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CONSTRUCTION INDUSTRY ADVISOR

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Could your construction company benefit from a PTET?

If your construction business is structured as a partnership, limited liability company or S corporation, don't overlook the potential benefits of a state's pass-through entity tax (PTET).

Nearly every state with a personal income tax has enacted or is considering enacting an elective PTET as a workaround for the $10,000 federal limit on deductions of state and local taxes (SALT). If your company's partners or shareholders have substantial state income tax liabilities, a PTET may provide them with significant tax savings.

However, electing a PTET isn't necessarily a no-brainer. In some cases, it can increase business owners' state tax liability. And administering the tax can be complex for contractors who work on projects in multiple states.

Where it came from

The Tax Cuts and Jobs Act of 2017 imposed a $10,000 limit on SALT deductions by individual taxpayers for federal tax purposes, effective from 2018 through 2025. The cap substantially reduces itemized deductions for many taxpayers — especially those in states with high personal income and property taxes — causing their federal tax liabilities to rise.

To soften the blow, states began to create a variety of creative workarounds to help taxpayers in their states circumvent the $10,000 limit. The IRS rejected most of these solutions but, in 2020, it gave its blessing to the PTET concept.

How the tax works

The mechanics of each PTET vary from state to state, but a typical tax works like this: An eligible pass-through entity elects to pay tax on income

derived from business activities in that state — usually, but not always, at the highest individual income tax rate. The entity's shareholders or partners receive a state income tax credit equal to their pro rata share of the entity's tax liability to offset their individual state taxes on the same income. In other words, they avoid double taxation.

Essentially, a PTET shifts liability for state income taxes from the individual owners to the entity. But unlike the individual owners, who are subject to the SALT limit, the entity can deduct the full amount of the state taxes as a business expense on its federal tax return. Doing so reduces the amount of income that flows through to the shareholders or partners.

The financial result for the business owners is roughly the same as if they'd paid state income taxes themselves on their pro rata shares of the entity's income and then fully deducted them on their federal returns with no limit.

And now, the fine print

As noted above, precisely how each PTET works varies depending on which state(s) you operate in. That's why it's important to evaluate the potential impact — both positive and negative — on your construction business and its owners' financial situations before making the election.

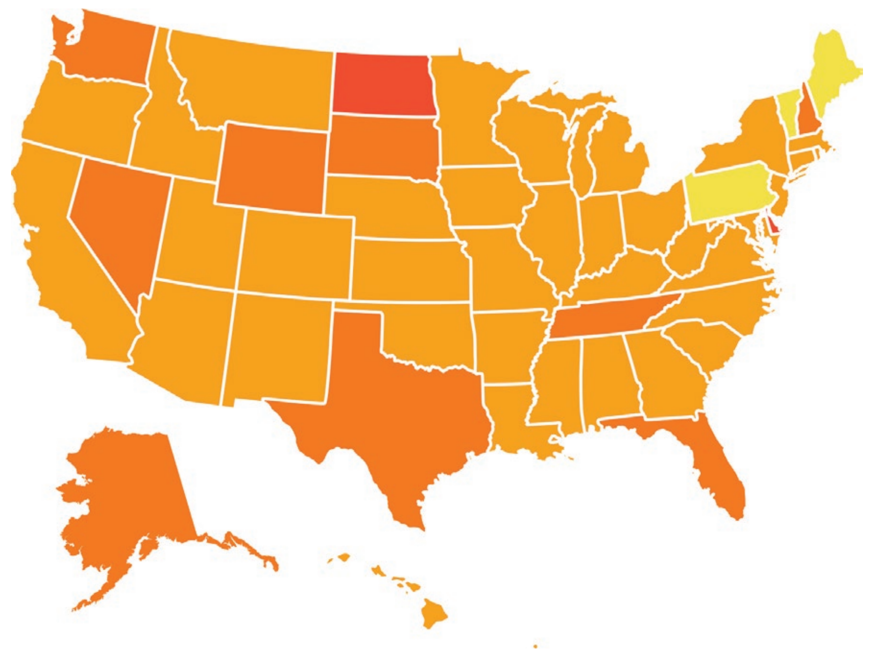
The state of PTETs

As of this writing, the state of pass-through entity tax (PTET) legislation nationwide is as follows:

