

Ellin & Tucker, Chartered



Contractors' Perspective

FALL 2011



Year end tax planning
Explore current
incentives to boost
your cash flow

3 ways to get
more from mobile
technology

Staying focused
in the fight against
profit fade

PLUS!

Construction Success Story

Housing contractor
turns extra work into
extra pay

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Year end tax planning

Explore current incentives to boost your cash flow

As year end rolls in, contractors should be on the lookout for smart ways to reduce their tax burdens and boost their cash flows. Many of the incentives included in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 and other 2010 legislation are set to expire at the end of this year (though Congress might extend them). So now is a good time to start exploring ways to lock in those breaks and lower your 2011 tax bill.

Hiring

Contractors who downsized during the recession may be able to score some tax savings by adding personnel now. The Tax Relief act extended the Work Opportunity credit for employers that hire workers from certain disadvantaged groups, such as disabled veterans, ex-felons and people who receive food stamps or other supplemental income from the government.

The Tax Relief act provides qualified contractors with a \$2,000 tax credit for each home they build that meets certain efficiency standards.

The credit may provide tax savings equal to as much as 40% of the first \$6,000 in wages for each new hire (\$12,000 for qualified veterans), and you can claim the credit for an unlimited number of workers. Businesses that are in government-classified federal empowerment zones, or that hire employees from these areas, may qualify for additional credits.

But act quickly: These credits are scheduled to expire at the end of 2011.



Energy efficiency

Whether you're constructing houses or government offices, check out current tax incentives for energy-efficient buildings. The Tax Relief act provides qualified contractors with a \$2,000 tax credit for each home they build that meets certain efficiency standards. You must *sell* the home by the end of 2011 to qualify.

In addition, construction companies that install energy-efficient lighting, heating and cooling, or building envelope systems for publicly funded projects, such as libraries and schools, can tap into tax deductions of up to \$1.80 per square foot. This incentive applies mainly to design-build contractors, because a business must design the energy-efficient system to qualify. This break is available through 2013. (The building must be completed before Jan. 1, 2014.)

Research and experimentation

An extension of the research credit (often referred to as the "research and development," "R&D" or "research and experimentation" credit)

included in the Tax Relief act covers expenses accrued in 2010 and 2011. The credit can be calculated in one of two ways:

1. The traditional research credit is equal to 20% of qualified research expenses over a defined base amount related to your gross receipts and previous research spending.
2. The simplified credit is equal to 14% of any spending for that year that's over 50% of the average of your annual research expenses for the previous three years.

The research credit is especially useful for design-build contractors, because designing a building falls under developing or improving a business component — which is a qualified expense. Other qualified expenses relevant to contractors include researching new building materials, improving plumbing systems and performing CAD modeling.

New equipment

If you've been waiting to invest in a new crane, this may be the time to do it. Enhanced bonus depreciation and increased Section 179 expensing limits offer significant tax savings on qualified asset purchases — including machinery, equipment, vehicles and furniture.

Normally, you would need to deduct the cost of a big-ticket purchase over a number of years.

With bonus depreciation, however, you can deduct 100% of the cost of qualified assets acquired and placed in service this year on your 2011 tax return, and 50% of the cost of qualified assets acquired and placed in service next year on your 2012 return. The amount of qualified property on which you can claim bonus depreciation is unlimited, but the property must be *new*.

Increased limits on Sec. 179 expensing offer another way to save. For tax years that begin in 2011, you can deduct up to \$500,000 of qualified asset purchases. However, for each \$1 of purchases in excess of \$2 million, your deduction will be reduced by \$1. For tax years starting in 2012, the deduction limit is scheduled to drop to \$125,000 and the purchase limit to \$500,000, though both amounts will be indexed for inflation.

Both new *and* used property qualify for Sec. 179 expensing. Off-the-shelf computer software also qualifies, making now a smart time to consider upgrading your technology.

More ways to save

In addition to possibly qualifying for the opportunities outlined here, you may be eligible for many other tax incentives. Discuss your options with your tax advisor to make sure you're saving as much as you can. ■

Cost segregation studies offer bigger tax savings than ever

Cost segregation studies can help property owners shave a significant amount from their project costs — and bonus depreciation incentives in place through 2012 may mean even bigger tax savings for the people and entities that bring business to you.

