December 31, 2026.
- Beginning January 1, 2027, all new investments follow the permanent regime established by the OBBB.
- Opportunity Zones are now a permanent feature of federal tax law.

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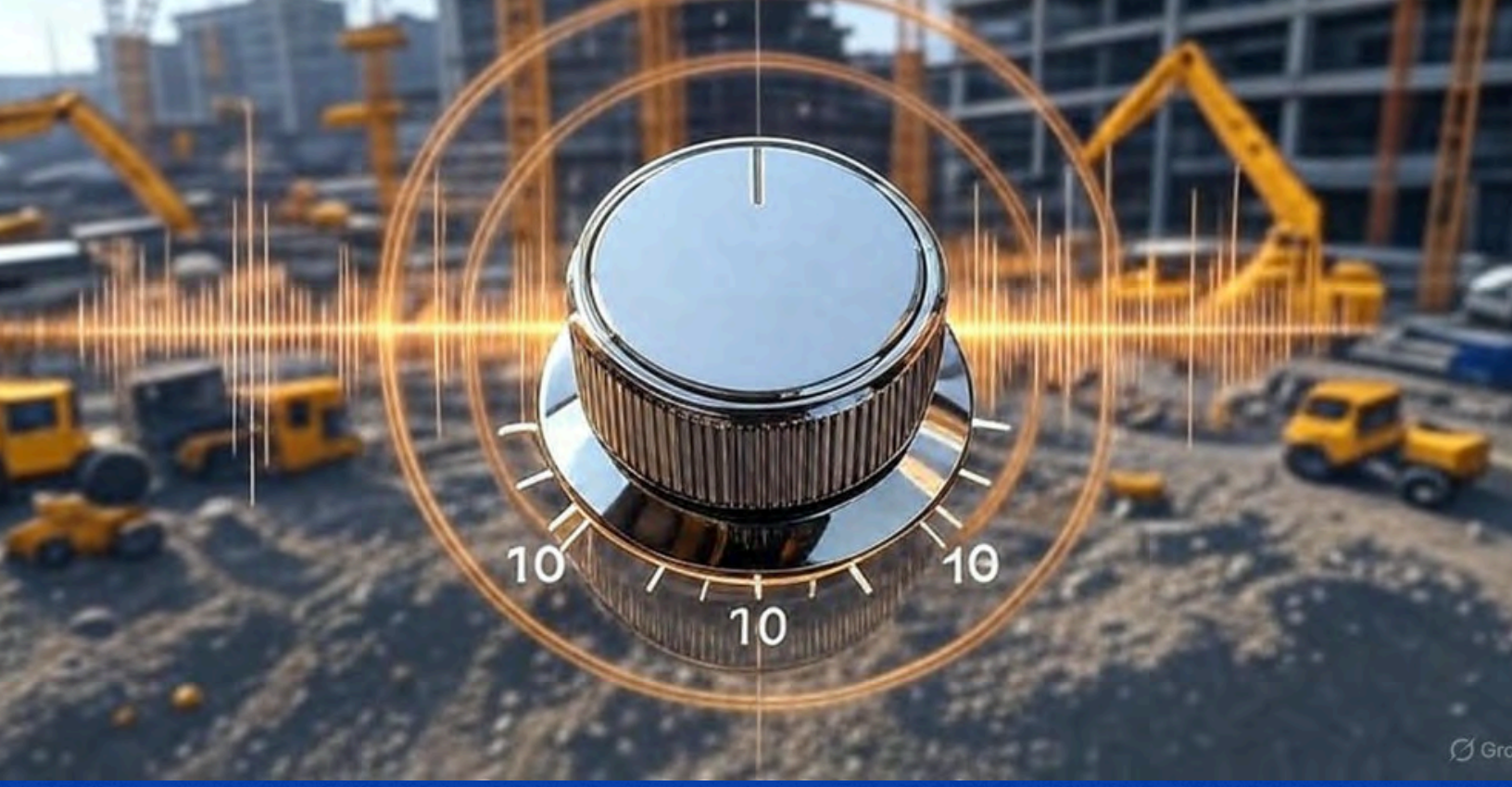

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