States with a PTET*	States with pending PTET legislation	States with a personal income tax but no PTET**	States with no personal income tax
Ala., Ariz., Ark., Calif., Colo., Conn.,† Ga., Hawaii, Idaho, Iowa, Ill., Ind., Kan., Ky., La., Mass., Md., Mich., Minn., Miss., Mo., Mont., N.C., Neb., N.J., N.M., N.Y., Ohio, Okla., Ore., R.I., S.C., Utah, Va., Wis., W.Va.	Maine, Pa., Vt.	Del., N.D.	Alaska, Fla., Nev., N.H., S.D., Tenn., Texas, Wash., Wyo.

* New York City also has its own PTET.
** Washington, D.C., also has a personal income tax but no PTET.
† Connecticut's PTET had been mandatory but became elective in 2024. All other states' PTETs are elective.

States have different rules about which entities and owners are eligible. For example, in some states, eligibility is limited to entities whose owners are individuals, estates, trusts or corporations — but not partnerships. Others limit eligibility to entities whose owners are all individuals. Some states have no restrictions at all. Ineligible entities may be able to restructure themselves to qualify.



Some states permit shareholders or partners to decide whether they'll participate in the PTET. In those states, the entity pays the PTET on their consenting owners' pro rata or distributive shares of the entity's net income, and the consenting owners receive a corresponding credit. In other states, the entity must decide as a whole whether it'll file a PTET election on behalf of the owners. The rules for making this decision vary from state to state.

Decision criteria

In deciding whether to make the election, it's important to consider the impact on owners' state tax liabilities. Depending on the mechanics of the credit, and the rate at which it applies, a PTET can increase those liabilities in some cases.

For instance, if owners receive a refundable credit for the full amount of their pro rata shares of the PTET paid by the entity, from a state tax perspective, they'll be in the same position as if the election hadn't been made. Some states offer only a partial credit; for example, 80% of the PTET. There are also states where the credit is nonrefundable — though it may be carried forward indefinitely or for a specified number of years. In other words, depending on state law, the PTET may increase some owners' state taxes, which must be weighed against the benefits of avoiding the SALT deduction limit.

There are other factors to consider as well. As mentioned, multistate tax and administrative issues can be challenging. For instance, does your primary state offer residents a credit for their pro rata shares of a PTET paid in other states? On the administrative side, you'll need to make the initial election, file entity and individual tax returns, and keep up with estimated tax payments.

Not a simple decision

Under the right circumstances, claiming a PTET can generate tax savings for eligible construction companies. But determining whether it's the right move for your business is far from a simple decision. If interested, work closely with your CPA to explore the idea. ■

Managing your construction company's workers' comp costs

In a physically intensive industry such as construction, injuries happen. For this reason, workers' compensation insurance has got to play a critical role in your risk management efforts.

From a financial perspective, the challenge is preventing workers' comp costs from spiraling out of control. Doing so isn't always easy, but there are ways to keep your construction business — and its workers — on safer ground.

Train continuously

Because of the skilled labor shortage, many construction companies have had to hire inexperienced workers — greatly increasing the risk of accident and injury. Be sure to allocate the time and dedicate the resources to providing thorough safety training to new hires.

But such training shouldn't be limited to new employees. Top-performing construction companies train continuously, both to keep employees "fresh" when it comes to safety and to update them on new risks or better practices. Among the best ways to do so is to hold "toolbox talks," open discussions about safety incidents and strategies, as often as possible.

Indeed, you've got to regularly review and revise your training to keep up with evolving risks. For example, many construction companies were abruptly forced to add protocols regarding infectious diseases during the pandemic. You also might want to update your training when OSHA rolls out new National Emphasis Programs.

Find ways to support employees

You can reduce workers' compensation costs by encouraging injured or ill employees to receive immediate and ongoing medical attention appropriate to their conditions. Doing so will help them recover sooner and avoid unnecessary treatment costs.