Commercial buildings typically must be depreciated over 39 years. But, by separating out building assets that have shorter tax lifetimes (such as fixtures, flooring and landscaping), owners can take deductions for those items sooner rather than later. Cost segregation studies target such assets, thereby accelerating applicable tax deductions.

Bonus depreciation included in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 speeds up the tax savings even more, because many of the assets identified during a cost segregation study qualify for bonus depreciation. (See main article.)

Although cost segregation studies don't put more dollars in your pocket (unless you own the property on which you're building), helping owners complete them can strengthen your relationships with these parties. You can also establish your construction company's reputation as a specialist in this area.

3 ways to get more from mobile technology

Contractors who juggle projects at multiple sites know it can be tricky to accurately track job data and employee activities. The good news is that there are now a wide variety of apps available for smartphones, tablet computers, laptops and construction vehicles that allow you to store and view data regarding labor hours, vehicle and equipment use, and daily job-site production. Here are three ways to get more from mobile technology.

1. Use wireless time cards

To accurately track labor costs, consider wireless time cards. By having employees clock in at job sites with their smartphones and a wireless time card app that verifies they're on-site, you can avoid the risks of "time rounding"



(when workers round their times up or down for their benefit) or outright time theft associated with paper time cards.

In addition, going paperless saves employees trips to the office, so they spend more time working. And in-office staff reduce the time they must spend performing data entry for payroll. Plus, understanding your true labor costs allows you to bid on new projects more accurately.

Going paperless saves employees trips to the office, so they spend more time working.

2. Try geo-fencing software

Contractors can cut back on physical site checks by equipping company vehicles with activity-monitoring software. For example, "geo-fencing" software alerts you or your fleet manager when a vehicle leaves a predefined area or when one is stopped when it shouldn't be.

Geo-fencing software can also alert you when a vehicle is entering the monitored area so you know, say, when work crews or supplies are arriving. These programs allow you to update owners and other interested parties (architects, subcontractors) on the exact locations and estimated arrival times of pertinent assets, too.

3. Install global positioning systems

Slashing your fuel bill is as easy as installing a global positioning system (GPS) in your construction company's trucks or on key employees' smart phones. GPS capabilities allow workers to avoid traveling to the office to print directions

and reduce wasted driving — a necessity while fuel prices are sky-high.

There are security benefits to GPS technology as well. Joy-riding employees will have nowhere to hide when you're tracking a vehicle. And you'll be able to assist the authorities in tracking down stolen equipment, potentially saving you thousands in losses.

Benefits of a boost

Implementing technology like this requires an investment of time, money and energy. But the benefits can pay off if you're able to put these tools to good use. Work with your financial advisor to determine whether your construction business could benefit from a mobile boost and if you have the cash flow to make the investment. ■

Staying focused in the fight against profit fade

Just about every contractor has been there — a project starts out strong but, as it moves forward, delays and incidental added work and changes knock dollars and cents off of the bottom line. There's a name for these situations: "profit fade." There are also a variety of ways to stay focused in the fight against this continuing problem.

Know the contract and budget

Before work begins, understand fully what you've contracted to do by carefully reviewing the contract at hand. Legal language is often unclear, resulting in differences in interpretations that can disrupt and delay projects, increasing costs.

Also make sure your project managers understand the contract language fully. Meet with them before every project to discuss not only the contractual provisions for scope of work and change orders, but also what you bid and why. If your managers don't know how much you allocated for materials, and how you arrived at that number, they can't reasonably be expected to meet your budget.



Stay on top of changes

The profit you calculate when bidding a job can fluctuate dramatically as work progresses. For every phase you finish under budget, there may be an unexpected problem waiting to wipe out any savings that you've planned and budgeted for.

So as work progresses, meet with your project managers regularly to make sure they're

comparing their actual costs to the bid cost amounts. If a problem arises, they can address it immediately.

Remember that your leverage is strongest before the project is finished. Owners need your help to meet their goals, and they may be more amenable to approving change orders while you're still on the job. If you wait until the project is done, the owner will have use of the facility and may not release your retainage.

As work progresses, meet with your project managers regularly to make sure they're comparing their actual costs to the bid cost amounts.

Every significant cost increase should be accompanied by a signed change order that increases the value of the contract. (For more on change orders, see "Construction Success Story: Housing contractor turns extra work into extra pay" on page 7.) If costs are going up faster than contract value, determine why. Was your initial estimate off? Or have you done extra work that wasn't covered by a change order?