Don't leave getting workers back on the job to an ad hoc process. A formal return-to-work

(RTW) program will reduce your need to recruit and train replacement workers or pay overtime to employees filling in for those on leave. It also better prepares you to find positions suitable for employees with medical restrictions, so they can rejoin the team in some way as soon as possible.

Above all, a supportive RTW program is good for employee morale and the bottom line. By offering one, you're demonstrating to your workforce that you're actively engaged in helping them get and stay healthy.

Create a "culture of safety"

Your construction company's leadership team must go beyond occasionally mentioning that safety is a priority. Create a culture of safety that starts at the top. Workers notice, for instance, when managers and supervisors don't follow safety rules themselves or cut corners. They take heed, as well, when you provide top-notch personal protection equipment and not just the bare minimum.

In addition, you should facilitate the easy reporting of incidents, hazards and risky behaviors — perhaps anonymously. It's critical, though, that you act promptly to address reports and publicize responses so employees know that you're taking their concerns seriously.

You can increase employees' investment in safety by giving them a voice. For example, appoint worker representatives to a safety committee and include their input when formulating policies and procedures as well as reviewing accidents and near-misses. You may find employees are aware of risks that managers aren't.

Monitor your X-Mod

Along with maintaining the highest levels of safety, take a proactive role in the administration of your insurance coverage. Insurers use an experience modification (X-Mod) factor to adjust workers' comp premiums for construction companies and other types of businesses. It's based on your actual and expected costs of injuries. If your number is higher than the X-Mod for the industry, you'll probably have to pay higher premiums.

Don't assume that your construction company's X-Mod is always accurate. The factor is typically calculated using data from not only your business, but also other sources such as the insurer and, where applicable, third-party payroll service providers. It's worth double-checking everyone's numbers to ensure accuracy.

Get all the benefits

There's no doubt that maintaining a strong safety record can help control workers' comp costs. But it can pay other benefits as well — not the least of which is drawing job seekers to a construction business with a reputation for taking care of its employees. ■

Why WIP schedules are so wonderful

When evaluating the financial performance of a construction company, lenders, sureties and other stakeholders often want more than just an income statement, balance sheet and statement of cash flows. Although these three traditional parts of financial statements are critical, they report only *historical* results. Many interested parties want something more current and, ideally, forward looking.

That's where work-in-progress (WIP) schedules come in. These supplements to financial

statements do a much better job of revealing the *current* strengths and weaknesses of the construction business in question. And for this very reason, WIP schedules also serve as a wonderful tool for contractors and their leadership teams.

Critical information

Essentially, WIP schedules track critical information about ongoing jobs. Pertinent data points include contract value, estimated costs, estimated gross profits, costs incurred to date, revenues recognized, percentage of completion and billings to date.

To garner the most value from WIP schedules, your construction business should generate one at least monthly. Some companies even review them weekly. Monitoring this information can help you recognize revenue accurately, assess whether jobs are on target to be profitable and detect early warnings of potential problems.

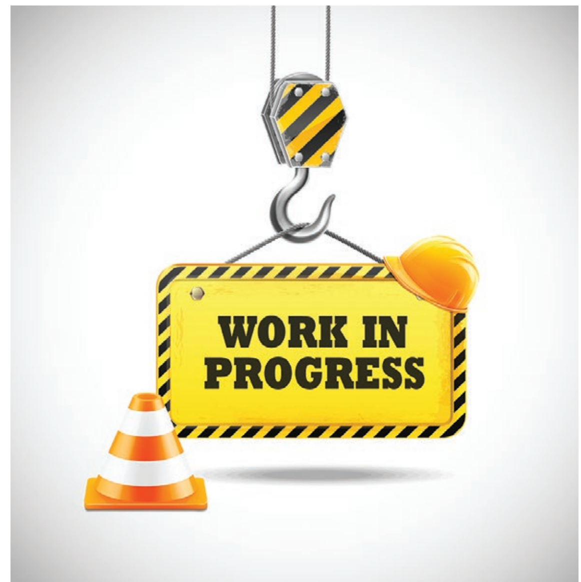
Red flags

Indeed, by monitoring jobs in something approaching real time, WIP schedules can raise red flags while there's still time to address the related issue. For example, a comparison of billings to date with revenue recognized can reveal underbillings or overbillings.

As the name suggests, underbillings refer to billings that fail to keep up with a job's progress in terms of revenue recognized. There are many potential explanations for this phenomenon, some troublesome and some benign.

If underbillings result from cost overruns, poor project management or delays in billing, for example, they may be a warning sign of potential cash flow problems in the future. On the other hand, if underbillings can be explained by other factors, they may not be cause for concern.

For example, perhaps you have unapproved but legitimate change orders or front-loaded costs that will be recovered over the course of the project. The key is to understand the underlying causes of underbillings and be prepared to correct any of the deficiencies causing them.



Similarly, overbillings may or may not be a warning sign of potential financial trouble. This is when a contractor bills for labor or materials before the related work is completed. When done within the rules, overbillings may reflect strong project management and diligent billing practices. On the other hand, if they reflect poor or incomplete documentation, or that revenue from one project is being used to cover costs on another, overbillings may be a major red flag.

WIP schedules can also provide an early warning of profit fade; that is, when estimated gross profits gradually decline over the course of a job. Possible causes include subpar project management, sloppy estimating or poor change order management — all things that may be fixable with sufficient warning.

Now's the time

Regularly supplementing well-prepared financial statements with WIP schedules is among the most effective ways to monitor your construction business's financial status. If you haven't been doing this regularly, or at all, now's a good time to start. Your CPA can serve as an invaluable resource in setting up and maintaining these schedules. ■

3 FAQs about the SBA's Surety Bond Guarantee Program

Most federally funded projects and even some privately funded ones require contractors to obtain payment and performance bonds. Unfortunately, qualifying for those bonds can be a challenge for small construction businesses.

One potential solution is to obtain a surety bond guarantee from the U.S. Small Business Administration (SBA). Here are three frequently asked questions about the agency's Surety Bond Guarantee Program (SBGP).

1. How small is small?

To be eligible for the SBGP, a construction company must qualify as a "small business." For most building and heavy construction companies, a small business is one with average annual receipts of no more than $45 million. The threshold is $19 million for most specialty trade contractors. The contract must be small as well: Up to $10 million for federal contracts and up to $6.5 million for nonfederal contracts.

2. What's guaranteed?

Under the SBGP, the SBA guarantees a portion of a surety's losses — from 70% to 90%, depending on the specific program — in the event the covered construction business defaults. There are two programs within the SBGP: The Prior Approval Program and the Preferred Surety Bond Program.

Under the Prior Approval Program, the SBA guarantees 90% of a surety's losses on contracts that are either:

- Valued at $100,000 or less, or
- Awarded to certain socially and economically disadvantaged contractors.

Examples of disadvantaged contractors include military veteran business owners, service-disabled business owners and eligible contractors whose companies operate in a Historically Underutilized Business Zone — commonly called a "HUBZone."

For contracts that don't fall within either group, the SBA guarantees 80% of a surety's losses. Under this program, the surety must obtain the SBA's approval before issuing a bond. There's a streamlined approval process for contracts valued at $250,000 or less, called the Quick Bond Program, which combines the contractor's application with the guarantee agreement between the surety and the SBA.

The Preferred Program allows SBA-approved sureties to issue bonds without prior approval. The SBA offers a 70% guarantee under this program.

3. How can we get a guarantee?

To obtain a bond guarantee, start by finding a participating surety. Complete the surety's application and, if the surety determines that an SBA guarantee is needed for it to issue a bond, complete any necessary SBA forms for the appropriate program. The surety should be able to assist you with this.

Keep in mind that contractors who receive bond guarantees under the SBGP must pay the SBA a fee of 0.6% of the contract price, in addition to the surety's fees. If you're unsure whether the program is right for you, consult your CPA for help weighing the costs vs. benefits. ■

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