Make valid assumptions

In addition to monitoring your work in progress, study your estimating and profit histories. Review some of your profitable jobs and some that didn't work out so well to determine where the jobs didn't meet budgets and whether expenses were allocated properly.

Discuss with your job supervisors whether the assumptions you used in estimating the projects were valid. Did you, for example, realistically calculate the number of bricks your crews could lay in a day? Were your average labor costs accurate?

Also consider direct and indirect costs, and compare your estimates on jobs that lost money to those you used on profitable projects. Then use the results to improve your estimating procedures on future projects. For example:

- If projects were delayed because you expected your project manager to obtain final foundation design approvals and shop drawings while also getting the job under way, you may need to revisit your staffing estimates.
- If you're typically plagued by weather delays during a certain time of year, you may need to build a little more time into your bids.
- If a supplier or subcontractor is always late, you may need to find other sources for those materials or services.

Look, too, at whether certain owners cost you money. If one owner consistently has moved walls or added doors, you may want to be sure any future contracts with that owner include very specific language regarding scope and specification changes, change orders and schedule revisions.

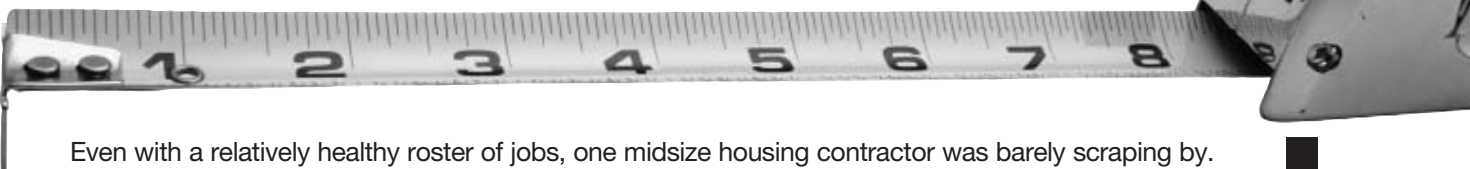
Pay close attention

When it comes to the battle against profit fade, remember that old saying: Hope for the best, but expect the worst. Only by paying close attention to detail can you stay on your feet in this fight. ■



Construction Success Story

Housing contractor turns extra work into extra pay



Even with a relatively healthy roster of jobs, one midsize housing contractor was barely scraping by. Extra work and change orders had cropped up on several recent projects, and she kept running into disputes with owners over the costs. Tracking down invoices and other documentation was a hassle, too, and the contractor's out-of-pocket expenses for the work were eating away at her bottom line.

Anxious to put the books in order, the contractor asked her financial advisor for help establishing better procedures for documenting extra work and change orders.

Finding a better way

First, the advisor noticed some inconsistencies in the contractor's project cost accounting system. She needed to establish uniform cost codes for project estimates and incurred job expenses so they'd be easier to compare.

She also needed to enhance her accounting system to break out all costs associated with extra work or change orders — including labor, equipment, materials and other expenses. Then the contractor would need to ensure that her staff used the system to track each expense for every project.

The advisor also suggested developing a standard set of forms for documenting extra work and change orders. Providing prompt documentation would go a long way toward heading off potential disputes.

Together, they created an order approval form that would require an owner's signature and include details about the phone conversation, field directive or other information that led to the changed or extra work. A change order log, time cards that broke out hours spent on extra or changed work, and a form for recording additional use of equipment rounded out the new documentation procedures.

Doing due diligence

Performing the right research before and during construction would be important as well. It would not only make change orders more manageable, but also possibly reduce the number of changes during a job, the advisor explained. For example, some project owners — particularly in the public sector — have special requirements or accounting procedures for changes, so the contractor needed to investigate those ahead of time.

The advisor also encouraged her to develop a checklist of project risks that might trigger work changes. Common examples include an unusually tight schedule, poor design documents and environmental hazards. The contractor should share a copy of the checklist with the project owner before work begins.

Getting paid

Upgrading her accounting system and establishing the new procedures took some time. But it proved to be time well spent. Thanks to the help of the contractor's financial advisor, getting paid for her next change order went much more smoothly. ■

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For additional information regarding the services listed above, or the ideas presented in this newsletter, please contact Frank Brodnax, Todd Feuerman, Kristin King, or Mike Strauss. We would welcome the opportunity to help you build your success.

OUR MISSION

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